Attachment No. 2

Government Financial Services Memorandum to EPASD re: Financing Sanitary System Infrastructure

Government Financial Strategies

MEMORANDUM

To:	Akin Okupe, MBA, PE, General Manager
From:	Lori Raineri Keith Weaver
Date:	December 14, 2022
Re:	Financing Sanitary System Infrastructure

This memorandum describes options and recommendations for an Infrastructure Financing Plan. This plan has previously been presented to the following groups:

- East Palo Alto Sanitary District staff including two members of the Board of Directors on August 25, 2022,
- "All Hands" staff meeting, including the District's team from Bartle Wells Associates, Hildebrand Consulting, and Sierra West Consultants, on August 31, 2022,
- Rate Advisory Committee on September 7, 2022,
- A group of developer representatives on October 6, 2022,
- Board of Directors on November 1, 2022.

In addition, you presented a summary overview to the City Council of East Palo Alto on September 20, 2022.

Current Status Update

Feedback from the Rate Advisory Committee, District staff, and the District's consultant team was positive. The primary recommendation arising from the discussions was that the new development should shoulder an appropriate share of the costs, and the plan was updated accordingly.

The possibility existed for potential collaboration with the City and/or developers. However, feedback indicates there does not appear to be interest in a collaborative effort to finance infrastructure from either group. Therefore, the District may consider a stand-alone effort and proceed under its own initiative.

Feedback from the Board of Directors meeting was a request for more details that would help better inform the decision-making process. Providing such details is the purpose of this memorandum.

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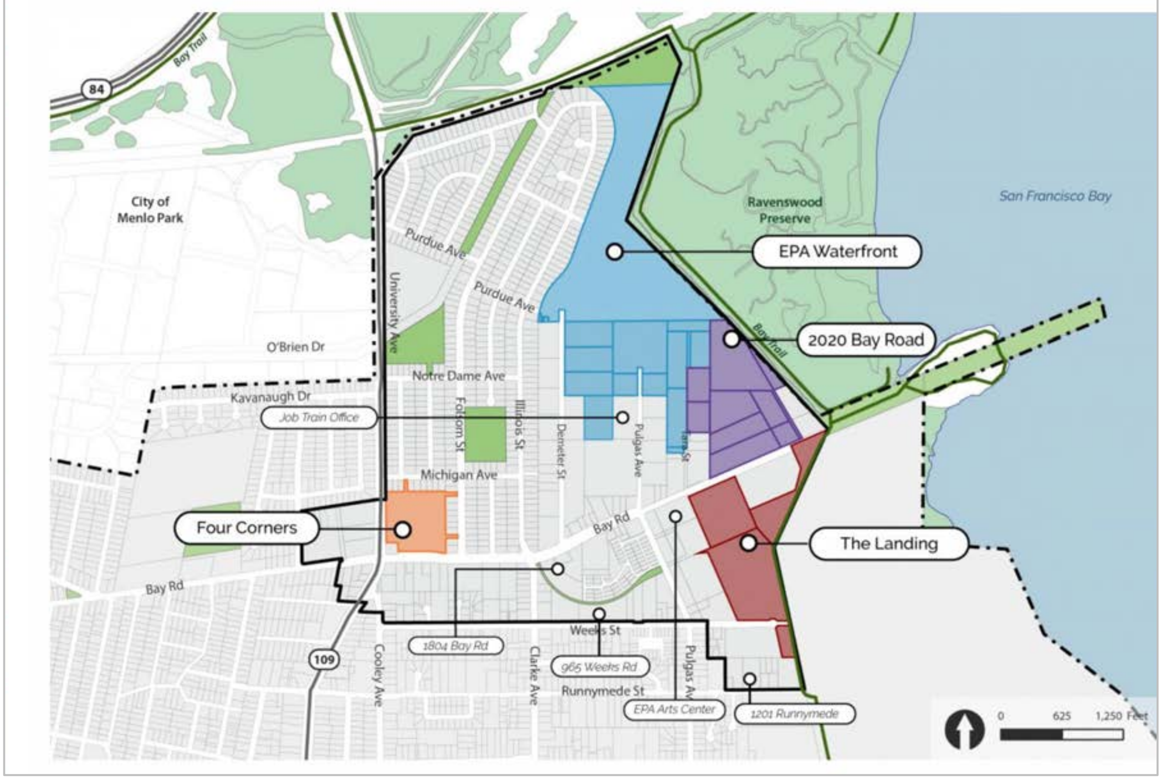
Development Overview

