

Clean Water Services

Clean Water Advisory Commission

Meeting Minutes

November 13, 2013

Attendance

The meeting was attended by Commission Chair Tony Weller (Builder/Developer) and Commission members Molly Brown (District 2-Malinowski), Cathy Stanton (District 1-Schouten), Erin Holmes (Environmental), John Kuiper (Business), Mike McKillip (District 3-Rogers), Art Larrance (At-Large-Duyck), Judy Olsen (Agriculture), Stephanie Shanley (Business), Richard Vial (District 4-Terry), David Waffle (Cities), Jerry Ward (Agriculture), and Clean Water Services District General Manager Bill Gaffi.

Commission member Alan DeHarpport (Builder/Developer) was absent. Sandy Webb (Environmental) has resigned her position.

The meeting was also attended by Ray Bartlett (EFA, consulting firm) and Lori Hennings (interested citizen).

Others attending included Bob Baumgartner (Regulatory Affairs Department Assistant Director), Nora Curtis (Conveyance Systems Department Director), Diane Taniguchi-Dennis (Deputy General Manager), Roger Dilts (Regulatory Affairs), Mark Jockers (Government and Public Affairs Manager), Kathy Leader (Finance Manager), Jerry Linder (General Counsel), Carrie Pak (Conveyance Systems Department, Engineering Division Manager), Mark Poling (Business Operations Department Director), Lorien Walsh (Government and Public Affairs), and Ken Williamson (Regulatory Affairs Department Director), all from Clean Water Services.

1. Call to Order

The meeting was called to order by Mr. Weller at 6:34 PM in the conference room at the Clean Water Services Administration Building. Self-introductions were offered.

2. Review/Approval of September 11 Meeting Notes

Ms. Brown moved to approve the minutes of the meeting held September 11, 2013. The motion was seconded by Mr. McKillip. Motion passed.

3. 2013 Stormwater Report

Mr. Dilts distributed copies of the Clean Water Services Stormwater Program Annual Report and briefly reviewed the contents. The report is required as a condition of the District's NPDES (National Pollutant Discharge Elimination System) permit issued through DEQ (Oregon Department of Environmental Quality), and must include nearly a dozen sections addressing specific aspects of a stormwater management program. It brings together information about stormwater collection, illegal discharges, and industrial pretreatment activities from several departments at Clean Water Services and the

District's partner cities, who are co-implementers of the permit. Mr. Dilts noted that city and District staff members are proud of the work they do all year every year and appreciate the chance to showcase it in the report. Some of that work included: 15,800 separate construction site inspections, 28,000 miles of streets swept with nearly 13,000 cubic yards of debris removed, more than 40,000 catch basins cleaned, and more than 300 miles of storm sewer line cleaned, and inspection of all 85 industrial discharge permit-holders added 317 acres of new or redeveloped stormwater treatment area, and added 22 new LIDA (Low Impact Development Approach) sites.

The report is also available on the Clean Water Services website.

4. Regional Stormwater Management Charge (RSMC) Update

Ms. Curtis shared a brief update on the RSMC (Regional Stormwater Management Charge) process, for which the Commission has provided input during several previous meetings. The RSMC will apply to development that is served by publicly-funded regional stormwater facilities. A Commission subgroup including Mr. Weller, Ms. Brown, Mr. McKillip, and Mr. Waffle has also participated in three stakeholder meetings since the last Commission meeting. Ms. Curtis said an ordinance and methodology have been drafted and reviewed, with a public reading on the Ordinance scheduled for the end of November and a public reading/public hearing on both the Ordinance and Methodology scheduled for December 3. As required by law, there will be a third reading of the ordinance December 17. The first facility providing the cost basis for the new RSMC is now under construction. Ms. Curtis estimated completion in early 2014.

Ms. Curtis said comments from the development community have been generally positive and thoughtful as everyone determines how the program will work in practice. She added that the stakeholder group has recently begun discussing reimbursements for privately-funded regional stormwater facilities, which will likely spark some new comments. Mr. Weller commented that the process has moved forward very quickly given its scope and suggested that some adjustments should be expected.

5. System Development Charge Financing Policy Review

Mr. Poling reviewed the Board's charge that the Commission consider the question of offering SDC financing to commercial and industrial customers (*presentation attached*). He also reviewed the process and schedule for gathering information and drafting recommendations through January, 2014, then accepting public comments before finalizing recommendations for the Board by the end of March, 2014.

Mr. Poling reviewed the current Clean Water Services ordinance offering SDC financing to residential (single- and multi-family) property owners. Clean Water Services does not offer SDC financing to commercial or industrial customers. Commercial customers are required to pay SDCs when the building permit is issued but industrial customers are not required to pay until the time of discharge. Clean Water Services defines "industrial" customers as those which hold an industrial pretreatment discharge permit. There are currently 85 such customers, which vary greatly in size.

