OFFICE OF THE CITY MANAGER

October 29, 2015

To the Honorable City Council
of the City of Pasadena

Mayor and Councilmembers:

WEEKLY NEWSLETTER

1. One-Day Watering Schedule Resumes November 1st as Pasadena's Conservation Progress Holds at 24%:

Since the City Council implemented the Level 2 Water Supply Shortage Plan in June 2015, Pasadena has saved more than 1.2 billion gallons of water. The gauge continues to hold steady at 24% conservation, 4% less than the City's 28% conservation mandate set by the State Water Resources Control Board ("SWRCB"). For the past several weeks the gauge has stayed between 24% and 25%. The gallons of water saved and the 24% conservation data are cumulative results based on water usage by all Pasadena Water and Power ("PWP") customers from June 1 through October 21, 2015.

According to Eric Klinkner, Interim General Manager, each month, the SWRCB compares residential and commercial water use by urban water suppliers and compares it with their use for the same month in 2013 to determine if the water suppliers are on track for meeting their conservation goal. The SWRCB mandated that cities must reach and maintain their conservation goal from June 1, 2015 through Feb 28, 2015 or face fines of up to $10,000 a day.

City officials hope to achieve additional water savings after November 1 when the City resumes its one day per week winter watering schedule. Specifically, **Pasadena's fall/winter outdoor watering schedule runs November 1 through March 31, and limits outdoor watering to one day per week on Saturdays only**. The watering schedules are in accordance with the City's Level 2 water Shortage Supply Plan. (Please note that the fall/watering schedule was also one day per week in 2014 under the Level 1 Water Shortage Supply Plan.)

Additionally, feedback from the community indicates that water wasting is occurring as a result of some residents irrigating more frequently than the designated watering days in the early hours before the sunrises. As a result, the city expanded its water waste enforcement to include early morning patrols.

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Data from June 1 – Oct. 21, 2015
More conservation is needed.
Help us get to 28% by February!

For a weekly status on how much water Pasadena has conserved to date, the water savings gauge is posted to the city's website http://www.CityofPasadena.net, and can also be seen on KPAS during the Pasadena City Council meetings. Residents, visitors and businesses can also report water waste by calling the Pasadena Citizen Service Center at (626) 744-7311, reporting online at http://cityofpasadena.net/CSC or using the City's free app for smart phones and tablets. Links for all devices are available at http://www.cityofpasadena.net/CSC/Mobile-App/. To view a complete list of water restrictions or to learn how the water conservation goals are established, visit http://www.cityofpasadena.net/waterandpower/SaveWater/

2. PWP Receives AA rating for its Electric System Revenue Bonds and AA+ for its Water Revenue Bonds

Eric Klinkner, Interim General Manager is pleased to announce that on October 20, 2015, PWP received affirmation of an AA rating for its Electric System Revenue Bonds and an AA+ rating for its Water System Revenue Bonds, with stable credit outlooks for both utilities. Water & Power and Finance Department staff presented updated financial and operational information to the Fitch Rating analysts on September 30. Fitch Ratings is a nationally-recognized statistical rating organization designated by the U.S. Securities and Exchange Commission. The organization provides credit ratings, commentary, research and analysis for organizations nationwide.

According to Fitch Ratings, an AA and AA+ rating provides financial institutions and prospective investors with an indication that an agency has a very strong capacity for making its financial payments and commitments. The company's ratings are also used as a guide by investors to understand how much, and what kind of debt is held by the company.

PWP's electric and water revenue system bonds were evaluated using a series of criteria including rate structure and rating sensitivities, credit profile, the impact of environmental regulation and historical performance, to name a few. Specifically, PWP's Power Integrated Resources Plan ("IRP") was noted as providing "Proactive Environmental Targets." Because the IRP contains efficiency and conservation goals that are more aggressive than state mandates, Fitch Ratings stated that, "PWP's proactive approach to garner ratepayer support for its environmental program is an additional positive

attribute of the IRP." For details on electric and water revenue bond systems ratings, please see the attached documents from Fitch Ratings.