The City of East Palo Alto's Ravenswood Business District / 4 Corners Specific Plan Update includes plans for new development that, upon buildout, will impact the Sanitary District. The Specific Plan Update identifies four major projects involving:

- EPA Waterfront
- 2020 Bay Road
- The Landing
- Four Corners

The locations of the projects are shown in the map below:

Ravenswood Business District / 4 Corners Specific Plan Update



The four major projects are expected to have 530 residential units and approximately 4.2 million square feet of non-residential development.[1] Adding to these four major projects are 18 minor projects planned for development, and in total, the combined projects involve plans for 1,469 residential units and approximately 4.7 million square feet of non-residential development.

[1] New development information per San Mateo LAFCO Municipal Service Review Updates: City of East Palo Alto, East Palo Alto Sanitary District, West Bay Sanitary District. Prepared by Berkson Associates in association with Policy Consulting Associates LLC, June 6, 2022.

Infrastructure Overview

The planned new development drives the need to increase capacity for the Sanitary District's infrastructure. The infrastructure capacity involves three types of necessary upgrades:

- The local collection system capacity requires upsizing of local pipes: estimated cost of $22 million.
- The trunk capacity serving the Palo Alto Regional Water Quality Control Plant (RWQCP) also needs to be upsized: estimated cost of $13 million.
- More treatment plant capacity will need to be purchased from RWQCP: estimated cost of $5 million.

In total, the estimated cost for infrastructure is $40 million.[2]

Cost Sharing Considerations

Existing customers will receive some benefit from the upsizing of local pipes by the extension of the pipes' useful lives, and therefore the costs to be allocated will reflect benefits received by both new and existing development. Most of the capacity increases are exclusively necessary to serve the new development. Therefore, new development will mitigate its costs appropriately and receive the associated benefits. The cost sharing allocation is shown in the table below:

Project	*Estimated Project Cost*	*New Development Share*	*New Development Cost*	*Existing Development Share*	*Existing Development Cost*
Local Collection Capacity	$22,000,000	75%	$16,500,000	25%	$5,500,000
Trunk Capacity	$13,000,000	100%	$13,000,000	0%	$0
Treatment Plant Capacity	$5,000,000	100%	$5,000,000	0%	$0
Total	$40,000,000	86%	$34,500,000	16%	$5,500,000

Note: cost sharing determined in consultation with Bartle Wells Associates.

Funding Options

Funding options include both traditional sources of funding for sanitary districts as well as supplemental funding sources that are less widely used but available to target specific needs.

Traditional Funding Options

Traditional options for funding the needs of sanitary districts include:

Sewer Rates

Pro: sewer rates are an existing funding option already in place, paid by the Sanitary District's existing ratepayers.

[2] Infrastructure needs and costs per 2022 Capacity Charge Study, Hildebrand Consulting, August 3, 2022.

Con: the challenge with this funding option is that the existing ratepayers are not causing the need for new infrastructure; it is new development that is driving the new infrastructure needs.

Conclusion: increasing sewer rates does not appear to be an appropriate funding option for the new infrastructure.

Capacity Charges

Pro: capacity charges are paid by new development. Developers pay this one-time charge in order to receive a will-serve letter from the Sanitary District.

Con: we understand District staff has received feedback from some developers that the capacity charge may be perceived as prohibitively expensive.

Conclusion: capacity charges are an appropriate funding option though an alternative choice would be helpful to allow new development to proceed at less expense.