Mr. Poling and Mr. Linder explained there are multiple interpretations as to whether the statutes addressing SDC payments over time actually require, or simply allow, financing for owners of single-family, multi-family, mixed-use, and/or commercial and industrial properties. In addition, customer classes are not clearly defined in the statute, which was originally intended simply to help single-family homeowners during a past economic downturn but was immediately expanded as others lobbied for inclusion.

Mr. Poling, Ms. Leader, and Mr. Bartlett reviewed sections of the white paper (*attached*) sent out prior to the meeting. First, Mr. Poling reviewed the customer class definitions. Based on discussion during the last meeting, he included some possible residential subclasses and left open the possibility of identifying subclasses for commercial or industrial.

Next, Ms. Leader summarized information from Clackamas County and the cities of Bend, Gresham, and Salem. Clackamas County does not offer financing at all, while the three cities offer financing to commercial and industrial customers as well as single-family and multi-family. All require a first lien, charge a relatively high interest rate, and have relatively small total outstanding amounts. All three offer financing on a 10-year term with 20 payments as described in the state statute (Bend also offers shorter-term alternatives), but most projects financed are single-family residential construction and are usually paid off in 2-3 years when the owner sells the property. Ms. Leader noted that among Clean Water Services partner cities, only Tualatin offered a financing program for commercial/industrial but it was discontinued due to risk factors and the administration required and there has not been an outcry for its return. All partner cities use the 10-year/20 payments plan.

Ms. Leader also reviewed printed and graphic information comparing District, city, and total combined SDC revenue by customer class over the past few years. She noted that even with some data still outstanding, it is obvious that amounts collected vary greatly from year to year, as does the proportion collected from each class. The largest share of SDC revenue to Clean Water Services has been from industrial customers, followed by single-family, multi-family, and commercial. Commercial has also accounted for the smallest share of SDCs collected by the cities. Mr. Poling pointed out that commercial SDC revenue, though relatively small, has been surprisingly stable over the past decade. He clarified that “commercial” is anything that is not residential or industrial.

Mr. Bartlett then outlined risks associated with financing SDCs for each customer class. Providing financing opens Clean Water Services to financial risk (partial, late, or non-payment) and to operational risk (expected demand doesn't materialize after capacity has been expanded; fees from additional usage don't cover costs of providing additional services). Financing SDCs for single-family residential development presents low financial risk and low operational risk for the District. The residential SDCs financed so far by Clean Water Services have been of no concern when the District issues debt—such a small amount will not make or break a bond issue.

As detailed in the white paper, the risks increase as the financing option is extended to

other forms of development. There is medium to high risk with large multi-family, mixed use, or other commercial properties, which change often (Jantzen Beach has been completely leveled and rebuilt three times in the past 20 years) and may have an expected life shorter than the usual 10-year finance term. In commercial development, most of the value is usually in the business rather than the land and building, and they are often owned by multiple corporate entities which may be harder to find or hold accountable than individuals. Industrial developments present high financial risk, as the primary value is usually in equipment which may have limited resale value and will likely be obsolete in 2-5 years. Industrial developments are also likely to have different and/or multiple corporate ownerships on the land, the building, and the equipment, making it more difficult to place a lien. Clean Water Services already incurs significant financial and operational risk by allowing industrial customers to delay paying the SDC until the actual time of discharge, as the infrastructure for service must be in place by then. Mr. Bartlett noted that the general industry expectation for recouping investment on single-family development is about 7 years, but is 1.5 years on industrial projects.

Mr. Bartlett also reviewed ways to mitigate risks, also detailed in the white paper. Depending on the customer class, the District could require first lien position (which may still offer inadequate protection in some cases), charge a higher interest rate, reduce the length of time allowed for payment, and/or require that the outstanding balance be paid if/when the property title is transferred.

Ms. Leader continued, explaining how financing SDCs might affect rates, SDC revenue, and bonds, all sources of revenue for capital improvements. A debt coverage ratio graph (slide #17) showed that SDC revenue combined with other revenue has kept the ratio above 2.0 to maintain good credit ratings and keep cost of debt low. A debt coverage ratio below 1.2 is considered default. The high ratio shown for 2013 reflects a bond being paid off and an unusually large industrial SDC payment. The projections beyond 2014 assume periodic bond issues, which might come earlier, more often, and/or in larger amounts depending on the amount of SDCs financed.

