STATE OF COLORADO

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Governor

Mike King
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Jennifer L. Gimbel
CWCB Director

TO: Colorado Water Conservation Board Members

FROM: Tim Feehan, PE, Chief
Finance Section

DATE: July 1, 2011

SUBJECT: **Agenda Item 20b - July 12-13, 2011 Board Meeting**
Finance Section – Financial Matters
Financial Policy No. 7 Revisions

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 the CWCB to remain a self-supporting agency. This memo is provided as background for discussion and approval of Water Project Loan Programs suggested revisions to Financial Policy No. 7, attached hereto.

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 Financial Policy No. 7. One new interest category would establish interest rates for hydroelectric projects, and the other new interest category would provide an interest rate reduction for borrowers that address reservoir restrictions imposed by the State Engineers Office (SEO). These two new interest categories were presented at the May 2011 Board Meeting. At that meeting, the Board requested that additional information be developed and presented at the July 2011 Board Meeting for further consideration. This memo addresses the additional information requested by the Board.

Staff Recommendation

Staff recommends that the Board approve the proposed revisions to Financial Policy No. 7 to include new interest categories and rates for hydroelectric projects and water projects that remove SEO's reservoir restrictions, to apply to all loans recommended to the General Assembly or approved by the Board from July 15, 2011 through June 30, 2012, per revised Financial Policy No. 7, dated July 13, 2011, attached.

New Interest Rate Categories

Hydroelectric

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 No. 7 does not specifically address the interest rate for hydroelectric water projects.

The Colorado Water Resources and Power Development Authority (CWRDPA) currently has a hydro-loan component in its program. CWRDPA offers a 2% interest rate for hydroelectric projects with a maximum of $2 million in loan funds available per year. In order to stay competitive in the market and to provide adequate funding levels to meet future demand, 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. The 2% hydroelectric interest rate would only apply to the hydroelectric component of a project.

At the May 2011 Board Meeting, it was a concern of the Board that CWCB would be competing with CWRDPA for hydroelectric loans and that CWRPDA funds should be expended prior to utilizing CWCB's hydroelectric loan funds. Staff has been in contact with CWRPDA throughout the development of the hydroelectric interest category and is in agreement with this request. Attached is a letter from the Michael Brod, Executive Director of CWRPDA, summarizing CWRPDA's position on CWCB's proposed hydroelectric interest rate category. It is acknowledged by both parties that it may be beneficial at certain times to fund projects jointly or to allow CWCB to fund projects solely, based on projected need, funding level requirements, and type of borrowers allowed by CWRPDA. CWCB staff will provide a letter of acknowledgement from CWRPDA for any hydroelectric loan request brought to the Board.

Restricted Reservoirs

Staff is also recommending that a second category be added to Financial Policy No. 7 that provides a Restricted Reservoir interest rate for projects that address storage restrictions imposed by SEO. According to the current restricted reservoir list provided by SEO, there are approximately 117,000 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.

At the May 2011 Board Meeting the Board had a number of comments or questions regarding the proposed restricted reservoir interest rate category. The comments/questions raised by the Board are summarized below.

- What is the lost revenue if the proposed interest rates are approved?
- Should the restricted reservoir rates apply to agricultural borrowers only?
- What is the ownership of the reservoirs that are restricted?
- Is there a market for the proposed interest category and should there be a trial period?

To address the question of lost revenue, staff developed an approved project list from April 2007–2011, and identified the number of restricted reservoir projects the Board had approved during that timeframe. During that five-year period, the Board approved 88 projects, of which 18 were restricted reservoirs. The interest revenue for these 18 restricted reservoirs was then calculated using their approved interest rate and then compared with the proposed restricted reservoir interest rate, as presented on page 4. It was determined that using the proposed restricted reservoir interest rates, CWCB would have lost $5,080,755 in interest revenue over a 30-year period or approximately $170,000 per year. In comparing that with the total accrued interest on all 88 projects of $124,688,892, it would have represented an approximate 4% loss in interest revenue over that five year project period. Attached is the restricted reservoir interest calculation.

