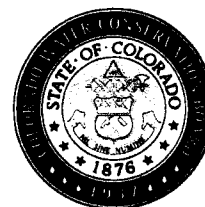


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CWCB Director

TO: Colorado Water Conservation Board Members

FROM: Tim Feehan, PE, Chief
Finance Section

DATE: May 6, 2011

SUBJECT: **Agenda Item 26b - May 17-18, 2011 Board Meeting**
Finance Section – Financial Matters
New Loan Lending Rates for FY11/12 and Revisions to Policy No. 7

Introduction

The CWCB utilizes two revolving funds to reinvest in Colorado's aging water supply infrastructure. These funds are not only of paramount importance to the borrowers that qualify for raw water project loans, but the interest revenue from these loans allows CWCB to remain a self-supporting agency. This memo is provided as background for discussion and approval of Water Project Loan Program's Lending Rates for FY11/12 and for suggested revisions to Policy #7, attached hereto. The process used for determining the recommended interest rates is found in Financial Policy #7 – *Annual Construction Fund and Severance Tax Trust Fund Perpetual Base Account Lending Rate Determination*.

Additionally, in an attempt to expand the CWCB's Loan Program market base and to provide future borrowers an incentive to rehabilitate restricted reservoirs, staff investigated the potential benefit of creating two new interest rate categories within Policy #7. One new interest category would establish interest rates for hydroelectric projects, and the other new interest category would provide an incremental interest rate scale for borrowers that address reservoir restrictions imposed by the State Engineers Office.

Staff Recommendation

Staff recommends that the Board adopt the schedule of 30-year lending rates, as shown in Table 1, based on the Board approved Financial Policy #7 for all loans recommended to the General Assembly or approved by the Board from July 1, 2011 through June 30, 2012.

Staff also recommends that the Board approve the proposed revisions to Policy #7 to include new interest categories and rates for hydroelectric projects and water projects that remove State Engineer reservoir restrictions, to apply to all loans recommended to the General Assembly or approved by the Board from July 1, 2011 through June 30, 2012, per revised Policy #7, dated May 17, 2011, attached.

Supporting Information

Lending Rates:

Attached is a graph of weekly yields for the 30-year 'A' rated municipal bond for the period November 1, 2010 to April 25, 2011.* As the graph indicates, the average yield for the municipal bond was 5.86% for the past six-month period (Baseline Rate).

In FY09/10, the Board approved interest rates that were artificially discounted to help stimulate water project spending. The discount was needed due to the unprecedented spike in FY09/10 Baseline Rate. This allowed the Loan Program's interest rates to go up, but not shadow the extreme Bond Market spike. In FY10/11, interest rates were not artificially discounted and were approved as calculated per Policy #7. For FY11/12, staff is requesting again that the Board approve discounted rates for the Municipal High and Middle Income rates and the Agricultural rate by a quarter percentage point each, which will duplicate FY10/11 interest rates overall, with the exception of the commercial rate. Staff also recommends keeping agricultural rates below 3%.

The CWCB Loan Program interest rates are calculated as a percent of the Baseline Rate and rounded to the nearest 0.25% per Financial Policy #7.

Table 1.
Recommended Lending Rates for FY 2011/2012

Type of Loan	FY10/11 Int. Rate	Calc. FY11/12 Rate	Recommended Rate
Commercial/Industrial	6.25%	6.50%	6.50%
Municipal High Income	5.00%	5.25%	5.00%
Municipal Middle Income	4.50%	4.75%	4.50%
Municipal Low Income	4.00%	4.00%	4.00%
Agricultural	2.75%	3.00%	2.75%

* Standard & Poor's definition of an 'A' bond rating is: "A debt rated 'A' has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories."