Supplemental Funding Options

Supplemental funding may be garnered through four types of local taxes and assessments available for use by sanitary districts. These are as follows:

General Obligation Bonds

Authorization: general obligation bonds require a two-thirds voter approval by registered voters at an election.[3]

Pro: the bonding authority provides for the issuance of bonds to finance infrastructure projects. Bonds are then repaid from "ad valorem" taxation (based on the assessed value of property) and the tax is only levied to repay the bonds.

Con: challenges include that this funding mechanism is restricted to land and buildings without the option for equipment. In addition, there is no flexibility to create special boundaries around new development, meaning that existing ratepayers would be subject to the same taxation as new development.

Conclusion: general obligation bonds do not appear to be an appropriate funding option for the new infrastructure.

Parcel Taxes

Authorization: parcel taxes also require a two-thirds voter approval by registered voters at an election. The method of taxation is anything but ad valorem and is often a flat tax per parcel.[4]

Pro: this tax may be used for either services or infrastructure projects.

[3] Authority for sanitary districts to issue general obligation bonds is found in Government Code Section 53500 et seq.
[4] Authority for sanitary districts to levy parcel taxes is found in Government Code Section 50075 et seq.

Con: challenges include that parcel taxes are primarily used for services because there is no authority to issue bonds to finance infrastructure projects. In addition, there is no flexibility to create special boundaries around new development, meaning that existing ratepayers would be subject to the same taxation as new development.

Conclusion: parcel taxes do not appear to be an appropriate funding option for the new infrastructure.

Assessment Districts

Authorization: assessment districts require a form of 50% voter approval by landowners at a mailed ballot election. The ballots are weighted by the amount of the assessment proposed for each landowner.[5]

Pro: bonds may be issued to finance infrastructure projects with the assessment used to repay the bonds. This option has flexible boundaries that can be set around new development.

Con: challenges include that the assessment is based on a rigid formula according to the benefit that each property receives from the new infrastructure. It must be a special benefit over and above any general benefit provided. The amount of assessment must be determined by an engineer and there is little to no flexibility in customizing the assessment based on any other factors.

Conclusion: while an assessment district would appear to be an appropriate funding option for the new infrastructure, it may not be the most beneficial option because of the inability to tailor the assessment to achieve the community's goals.

Mello-Roos Community Facilities Districts (CFDs)

Authorization: community facilities districts require two-thirds voter approval, with the method of voting depending on the number of registered voters within the CFD. If there are less than 12 registered voters within the CFD, it is a vote by landowners. If there are 12 or more registered voters, it is a vote by registered voters. The method of taxation is anything but ad valorem, and it is often per square foot, per unit, or per acre.[6]

Pro: bonds may be issued to finance infrastructure projects with the tax being used to repay the bonds. This option has the flexibility to create special boundaries: the boundary can be set the same as the Sanitary District's boundary or it can be a smaller subset. Sometimes a CFD boundary focuses specifically on new development, with a non-contiguous "Swiss cheese" approach allowed. The tax is often referred to as the "designer tax" due to the flexibility to meet the community's needs. A Rate and Method

[5] Authority for sanitary districts to levy assessments is included in the 1911, 1913, and 1915 Acts found in Streets & Highways Code Sections 5000, 8500, and 10000. Proposition 218 placed numerous restrictions on assessments and is found in Government Code Section 53750. More assessment options exist in statute also.
[6] Authority for sanitary districts to create CFDs is found in Government Code Section 53311 et seq.

of Apportionment (RMA) would describe how the taxes are to be levied. Taxes can be levied based on geographic boundary or RMA description or both.

Con: the primary challenge is the high bar of a two-thirds voter approval threshold. The opportunity for the CFD to be designed specifically for the purpose at hand, with community input, may be helpful in overcoming this challenge.

Conclusion: a CFD would appear to be an appropriate funding option for the new infrastructure.