Of the 18 restricted reservoirs described above, only 8 of the companies had 100% agricultural interests. The remaining 10 companies were comprised of a combination of agricultural and municipal, requiring a blended interest rate. It is the opinion of staff that requiring 100% agricultural ownership to receive the proposed restricted reservoir interest rate could potentially eliminate a large percentage of companies from qualifying for the interest rate reduction. In many cases, the percentage of municipal ownership in an irrigation company is small. To address this issue, staff would recommend that companies with a mixed ownership of agricultural and municipal qualify for the restricted reservoir rate; however, reservoirs owned solely by municipalities or have 100% commercial interest do not.

In reviewing the actual restricted reservoir list provided by SEO, it appears from a general overview of the 176 owners listed, 7% are purely agricultural, 77% are a combination of municipal and agricultural and the remaining 16% are entirely municipal ownership. Although it appears that a large percentage of the owners listed would qualify for the proposed restricted reservoir rate, it is staff's opinion that only a small percentage of owners are in a position to address the restriction, either due to location and/or the financial investment to initiate the project. Staff has been in contact with a number of ditch companies and water districts to discuss the proposed interest rate categories. It is staff's opinion that a number of companies would take advantage of the interest rate reduction to address SEO restrictions to their reservoirs, but does not foresee excessive requests. The effectiveness and continuation of the restricted reservoir category would be reviewed annually, per Policy No. 7.

At the May 2011 Board Meeting, staff recommended an incremental restricted reservoir interest rate. The rates presented were; 0.5% for 0 – 5 years, 1.0% for 5 – 10 years, 2.0% for 10 – 20 years, and 3.0% for 20 – 30 years. Based on further internal discussions, accounting issues, and ease of marketing, staff is recommending a simple reduction in the approved agricultural interest rate or the calculated blended rate for different ownership combinations, as illustrated below in Table 1.

Table 1.
Suggested Restricted Reservoirs Interest Rates

Years of Payment	Ag. Interest Rate FY11/12	Restricted Reservoir Rate
10 years	2.25	1.25
20 years	2.50	1.50
30 years	2.75	1.75

Companies that are not purely agricultural and have a blended interest rate based on a percentage of municipal ownership shall have their rates decreased by 1 percent, with an additional reduction for borrowers who elected to reduce their loan term, per Financial Policy No. 7.

Staff Recommendation

Staff recommends that the Board approve the proposed revisions to Financial Policy No. 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 15, 2011 through June 30, 2012, per revised Financial Policy No. 7, dated July 13, 2011, attached

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
July 13, 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 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 Interest Rate will be 2%. The 2% interest rate will be applied only to the hydroelectric component of the project and will be fixed rate for any loan term.
9. ~~7.~~ The CWCB is committed to addressing the State's long-term water needs and to assist in offering water providers with affordable financing to remove reservoir restrictions imposed by the State Engineer's Office. The Restricted Reservoir Rate shall be calculated by taking a 1 percent reduction from the annually approved agricultural rate or the calculated blended rate, as described under Section 7. An additional interest reduction will be granted under Section 5. 100% municipal or commercial borrowers will not qualify for the restricted reservoir interest rate. The Board reserves the right to deny any blended rate borrower the restricted reservoir rate based on the final determination of the borrower's ownership breakdown or to allow a 100% low income municipal rate borrower to apply for the restricted reservoir interest rate, subject to the review and approval of the Board.

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

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~~

COLORADO WATER RESOURCES &
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June 28, 2011

Jennifer Gimbel, Director
Colorado Water Conservation Board
1313 Sherman Street, Room 721
Denver, Colorado 80203

Re: Colorado Water Conservation Board (CWCB) Loan Program for Small Hydropower Projects

Dear Jennifer:

It is my understanding that the CWCB is considering a loan program to provide funding for small hydropower projects. I also understand that concerns were raised in the discussion of this program by CWCB Board members regarding the potential competition between this program and the Authority's existing Small Hydropower Loan Program.