Table 2.
History of 30-Year Lending Rates for FY 03/04 – FY 11/12*
 (%)

Type	FY03/ 04	FY04/ 05	FY05/ 06	FY06/ 07	FY07/ 08	FY08/ 09	FY09/ 10	FY10/ 11	FY11/ 12	9 yr. avg.
Baseline	5.08	4.85	4.74	4.71	4.25	5.08	6.29	5.81	5.86	5.81
Comm./Ind.	5.5	5.25	5.25	5.25	4.75	5.5	6.25	6.25	6.50	5.61
Muni-High	4.5	4.25	4.25	4.25	4.0	4.5	5.25	5.25	5.25	4.61
Muni-Mid	4.0	4.0	3.75	3.75	3.5	4.0	4.5	4.5	4.5	4.06
Muni-Low	3.5	3.5	3.25	3.25	3.0	3.5	4.0	4.0	4.0	3.55
Agricultural	2.5	2.5	2.5	2.5	2.25	2.5	2.75	2.75	2.75	2.55

*The lending rates presented above are policy calculated rates, with the exception of FY09/10 and FY11/12, which were artificially discounted.

New Interest Rate Categories

Staff is recommending that two new interest categories be included in Policy #7. Section 37-60-119 (1)(a), C.R.S. (2010) states that the board has the authority to provide loan funds for water projects that protect the hydroelectric resources and supplies of the state of Colorado. However, Policy #7 does not specifically address the interest rate for hydroelectric water project loans.

The Colorado Water Resource Development and Power Authority (CWRDPA) currently has a hydro-loan component in its program. CWRDPA offers a 2% interest rate for hydroelectric projects with a maximum of \$2M in loan funds available per year. In order to stay competitive in the market, staff is recommending that the CWCB establish a hydroelectric interest rate category, at a fixed rate of 2%, with no defined limit on the amount of funding available per year. It is staff's opinion that the amount of funding for a hydroelectric project should be evaluated on a case-by-case basis, based on funds available, fund projections, and loan forecast needs.

Staff is also recommending that a second category be added to Policy #7 that provides a Restricted Reservoir interest rate for water loan projects that address storage restrictions imposed by the State Engineer's Office (SEO). According to the 2008/09 SEO Annual Report, there are approximately 115,000 acre-feet of restricted reservoir storage statewide. This number will most likely increase upon implementation and enforcement of new SEO spillway requirements. Additionally, the CWCB 2010 State Water Supply Initiative Study has identified a potential M&I gap of 200K to 600K acre-feet by the year 2050. Additional reservoir storage will be a critical part of meeting that gap.

It is staff's opinion that providing a lower interest rate incentive to water providers to address storage restrictions in their systems is a positive step forward in providing affordable financing to address this issue.

The following incremental interest rate structure is recommended:

Table 3.
Suggested Restricted Reservoirs Incremental Interest Rates

Years of Payment	Interest Rate (%)	Actual Rate (%)
0 to 5	0.5	0.50
5 to 10	1.0	0.75
10 to 20	2.0	1.38
20 to 30	3.0	1.92

It is the opinion of staff that providing an incremental interest rate gives borrowers an incentive to initiate the project, with a significant interest savings if the borrower can pay off the loan within a 10-20 year term. The shortened term also keeps loan funds revolving more quickly, which promotes a greater distribution of funds throughout the entire loan program.

