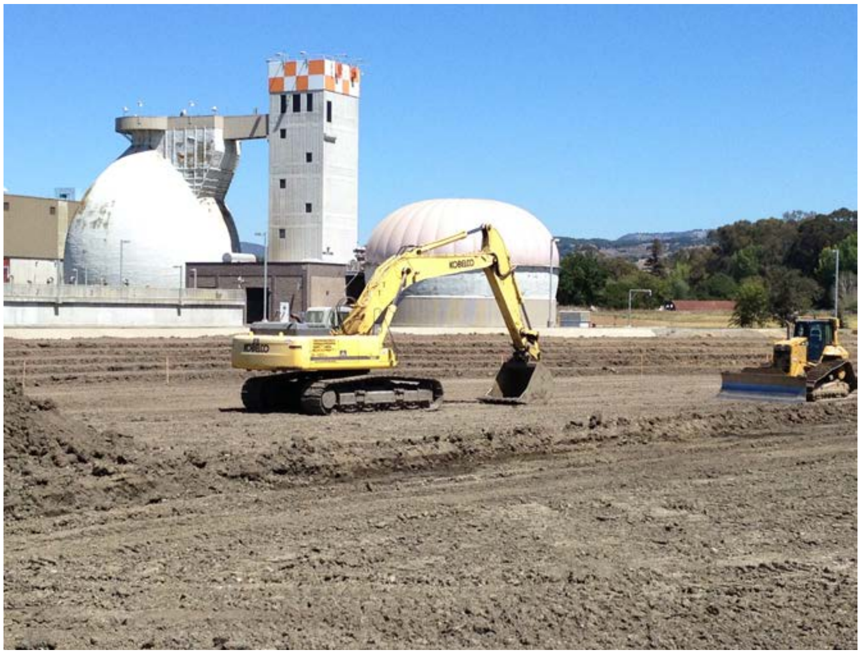
Debt



Construction of the secondary effluent equalization basin in 2014

Completed secondary effluent equalization basin

Debt

The Napa Sanitation District issues long term debt for the construction of significant capital assets. Debt service is the annual or semi-annual payments NapaSan makes to repay the principal and interest on its debt.

Debt Policy

As a matter of policy, NapaSan has a preference to use pay-as-you-go financing for its capital projects and only uses debt financing for improvements that it cannot readily finance from current revenues. Exceptions can be made on a case-by-case basis for no-interest and extremely-low-interest loan programs to pay for capital projects.

Debt can only be used for major, non-recurring capital items, and the debt repayment timeline cannot exceed the expected useful life of the asset being financed.

Debt can only be issued when it has been shown that NapaSan has the ability to pay all of its current obligations from current revenues and still have available 125% of the expected debt service amount to pay the debt service.

NapaSan's complete debt policy can be found in Appendix D, Section 5.

Current Debt Obligations

2003 SRF – In 2003, NapaSan entered into a 20-year loan with the State of California's State Water Resource Control Board Revolving Fund (SRF). The proceeds from this loan, $901,376, were used for replacement of pipes in the collection system. The interest rate on this loan is 2.5%, with annual debt service of $60,247. (See Debt Service Table 1.) Outstanding principal on this debt obligation is $279,895 as of July 1, 2018.

2008 SRF – In 2008, NapaSan entered into a 20-year loan with the State Water Resources Control Board. This loan, which came in two phases, was for a total of $1,559,673 and was used to replace aging infrastructure in the collection system. This is a zero-percent interest loan; however, the annual debt service payment of $93,581 includes a 16.667% state match and is recorded as imputed interest. (See Debt Service Tables 2 and 3.) Outstanding principal on this debt obligation is $923,024 as of July 1, 2018.

Series 2012A – These 20-year Certificates of Participation were delivered and executed to provide funds to repay the outstanding Adjustable Rate Refunding Revenue Certificates of Participation, Series 2009A and to finance $33 million in new capital projects. Annual debt service for this bond in FY 2018/19 is $2,658,775. (See Debt Service Table 4.) Outstanding principal on this debt obligation is $31,050,000 as of July 1, 2018.

Series 2017 – These 10 year Refunding Revenue Bonds were sold in December 2017 to advance refund the 2009B Certificates of Participation. The $14,185,000 advance refunding will save NapaSan ratepayers almost $1.27 million over the life of the bonds. Annual debt service for this bond in FY 20158/19 is $1,775,225. (See Debt Service Table 5.) Outstanding principal on this debt obligation is $14,185,000 as of July 1, 2018.