In speaking with Tim Feehan, CWCB staff, we have agreed that Authority staff and CWCB staff will work cooperatively on funding projects. Given the limited loan amount available from the Authority ($2 million per project and $6.5 million remaining overall) many projects would require funding from both programs. For projects that are eligible and approved for the Authority program (governmental agencies only, e.g. not irrigation companies or water associations) funding would first come for the Authority program with the remainder, if approved, coming from the CWCB program. Again, the Authority staff and CWCB staff will work cooperatively to assist the project sponsor in funding its project in the most effective and efficient way possible.

I was happy to hear about the CWCB's consideration of a loan program for funding small hydropower projects. We are aware of a number of possible projects that are being developed and there will be a need for additional capital. We look forward to working cooperatively with CWCB staff in encouraging the development of this valuable renewable energy source.

Michael Brod

Michael Brod
Executive Director

Cc: Authority Board of Directors

Restricted Reservoir Interest Rate Category - Revenue Assessment

BORROWER	Loan Amount	Term -yrs	Int. Rate	Calc. Interest	Adj. Int.	Adj. Calc. Interest
1. Stagestop HOA	192,708.00	20	4.25	97,201.00	3.25	72,376.00
2. Fort Morgan Res. & Irrig. Company	1,494,800.00	30	2.90	756,072.00	1.90	475,301.00
3. Farmers Res. & Irrig. Company	3,535,000.00	30	3.70	2,376,466.00	2.70	1,007,043.00
4. WRCC, Inc.	1,301,890.00	30	2.85	652,312.00	1.85	406,227.00
5. Lake Canal Reservoir Company	393,900.00	30	3.15	220,406.00	2.15	144,452.00
6. Riverside Res. & Land Company	2,838,100.00	30	2.50	1,229,832.00	1.50	707,185.00
7. North Sterling Irrig. District	1,094,840.00	20	2.25	276,821.00	1.25	149,345.00
8. Town of Dillion	1,515,000.00	30	4.00	1,113,378.00	3.00	803,825.00
9. WRCC, Inc.	1,285,730.00	30	2.55	569,452.00	1.55	331,779.00
10. Granby Ditch and Res. Company	254,520.00	30	2.35	103,034.00	1.35	56,701.00
11. HenryLynn Irrigation District	2,184,327.00	30	2.25	843,107.00	1.25	448,565.00
12. Bijou Irrigation District	2,408,850.00	30	2.25	929,769.00	1.25	494,673.00
13. Overland Ditch and Res. Company	1,130,000.00	30	2.50	489,662.00	1.50	281,568.00
14. Joseph W. Bowles Res. Company	1,703,870.00	30	4.65	1,489,832.00	3.65	1,127,857.00
15. Tom and Linda Hill	862,540.00	10	2.00	292,830.00	1.00	140,113.00
16. Logan Irrigation District	306,419.00	20	2.35	124,043.00	1.35	68,262.00
17. Bijou Irrigation District	723,950.00	30	2.50	313,708.00	1.50	180,390.00
18. Highland Ditch Company	545,400.00	20	2.25	210,513.00	1.25	112,001.00
Totals:	23,771,844.00			12,088,438.00		7,007,663.00

100% Agricultural Borrowers   Rev. Lost: 5,080,775.00

To address the question of lost revenue, staff developed an approved project list from April 2007 – 2011, and identified how many restricted reservoirs the Board had approved during that timeframe. During that five year period the Board approved 88 projects, of which eighteen were restricted reservoirs. The interest revenue for these 18 restricted reservoirs was then calculated using their approved interest rate and then compared with the proposed restricted reservoir interest rate. It was determined that using the proposed restricted reservoir interest rates, CWCB would have lost $5,080,775 in interest revenue over a 30 year period or approximately $170,000 per year. In comparing that with the total accrued interest on all 88 projects of $124,688,892, it would have represented an approximate 4% loss in interest revenue over that five year project period.