Comments from throughout the meeting are summarized in the Appendix. Key points and themes from the discussion included:

- 1) Single- and double-family units, especially those converting from a septic system, should be the priority for offering financing
- 2) No change to current policy for industrial customers
- 3) Need information from stakeholders about potential demand for financing commercial SDCs
- 4) Need more information from cities about their interest in financing commercial SDCs
- 5) Need more information from member Cities about the possibility/feasibility of delayed SDC payment for commercial customers
- 6) Want more information from cities nationwide about if and how they finance commercial SDCs
- 7) Members of the Commission cited a need to define/describe if/how the public

purpose is served by offering financing. Other members asked about whether the financing policy question is also a question of encouraging or discouraging development and how that related to the Board's charge

5. Announcements

Mr. Jockers presented plaques to Mr. Ward and Ms. Hennings in thanks for their service as Commission members. Staff will be working with the Board of Directors later this month on appointments to Mr. Ward's position and the Environmental position left open by Ms. Webb's resignation earlier this year. Ms. Stanton was appointed earlier this year to the District 4 position when Ms. Hennings' term expired.

The next meeting is scheduled for December 11.

6. Adjournment

Mr. Weller declared the meeting adjourned at 8:34 PM.

(Meeting notes prepared by Sue Baumgartner)

APPENDIX

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Discussion of SDC Financing for Commercial and Industrial Customer Classes

1. Classes and Subclasses

- a. Defining classes and sub-classes is a way to say who you are including and why, or who you are excluding and why, based on risk or other factors. (Brown, Weller)
- b. Single-family developers I've talked to aren't interested in financing, so that really just leaves single-family septic conversions. Maybe "septic conversion" is the classification/criteria to use. (Weller)
- c. Seems like a large multi-family project such as the one just financed should be considered commercial. (Brown)
- d. Commercial sub-classes could be Office, Restaurant, Retail. Industrial could be divided into Light, Heavy, "Clean Room.." (Vial)
- e. Financing for commercial is difficult to think about because it varies from a small fast-food place to a hospital to a flex-space so the SDCs could be very small or quite large, yet it's not a big component of the overall SDC revenue. (Weller)
- f. The idea of helping smaller businesses has come up often; maybe there could be wording to address that. We can ask how small business is defined in the various jurisdictions. For example, development codes in Beaverton differ for buildings above and below 50,000SF. (Stanton)

2. Risk and Financial Impact

- a. How much do you want in the finance pool? When you finance an SDC, you are essentially deferring the revenue stream for your capital improvement plan. There is usually about \$50 million budgeted for capital improvements and at some point these delayed payments will create a gap. (Weller)
 - i. It could be that we'd have to increase borrowing to replace that revenue. (Gaffi)
 - ii. When you think about the industrial risks identified in the white

paper, and the size of the industrial SDC amounts, that really ties in with the comment about the gap in the revenue stream. (Waffle)

- b. From what the debt coverage ratio graph shows, if we decided as a policy matter to encourage a class of development by offering to finance SDCs and that actually did trigger the need for additional capital in the bond market, we've got room (to borrow and still keep the ratio above the minimum). (Vial)
 - i. Yes, depending on the amount and the timing. Keep in mind there is more to that line than just issuing more debt—your bond rating will change as cash reserves are depleted through construction and as your debt service increases. That will increase your cost of capital. (Leader)
 - ii. Part of the reason for maintaining the ratio at 2.0 or higher is to keep us from being in the position of “needing” to borrow. As we saw in some of the other charts, the SDC amount is volatile. (Poling)
 - iii. The SDC for a retailer like Lowe's or Home Depot which has few fixtures might be less than \$200,000; something like the Cornelius Wal-mart with a grocery and deli could be more than \$1 million. (Poling, Leader)
 - iv. So even if we financed a \$5 million SDC, we'd have plenty of bond capacity if we needed it. I appreciate that the conservative levels shown on the graph are beneficial for us, but the argument for not offering financing because we don't want to risk having to add more bond debt because of the potential for a swing of a few million dollars in SDCs is not convincing. (Vial)
- c. If we look at single family as 40%-50% of SDCs except for 2013, and we look at who's going to be the users of a financing program, we can look at how much (money) is going to be in the program. I'm not necessarily advocating to expand financing, but we wouldn't zero out our SDC revenue. (Weller)
- d. The debt service coverage ratio should be preserved for your own capital needs. (Waffle)
- e. As a lender, the key thing I look for is debt coverage ratio, regardless of the loan purpose. Clean Water Services has a good strong ratio—why would you want to mess with that? Financing isn't your business—maybe you can use it to accomplish some of your objectives safely if you put enough caps and conditions on it, but otherwise leave it to the experts. If you can keep a good strong financial position, that's what you should do. (Ward)
- f. I agree, but I think the board is asking us if we want to try and expand the

financing of SDCs in order to encourage some kind of development in the area. And to say no because we want to protect our 2:1 ratio on our debt service doesn't answer the question. (Vial)

