



Monterey County

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Board Report

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Approve CAO response to Board Referral No. 2015.09 (10/20/15) to identify funds necessary to finance the Third and Final Funding and Reimbursement Agreement for the proposed Interlake Tunnel project.

RECOMMENDATION:

It is recommended that the Board of Supervisors take the following actions:

- a. Assign \$1.9M to the Interlake Tunnel project from unassigned FY 2015-16 fund balance;
- b. Direct staff to negotiate a Third and Final Funding and Reimbursement Agreement between the County of Monterey and the Monterey County Water Resources Agency (WRA) for the Interlake Tunnel project, and return to the Board for approval at the December 8, 2015 meeting;
- c. As a condition of a Third Funding Agreement, require WRA to hire a financial advisor to evaluate debt issuance and financing options for the Interlake Tunnel project; and
- d. As a condition of a Third Funding Agreement, require WRA to make quarterly reports to the Budget Committee and Board of Supervisors regarding:
 - i. Overall progress, design and permitting for the project;
 - ii. Activities of the Agency to procure grant funding for the project; and
 - iii. Progress with the California Department of Fish and Wildlife to resolve the white bass transfer issue.

SUMMARY:

The Interlake Tunnel project connects overflows from Nacimiento reservoir with San Antonio reservoir via an underground tunnel. A second portion of the project, the San Antonio Spillway Modification, increases the storage capacity of Lake San Antonio. Taken together, the tunnel and spillway modification provides significant water storage capacity increases as well as flood control protections. The County of Monterey, through a series of funding and reimbursement agreements, has advanced funds for design and permitting work on the project with the expectation of repayment pending a future Proposition 218 (Prop 218) assessment of benefited property owners or other financing mechanism to repay fund to the County provided through the Funding and Reimbursement Agreement, and fully finance the project.

DISCUSSION:

Background:

The Interlake Tunnel and spillway modification is estimated by the WRA to cost approximately \$72M. The WRA requested funds from the County in order to begin work on project design and permitting. In response to that request the County entered into several funding and reimbursement agreements with the Agency. The first agreement was entered into on July 2, 2014 in an amount not to exceed \$500,000. These funds were for preparatory work and were advanced on the condition that the County be repaid if the project is financed through an

assessment district or other financing mechanism.

At a December 9, 2014 Special Joint Meeting of the Board of Supervisors, the Board of Supervisors of the Water Resources Agency, and the Water Resources Board of Directors, the Agency was authorized to proceed with work on the Interlake Tunnel project. Direction given by your Board of Supervisors on December 9, 2014 authorized an additional commitment of \$2.5M to perform geotechnical and final design engineering, permitting and environmental approval, financing plan preparation and implementation; and implementation and project management services. Based on direction given, a total of \$3.0M has been committed by the County to date. These are general commitments; the actual identification of fund sourcing and specific authority to fund comes via the funding and reimbursement agreement as a legal document entered into by the two government agencies: the County and the WRA.

Accordingly, on March 17, 2015 a second funding and reimbursement agreement was entered into between the County and WRA in the amount of \$600,000. This funding was authorized for preliminary design/engineering, water rights analysis, spillway modification feasibility, technical support and project management support. The Second Funding and Reimbursement Agreement expires on January 31, 2016. The Third and Final Funding and Reimbursement Agreement was requested by the WRA to complete work to the phase of the project where a Proposition 218 vote is taken on the project. Cash flow projections (attached) by the Agency project that \$3.0M in County funds will finance the project through the Proposition 218 vote phase.

Issues related to Interlake Tunnel project:

There following issues related to the subject agreeenent are briefly described below:

1. **Impact to County finances and relative certainty of repayment:** There is no “guarantee” that the \$3.0M funds advanced by the County through the Funding and Reimbursement Agreements will be repaid. Given the constrained nature of County finances, this is a critical fact which must be acknowledged. Should the Proposition 218 vote fail, and other financing mechanisms are not realized, there will be no source of fund repayment. If there is a successful Proposition 218 vote, to comply with IRS requirements for repayment, tax exempt bonds must be issued within 3 years of adoption of a resolution of intent to reimburse. This resolution was adopted by both the WRA Board of Directors and the County Board of Supervisors on June 16, 2015. If tax exempt bonds are not issued by June 16, 2018, full reimbursement will be compromised. A subsequent resolution could allow for future expenses to be reimbursed.
2. **Debt financing costs:** Ron Holly, County Debt Manager, estimates that annual debt service for the project will be approximately \$6.0M. This is based on an estimated project cost of \$72.0M with a reserve of \$12.0M. The reserve cost is driven up by the fact that both Moody’s and Fitch have reduced WRA’s credit rating to “A+”. This rating impacts the cost of borrowing for the project. In discussions with Mr. Holly, it is highly recommended that, upon approval of this recommendation, WRA immediately hire a financial advisor to evaluate debt issuance and financing options.

3. **Potential grant and other funding sources:** The County has expended considerable effort to assist WRA in identifying grant funding sources for the project. Numerous conference calls and meetings have been held involving Supervisors Salinas and Potter (Board Ad Hoc Water Committee), Nossaman LLP (Strategic Grants Services), WRA staff, CAO staff, Secretary Laird, Assemblymember Alejo and representatives of the Leadership Group. To date, no assured source of grant funding has been identified. It is possible that grant funding will be available at a future date, however in some cases the regulations for certain grant fund sources have not yet been developed and could be at least one year away from release. In addition, these grants are competitive in nature and there is no guarantee that the funds being competitively sought will be awarded. It is recommended as part of this report that WRA staff be directed to pursue all available grant funding and other potential financing options, such as public-private partnerships and report the status to the Board of Supervisors quarterly.

4. **White bass transfer:** The California Fish and Game Code prohibit transfer of white bass due to the extremely predatory nature of the white bass and potential for negative impacts on the fish species. Following an initial meeting with Secretary John Laird of the California Resources Agency, two productive meetings have been held with California Department of Fish and Wildlife (CDFW) staff to attempt to resolve this issue in a manner that will allow the Interlake Tunnel project to proceed. Meetings in Sacramento have included Kevin Hunting, Chief Deputy Director of CDFW; Stafford Lehr, Chief of Fisheries, CDFW; Supervisor Potter, Supervisor Salinas, WRA staff, CAO staff and representatives from Nossaman LLP. Potential resolution of the white bass transfer issue will involve:
 - a. Determination of “substantial compliance” with Fish and Game Code requirements.
 - b. Project design modifications that may include a deep water intake.
 - c. Written documentation of the system wide benefits of the project including flood control, drought reserve, sea water intrusion mitigation and environmental enhancements.

It is staff’s understanding that WRA is working to provide the above documentation by mid-November. CAO staff is optimistic that, based on progress to-date, the white bass issue can be successfully resolved. However, final resolution of the white bass transfer issue has not yet been achieved. This is viewed as a critical path issue that must be resolved for the project to proceed.

OTHER AGENCY INVOLVEMENT:

Staff involved in the funding and reimbursement agreement process include County Counsel, Auditor Controller, Water Resources Agency, CAO-Budget and Analysis and CAO-Intergovernmental & Legislative Affairs. This item was brought before the Budget Committee on November 12, 2015.

FINANCING:

If approved, funds for the \$1.9M necessary for the Third and Final Funding and Reimbursement Agreement will be sourced from unassigned fund balance for FY 2015-16.

Approved by:

Nicholas E. Chiulos
Assistant County Administrative Officer

Attachments: Interlake Tunnel development schedule and cash flow projections