Proposed Infrastructure Funding Plan

After consideration of the funding options, it is recommended that an Infrastructure Funding Plan consist of the following three options:

Infrastructure Funding Plan	
Grants	A grant consultant has been retained by the Sanitary District to identify available grants and submit applications to receive grant funds for the new infrastructure needs.
Capacity Charges	The Sanitary District increased capacity charges from $6,060 to $14,464 per equivalent dwelling unit (EDU) per Board Resolution No. 1322 adopted October 6, 2022. Developers can pay this charge and receive a will-serve letter to proceed with new development. The capacity charges received from developers can help pay for the new infrastructure needs.
Mello-Roos CFD	This is a supplemental option recommended to finance the new infrastructure needs differently than capacity charges.

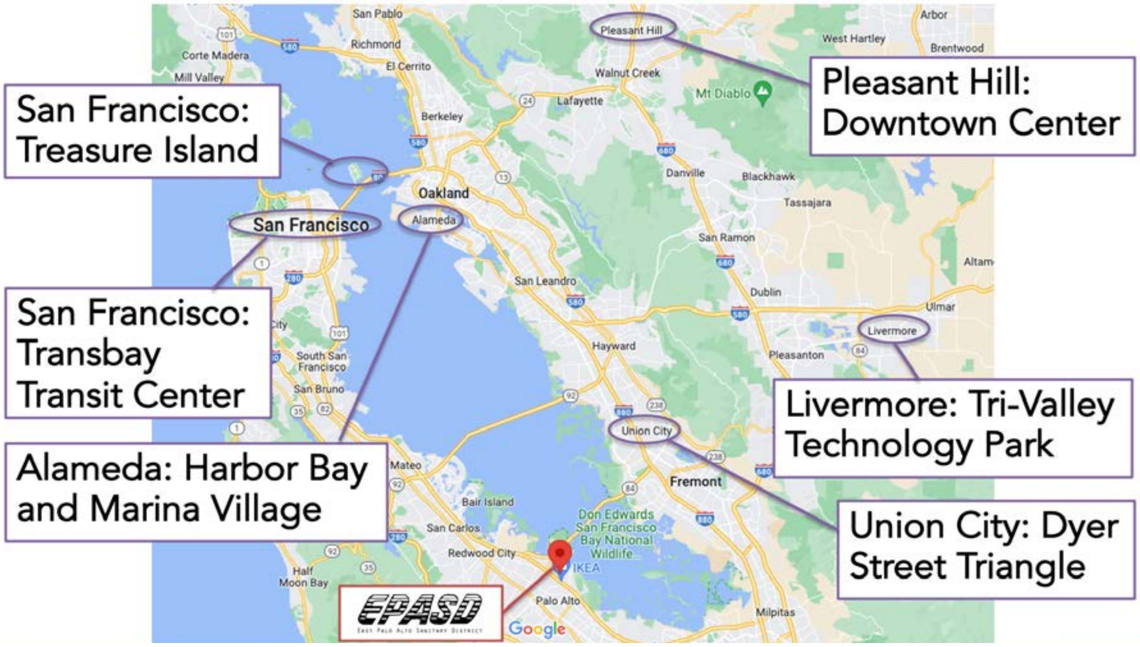
Regional CFD Case Studies

Case Study Selection

Several locations in the Bay Area using CFDs as a funding option for infrastructure needs were selected as case studies for comparison. Each case study has consisted of large-scale new developments which include non-residential property. They also involved the financing of infrastructure needed to specifically serve the new development, with several expressly identifying sewer improvements. The locations were:

- Treasure Island, San Francisco
- Transbay Transit Center, San Francisco
- Harbor Bay and Marina Village, Alameda
- Downtown Center, Pleasant Hill
- Tri-Valley Technology Park, Livermore
- Dryer Street Triangle, Union City

The locations of the case studies are shown in the map below:



Case Study Results

A summary overview of each case study is listed below:

Treasure Island, San Francisco

- 8,000 residential units
- 551,000 sq ft of commercial, office, and retail space
- Most recently $17 million of bonds issued in 2020

Transbay Transit Center, San Francisco

- 9 high-rise buildings
- 1,666,000 sq ft residential & 2,714,000 sq ft office/retail
- Most recently $34 million of bonds issued in 2021