- i. Where did the question of whether we want to support development come up? (Holmes)
 1. If Clean Water Services offers financing that the developer can't get from the bank or chooses to get from the District instead of from the bank, then Clean Water Services is facilitating the project (supporting development). (Weller)
 2. Remember this question of offering financing came up because there is no policy in place for commercial and industrial and because Hillsboro and Clean Water Services had different interpretations of the state statute. It wasn't really driven by economic development or jobs, though that undertone is there—it was really to clarify the policy on commercial and industrial for the future. The Holland project qualified for SDC financing under the current single-family/multi-family policy—it is a mixed-use commercial project but only the multi-family residential portion of the SDCs was financed—but it brought to light the differences in interpretation and the need for a policy. (Jockers, Linder)

- g. If this is the last line item in the construction budget that is going to make or break the deal, then there needs to be more equity in the deal. (Ward)
- h. Having sat in on budget and rate increase processes, I would say that anything that could potentially hurt credit ratings or raise rates should be considered ever so carefully. (Hennings)
 - i. It would be tough to explain a rate increase based on financing SDCs. (Weller)

3. Purpose/Demand/Interest

- a. The white paper notes on page 7 that it (providing financing beyond residential) “may” encourage economic development...if we can't quantify that, then what's the public purpose served in pursuing this? I'd want to see that it **would** encourage development, then the Board can decide if this is the development that you want to happen or don't want to happen. (Waffle)
- b. Are people clamoring for financing, asking for help—what's the demand? Part of our process is talking to stakeholders—have we asked any of them if not offering financing is actually a hindrance to development? (Ward, Weller, Vial, Shanley)
 - i. The main one we've had was an industry that wanted to do a small

- expansion, and we basically let them rent capacity. (Gaffi)
- ii. There isn't a lot of demand for this; partly because lenders don't want to give up first lien position. If the person who would most need this finance option is someone who can't get financing for SDCs through their bank, why would that same bank agree to subordinate first lien position to us? (Gaffi)
 - iii. I know of a senior housing project of about \$25 million with potential SDC probably about \$0.5 million. The developer is not interested in SDC financing as their project financing covers it and they would rather not do a separate deal with another agency; he rejected the idea even before talking about terms, such as first lien. (Weller)
 - iv. Single-family developers I've talked to have no interest in financing SDCs, but they would love to delay payment until closing. (Weller)
- c. It would be good to ask member cities about their interest in a financing program for commercial SDCs and who they think would use it. If cities have no interest, probably no need for Clean Water Services to lead the way. (Weller)
- i. Partner cities vary greatly in their interest. Hillsboro has high interest in attracting development (the rate they offered for The Holland project was lower than the lender's, which is what saved them enough money for the project to be feasible and for the lender to be willing to give up first lien position). (Gaffi)
 - ii. Important to get a full conversation with cities as different staff will have different perspectives. Dave and I sit on the city managers group and can discuss with them to get a coordinated opinion. (Taniguchi-Dennis)
- d. Need to know who else in the US is doing commercial and industrial SDC financing, and how much demand there is. (Stanton, Vial)

4. Approaches and Terms

- a. It was noted last meeting that if a limit was placed on the amount of financing extended, we did not want a single-family or owner-occupied duplex property to end up without financing just because others got there first. (Poling)
 - i. Single-family septic conversions should be our priority. (Weller)
 - ii. The importance of financing to get single-family homes off septic and onto sewer has come up repeatedly—that's good public purpose for health and safety. (Stanton)
- b. The turnover on commercial/industrial properties concerns me. Do a five-year instead of a 10-year term on those. (Weller, several others agreeing)

- c. Industrial (anyone with an industrial waste permit) could/should be excluded from a financing program due to the conflict of interest. (McKillip)
 - i. It would seem odd to borrow from our regulator. (Shanley)
 - ii. Industrial customers are already allowed to pay as they need the capacity—it's not really financing, but the payments are not required up front, either. (Weller)

- d. If we offer financing the terms must be set so that all our costs are covered, including administration. We should keep first lien position. We could set up a minimum initial payment up front. A fair rate would be higher than our own cost of money that we will have to borrow because of the delayed SDC revenue stream. (Weller)

- e. What about deferring payment until occupancy for commercial projects, as is already done for industrial customers—building the system and waiting for that payment would be no different than when we build the system before we get a payment from an industrial discharge permit customer. (Vial)
 - i. One subtle difference is that with industrial there is a permit issuance that triggers the SDC discussion, so we have our own administrative mechanism to ensure payment. With commercial we would rely on the city to track when they have issued building occupancy permits, and there are big differences between cities. (Taniguchi-Dennis)
 - ii. It looks like Gresham offers deferral options—let's find out how that is working and any administrative issues they have. (Vial)
 - 1. Would be good to talk to other cities and could also chat about other SDCs—parks, water, etc. There is already authority in place to defer transportation development tax until occupancy. (Gaffi, Waffle)