Debt Covenants

A debt covenant is a requirement imposed on NapaSan by a debt holder. These requirements range from requirements to pay the principal and interest payments on particular days of the year, to preparing and filing audited financial statements, to very specific financial performance requirements.

There is one significant debt covenant that has a financial impact to NapaSan. This covenant applies to all of NapaSan's debt, and is a debt service coverage requirement. Debt service coverage is the ratio of net revenues (revenues minus operating expenses) to annual debt service requirements. NapaSan is required by its bond covenants to maintain a debt service coverage ratio of at least 1.25. For FY 2018/19, the District's coverage ratio is budgeted to be 4.21.

Debt Capacity & Debt Limitations

Debt Capacity is the difference between the amount of debt NapaSan has outstanding (sold and authorized) and the maximum amount of debt NapaSan can incur within its legal, public policy and financial limitations.

Debt Coverage Ratio Calculation	Estimated FY 17/18	Budget FY 18/19
Revenue		
Sewer Service Charges	$26,162,000	$28,156,000
Capacity Charges	$6,276,000	$4,614,600
Recycled Water	$913,000	$1,042,000
Interest	$174,000	$311,000
Rents & Leases	$722,000	$725,000
Other Revenue	455,100	466,800
(excl. sale of property and grant revenue)		
Operating Expenses	($14,819,668)	($15,993,600)
Net Revenue	$19,882,432	$19,321,800
Parity Debt Service		
2003 SRF	$60,250	$60,250
2008 SRF	93,580	93,580
2009B COPs	1,958,250	0
2012A COPs	2,661,420	2,662,670
2017 RBBs	0	1,777,300
Total Debt Service	$4,773,500	$4,593,800
Parity Debt Coverage Ratio	**4.17**	**4.21**
(net revenue ÷ total debt service)		
(must be greater than 1.25)		

NapaSan does not issue general obligation debt, and as such, there is no legal limitation on the amount of debt it can issue. NapaSan is limited by the debt policies that it sets for itself (described above and in Appendix D) and by financial limitations. Financial limitations include two factors:
1) willingness of the bond market to loan NapaSan money, and 2) limitations on future debt placed on NapaSan by current debt.

First, the amount of debt NapaSan can issue is limited by whether there are financial and other institutions and other buyers in the market willing to purchase the bonds that NapaSan wants to issue. In tight capital markets, or if the financial health of NapaSan is in question, the amount of debt NapaSan can issue under favorable terms can be limited.

Second, the debt coverage ratio imposed by existing debt holders also applies to any future debt NapaSan may want to issue. By forecasting operating revenues and expenditures and applying the 1.25 debt coverage ratio, a debt capacity can be calculated.

Currently, NapaSan has the capacity to issue approximately $155 million in additional debt (3.5% TIC, 20 year term), assuming that there was a buyer for that debt in the bond market, NapaSan could pay the debt service, and other financial policies are maintained.

Future Debt Issues

The Ten-Year Capital Improvement Plan and the Ten-Year Financial Plan includes debt financing for four future capital projects:

1) **Browns Valley Road and West Napa Pump Station Improvements** – it is projected that the Clean Water State Revolving Fund (SRF) loan proceeds ($25 million) will be received as reimbursements during the same year the expenses are incurred, starting in FY 2018/19, with debt service payments not beginning until after the completion of construction in FY 21/22. NapaSan will apply for a Green Project Reserve grant for 50% reimbursement of expenses associated with increased energy efficiency. NapaSan will also utilize the "Local Share Match" program with the state to lower the initial financing amount in exchange for lower interest rates.

2) **Second Digester / Third Aeration Basin** – it is assumed that this project will be financed through the issuance of Certificates of Participation ($23.6 million), with debt service beginning in FY 2022/23. The forecast assumes a 25-year loan at 5% True Interest Cost (TIC).

3) **New 66"/72" Sewer Trunk** – this project, to replace the existing 66" sewer trunk, with either a new 66" or new 72" trunk, is expected to cost $45 million, with debt service beginning in FY 2022/23. This project will either be financed through the Clean Water State Revolving Fund program, or through the issuance of Certificates of Participation (COPs). To be conservative, it is assumed the debt will be financed through the issuance of 30-Year COPs at 5% TIC.

4) **NBWRA Recycled Water Projects** – these projects will be financed through 25% federal grants and federal low-interest water infrastructure loans. Estimated project cost is $5.1 million, with debt service beginning in FY 24/25.

Projected Debt Service Summary