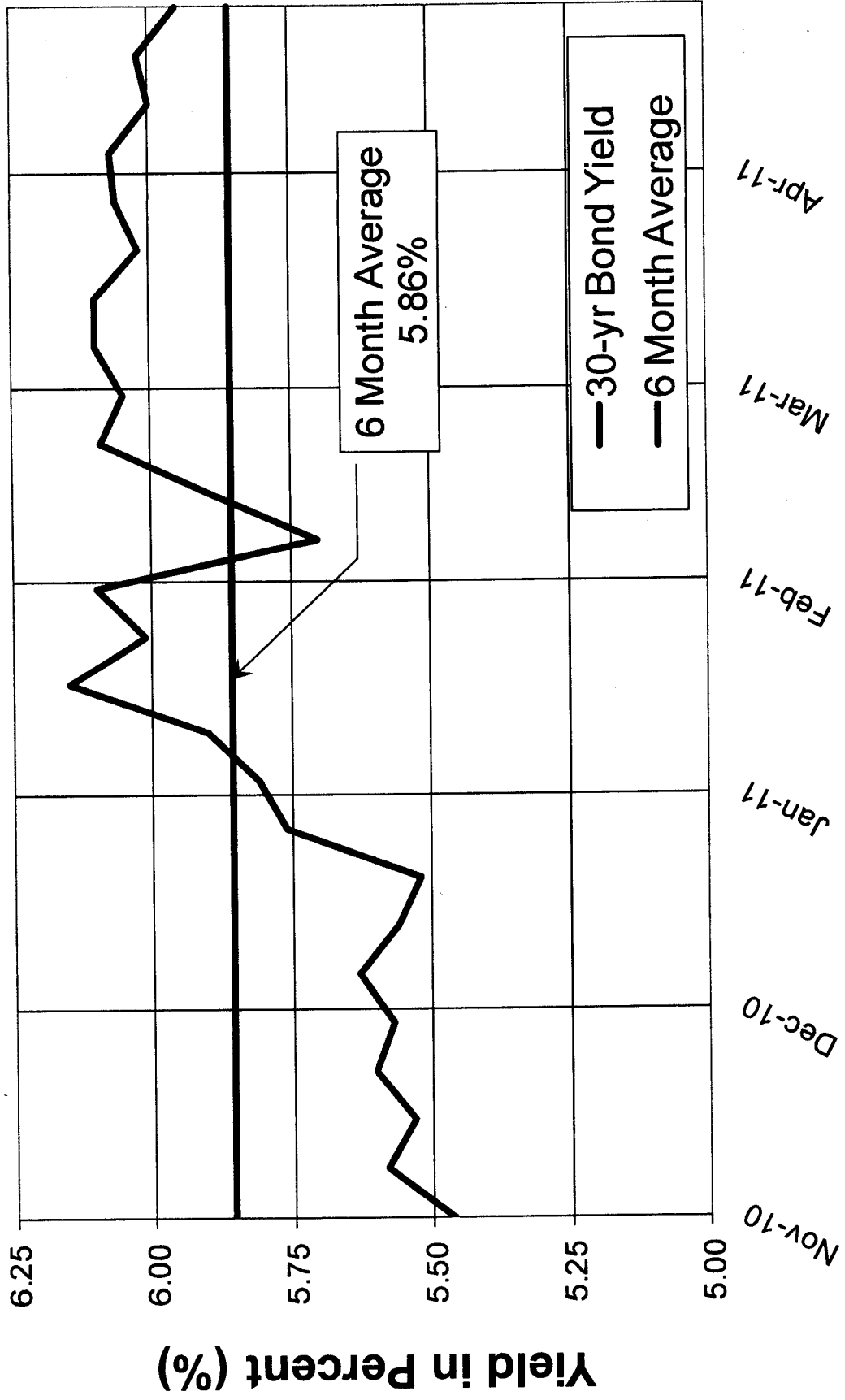
Staff Recommendation

Staff recommends that the Board adopt the schedule of 30-year lending rates, as shown in Table 1, based on the Board approved Financial Policy #7 for all loans recommended to the General Assembly or approved by the Board from July 1, 2011 through June 30, 2012.

Staff also recommends that the Board approve the proposed revisions to Policy #7 to include new interest categories and rates for hydroelectric projects, and water projects that remove State Engineer reservoir restrictions to apply to all loans recommended to the General Assembly or approved by the Board from July 1, 2011 through June 30, 2012, per revised Policy #7, dated May 17, 2011, attached

30-Year Municipal "A" Rated Bond Yield

November 2010 through April 2011



Date

POLICY NUMBER: 7

SUBJECT: ANNUAL CONSTRUCTION FUND AND SEVERANCE TAX
TRUST FUND PERPETUAL BASE ACCOUNT LENDING RATE
DETERMINATION

EFFECTIVE DATE: January 25, 1995

REVISED DATES: November 24, 1997
January 27, 1999
November 20, 2001
May 20, 2002
May 17, 2011

POLICY: The Colorado Water Conservation Board (CWCB) shall annually establish lending rates for loans to be made from the Construction Fund and Severance Tax Trust Fund Perpetual Base Account. Thirty-year lending rates will be established for agricultural, commercial, ~~and~~ municipal, hydroelectric, and restricted reservoir categories of loans using the procedure outlined below:

1. A Baseline Rate will be established equal to the average yield of the 30-year "A" rated* municipal bond for the six months preceding the May Board meeting of each year, and will be used to set all of the other lending category interest rates.
2. The Commercial Rate will be calculated as 110 percent of the Baseline Rate, rounded to the nearest one-quarter of one percent.
3. Municipal Rates will be based on the project sponsor's service area median household income, as established by the Colorado Department of Local Affairs, and will be structured as follows:
 - a. The Municipal High Income Rate will be calculated as 90 percent of the Baseline Rate rounded to the nearest one-quarter of one percent. The High Income Rate will apply where the median household income in the project sponsor's service area is greater than 110 percent of the state-wide median household income
 - b. The Municipal Middle Income Rate will be calculated as 80 percent of the Baseline Rate rounded to the nearest one-quarter of one percent. The Middle Income Rate will apply where the median household income in the project sponsor's service area is equal to 80 percent to 110 percent of the statewide median household income.
 - c. The Municipal Low Income Rate will be calculated as 70 percent of the Baseline Rate rounded to the nearest one-quarter of one percent. The Low Income Rate will apply where the median household income in the project sponsor's service area is less than 80 percent of the

statewide median household income.

4. Colorado's farms and ranches are irreplaceable resources providing food, fiber, open space, wildlife habitat, stable economies in rural areas and many other benefits. To help sustain the vitality of these economies, the Agricultural Rate will be calculated as 50 percent of the Baseline Rate rounded to the nearest one-quarter of one percent.
5. The 30-year lending rates established annually by the Board may be reduced for each lending category, with the exception of the Restricted Reservoir Rate and the Hydroelectric Rate, by one-quarter of one percent for all loans with maturities of 20 years or less but more than 10 years and by one-half of one percent for all loans with maturities of 10 years or less.
6. For specific projects that involve matters of statewide concern, such as interstate compacts, the Board may establish a lending rate somewhat lower than the adopted rate for the particular class of borrower.
7. For project borrowers that fall into more than one lending category, i.e. an agricultural irrigation company with municipal shareholders, a weighted average lending rate will be established based on the percent ownership of each lending category within the borrower's organization. The lending rate will be revised at any time during the life of the loan when an ownership change would increase or decrease the weighted average by more than 0.5%.
8. The State recognizes the importance of providing clean, renewable energy where feasible to assist in meeting its long term energy needs. To help promote this interest, the Hydroelectric Rate will be 2% fixed. The 2% interest rate will be applied only to the hydroelectric component of the project.
- 7.9. To assist in addressing the State's long term water needs and to provide water providers with affordable financing to remove State Engineer Office (SEO) reservoir restrictions, the Restricted Reservoir Rate will be as follows:

Years of Repayment	Interest Rate (%)
0-5	0.5
5-10	1.0
10-20	2.0
20-30	3.0

The Restricted Reservoir Rate shall only be for projects that remove a SEO restriction that was imposed due to safety issues with the facility, such as: seepage, outlet works, embankment, spillway, vegetation, and erosion.

PURPOSE:

To establish an annual lending rate structure for Construction Fund and Severance Tax Trust Fund Perpetual Base Account loans.

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APPLICABILITY: This policy and procedure apply to all applications for loans from the CWCB Construction Fund and Severance Tax Trust Fund Perpetual Base Account.

PROCEDURE: The CWCB staff will compile the closing weekly yields for the 30-year "A" rated municipal bond for the six months preceding the May Board meeting of each year and estimate the bond's average annual yield. A lending rate structure will then be developed as outlined above and will be presented to the CWCB at the May Board meeting of each year. The interest rates calculated based on this procedure will be effective for Construction Fund and Severance Tax Trust Fund Perpetual Base Account loan applications for the upcoming Fiscal Year and will be effective July 1 through the following June 30.

* Standard and Poor's definition of an "A" bond rating is: "A debt rated 'A' has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories."

Approved by the CWCB
May 20, 2002 Board Meeting
Agenda Item #9