Harbor Bay and Marina Village, Alameda

- 630 single-family homes
- 71 commercial / industrial parcels with offices, retail
- Most recently $19 million of bonds issued in 2010

Downtown Center, Pleasant Hill

- 10 parcels
- Mainstreet-style shopping, retail stores, central plaza
- Most recently $6 million of bonds issued in 2013

Tri-Valley Technology Park, Livermore

- 186 parcels
- business park offices, hotels, casino, retail, school
- Most recently $16 million of bonds issued in 2015

Dryer Street Triangle, Union City

- 32 parcels
- 104 acres commercial area, retail center, transit center
- Most recently $6 million of bonds issued in 2013

A summary of the CFD taxes for each case study is shown in the table below.

Regional Case Study Examples for Tax or Assessment Levied				Range for Residential			Range for Non-Residential		
Location	Development		District	Low Amount	High Amount		Low Amount	High Amount	
Alameda	Harbor Bay and Marina Village		CFD 1/AD 10	$6,932	$10,215	per unit	$18,287	$216,115	per parcel
Livermore	Tri-Valley Technology Park		CFD 99-1	n/a	n/a	n/a	$16,223	$222,285	per parcel
Pleasant Hill	Downtown Center		CFD 1	n/a	n/a	n/a	$1.25	$2.46	per sq ft
San Francisco	Transbay Transit Center		CFD 2014-1	$5.29	$8.80	per sq ft	$3.80	$5.87	per sq ft
San Francisco	Treasure Island	Initial Year	CFD 2016-1	$6.07	$9.17	per sq ft	$1.69	$3.38	per sq ft
		Annually After		$1.70	$2.76	per sq ft	$0.50	$1.01	per sq ft
Union City	Dyer Street Triangle		CFD 97-1	n/a	n/a	n/a	$276	$161,206	per parcel

Notes:
CFD 1 (Harbor Bay) amounts are the initial amount (set in 1989) with a 4% inflation rate (per RMA) to 2022.
AD 10 (Marina Village) amounts are per a 2010 reassessment with no inflation rate (per engineer's report).
CFD 99-1 (Tri-Valley Technology Park) amounts are per a 2000-01 tax levy with no inflation rate (per RMA).
CFD 1 (Downtown Park) amounts are the tax levies established for the 2022 year (per RMA).
CFD 2014-1 (Transbay Transit Center) amounts are the initial amount (set in 2013) with a 2% inflation rate (per RMA for max) to 2022 with the lows on rental residential 1-5 stories and on retail, and the highs on for-sale residential 50+ stories and office/hotel 50+ stories.
CFD 2016-1 (Treasure Island) initial year are the amounts before transition for facilities (set in 2016) with a 2% inflation rate (per RMA) to 2022 with the lows on townhome units and on commercial/retail space, and the highs on tower residential units and on hotel space.
CFD 2016-1 (Treasure Island) annually after are the amounts after transition for services (set in 2016) with a 3.4% inflation rate (per RMA) to 2022 with the lows on townhome units and on commercial/retail space, and the highs on tower residential units and on hotel space.

Preliminary Pro Forma and Tax Financing Plan

The preliminary pro forma assumptions are as follows:

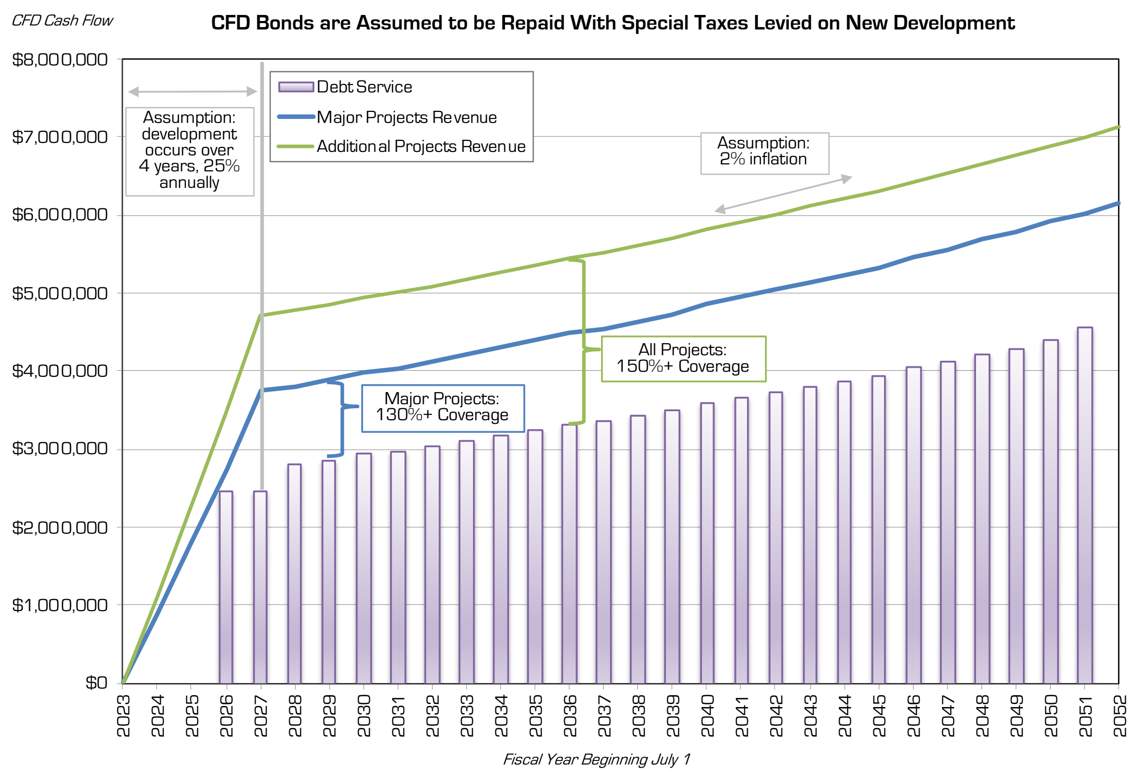
Assumptions	
Pro Forma Assumptions	
Funds to be received	$34.5 million from new development $5.5 million from existing development $40.0 million in total
New development timeline	4 years (2023 – 2026) (25% of planned development occurring per year)
Taxation type	Community Facilities District
Term of financing	30 years
Inflation rate	2% annually
Tax Assumptions	
New development	Identified by its own boundary or per the RMA
Residential tax	$600 per unit annually
Nonresidential tax	$0.75 per square foot annually
Undeveloped property	Can be taxed pending new development
Existing development	Identified by its own boundary or per the RMA
Tax per parcel of property	$90 per parcel annually

The taxes above can be compared to the regional CFD case studies, and it can be seen that the taxes above are relatively low in comparison to the taxes levied in the case studies.

Highlights of Preliminary Pro Forma Results

New Development

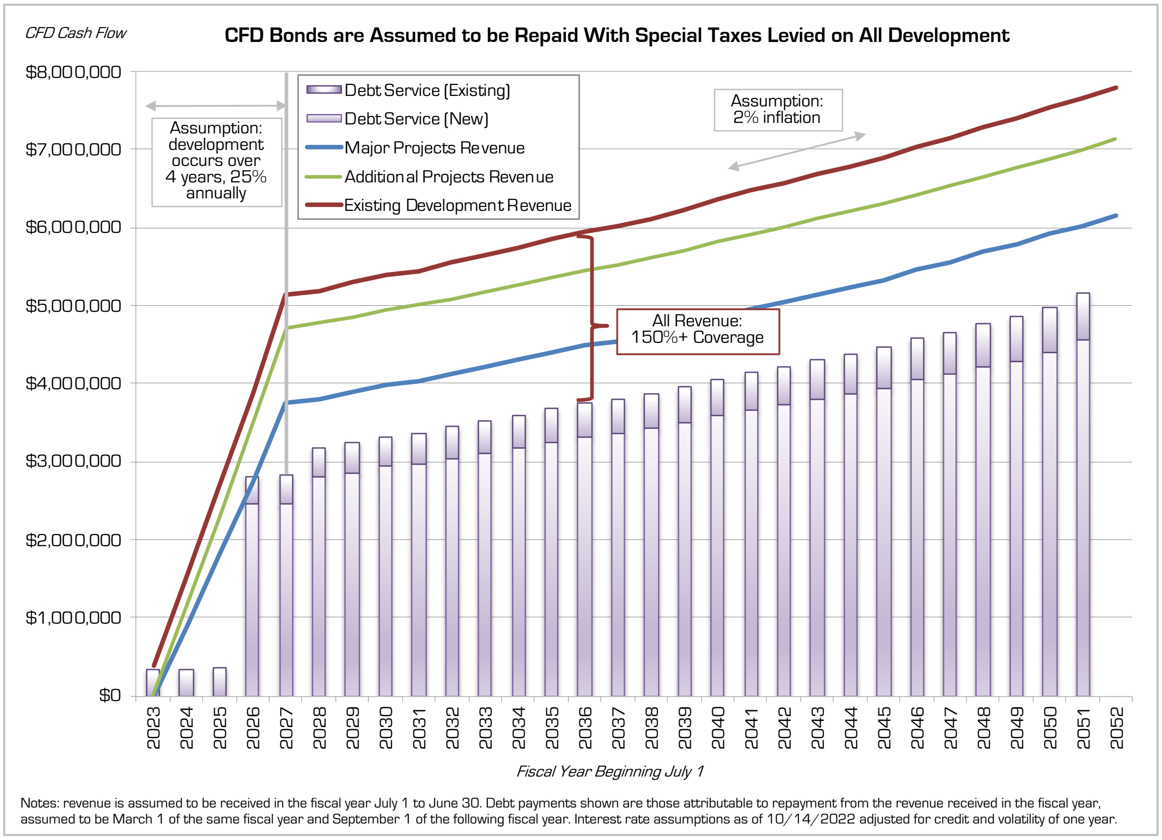
Under the above assumptions, it is feasible for CFD bonds to be issued to generate the $34.5 million from new development to fund their allocation of the infrastructure costs. The bonds can then be repaid with special taxes levied on the new development. For just the major new developments projects alone, tax revenue has a coverage ratio of 130% (the ratio at which revenue exceeds debt service). Including the minor new development projects, the coverage ratio is 150%. This is illustrated in the graph below.



Notes: revenue is assumed to be received in the fiscal year July 1 to June 30. Debt payments shown are those attributable to repayment from the revenue received in the fiscal year, assumed to be March 1 of the same fiscal year and September 1 of the following fiscal year. Interest rate assumptions as of 10/14/2022 adjusted for credit and volatility of one year.

All Development

Existing development can be included so that their allocation of the infrastructure costs can be funded as well. For all development combined, it is feasible for CFD bonds to be issued to generate the full $40 million to fund the total infrastructure costs. The bonds can then be repaid with special taxes levied on all development. For all new development projects, the coverage ratio is 150%. This is illustrated in the graph below.



Potential Benefits to Developers

There are several potential reasons that developers might benefit from the CFD option over the capacity charge option:

- The CFD tax can be paid upfront or overtime, rather than a capacity charge that must be paid upfront. The option to pay upfront is available every year for the CFD tax, meaning that a property owner can choose to pay annually for some time, and then pay the remainder upfront at a time of their choosing. The capacity charge does not offer such flexibility.
- If the CFD tax is not fully paid up front (at the property owner's option), the tax will be borne by each subsequent property owner following a sale of the property (for the term of the tax, currently assumed to be 30 years in the preliminary pro forma).
- Should developers opt to pay annually, the estimated indicative CFD tax in the first year of taxation totals approximately $3 million for all new development projects. In contrast, the estimated capacity charge totals approximately $37 million for all new development projects. Therefore, the initial expense required to proceed with new development is far less under the CFD tax than it is under the capacity charge.

Potential Benefits to Existing Ratepayers

There are a couple of potential reasons that existing ratepayers might also benefit from the CFD option over the capacity charge option:

- The primary benefit of the CFD option to existing ratepayers is the flexibility to allocate the appropriate share of infrastructure costs to new development in a way that would not be as prohibitively expensive. As a result, this option may help spur advancement of the new development and reduce the concerns of developers and possibly, the City of East Palo Alto as well.
- The CFD option offers the choice to incorporate the existing ratepayers' share of infrastructure costs into the funding to plan for new development. However, there is no requirement that the existing ratepayers fund their share of the infrastructure costs using the CFD. Funds can alternatively come from other sources, such as reserve funds, funds received from existing rate revenue, etc.

Mello-Roos Community Facilities District Formation

Formation of a CFD involves many steps for the Board, District staff, and the professional team. Highlights of the key steps at the Board level are listed below, and it can be completed in as short as a two Board meeting process:

Meeting #1:
Board considers adoption of:

- Goals and policies for the CFD
- Resolution of Intention to establish a CFD
- Resolution to Incur Bonded Indebtedness to finance the infrastructure projects

Meeting #2:

Board holds a public hearing
Board considers adoption of:

- Resolution of Formation of the CFD
- Resolution Calling an Election

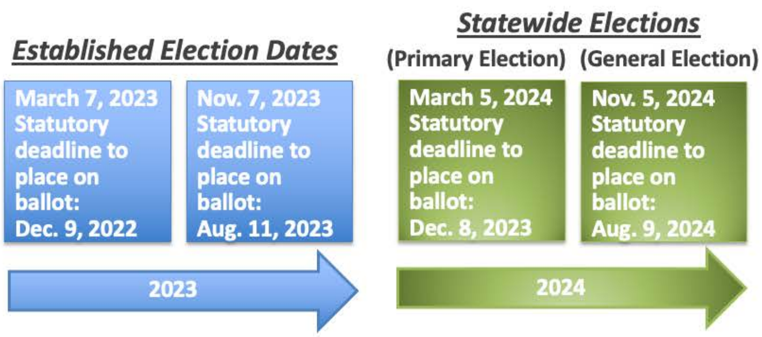
Election Options and Considerations

A CFD election can be conducted either in-person or via mailed ballot. Each option offers different allowable election dates and considerations.

In-Person Election Dates

In-person voting allows for voting at a polling place as well as mailed ballots. It can be held on either an established election date or a statewide election date, which are detailed below.[7]

[7] In-person election dates per Elections Code Section 1000 et seq. Pending confirmation from legal counsel.



Mailed Ballot Election Dates

The mailed ballot option does not provide for voting at a polling place. It can be held on an established mailed ballot election date, as detailed below.[8]

Election Date Considerations

Established Election Date

Other public agencies may choose to conduct elections. If they choose to conduct elections in 2023, many types of elections must be held on an established election date, though there are some exemptions. As a result, it is possible (but not guaranteed) that other public agencies may place items on the ballot on these election dates. There is then a potential for consolidation with other items on the ballot.

Statewide Election Date

Other items will be on the ballot for consolidation on a Statewide election date. This means that the election cost will be less expensive compared to a stand-alone election, and other issues on the ballot may occupy voters' attention. In addition, typically there is higher voter turnout for a Statewide election.

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[8] Mailed ballot election dates per Elections Code Section 4000 et seq. Pending confirmation from legal counsel.

Mailed Ballot Election

This would be a single-issue ballot solely focusing on the CFD.

Next Steps

Next steps for consideration are:

- Coordination of the infrastructure funding plan with the LAFCO proceedings
- The preferred type and timing of a CFD election
- Public engagement on the infrastructure needs and funding plan options
- Discussion and involvement of other key stakeholders

We hope this memorandum has been helpful and we look forward to further supporting East Palo Alto Sanitary District. Thank you.

LR:KW/abo