3. <u>A New Temporary Public Art Installation at City Hall</u>:

There is a new public art project at City Hall! "Lions, Tigers, and…." is a sound installation produced by the media organization Freewaves. According to Vince Bertoni, Director of Planning and Community Development, the project includes a motion-activated audio collage of sounds—lions, nature and music—in the City Hall Courtyard. Presented by the City's Cultural Affairs Division in partnership with Side Street Projects, this project is one of 12 funded through a National Endowment for the Arts *Our Town* grant that will be presented to the public in the Civic Center area periodically through September of 2016. Each individual *"My Pasadena"* project explores some aspect of civic life and engagement. The public is invited to participate by answering questions and sharing thoughts about the symbolism and interpretation of the cast-stone lions on the Pasadena City Hall façade. Each week, a Freewaves representative will be located at City Hall to engage the public and to inspire viewers to think about civic life. Responses will be incorporated into a revised public art sound installation for the Courtyard to be unveiled at Spring ArtNight in March 2016.

Respectfully Submitted,

JULIE A. GUTIERREZ
Assistant City Manager

/attachments

FitchRatings

FITCH AFFIRMS PASADENA, CA'S ELECTRIC SYSTEM REV BONDS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-20 October 2015: Fitch Ratings has affirmed the 'AA' rating on $202.7 million of electric revenue bonds issued by Pasadena, CA on behalf of Pasadena Water and Power (PWP).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a first lien on net revenues of the Pasadena electric system.

KEY RATING DRIVERS

STABLE, MATURE SERVICE AREA: Pasadena, a mature city located within the greater Los Angeles region, exhibits strong economic indicators, a stable population base and a diverse economy.

STRONG FINANCIAL METRICS: The city's retail electric system, operated by PWP, generates consistently strong financial ratios. Although there has been some decline in ratios due to substantial debt issuance, debt service coverage (DSC) is sufficient for the rating category and is expected to remain above a healthy 2x coverage level.

LARGE CAPITAL PLAN UNDERWAY: PWP's capital plan includes completing the construction of a new gas-powered plant, which is 85% debt funded. While the plant helps diversify PWP's power supply and moves the utility away from coal reliance, the initial bond issuance increased leverage by almost 50% and additional debt issuances are anticipated in fiscal 2017 and 2018. Favorably, a three-step rate increase schedule was implemented in fiscal 2015, which should help maintain strong metrics.

FLEXIBLE RATE STRUCTURE: Retail rates include components to allow for the pass-through of increases in energy and transmission costs, which provides flexibility to adapt to unexpected cost pressures. In addition, city council has shown support for base rate increases when requested, as evidenced by the recently implemented rate schedule.

PROACTIVE ENVIRONMENTAL TARGETS: PWP's integrated resource plan (IRP) historically set efficiency and conservation goals at a more ambitious level than earlier state mandates. These proactive targets strongly position the utility to meet the state's most recent and somewhat ambitious greenhouse gas and renewable goals. PWP's proactive approach to garner ratepayer support for its environmental program is an additional positive attribute of the IRP.

INCREASED INTERFUND TRANSFERS: Transfers to the city's general fund (GF) have been steadily increasing in recent years and, starting in fiscal 2015, internal policy will increase the transfer to 10%, which is somewhat high compared to peers. Management has stated that the transfer should remain at 10% for the foreseeable future. City charter caps the transfer at 16%.

RATING SENSITIVITIES

MANAGEMENT OF RATE STRUCTURE: Pasadena Water & Power's ability to manage its electric rates and maintain robust financial metrics in the wake of increased debt levels, stringent environmental targets and sizable general fund transfers is key to maintaining stable financial performance. Weaker than expected rate increases or continued increases in the general fund transfer that reduce coverage levels could result in negative rating pressure.

CREDIT PROFILE

PWP is a retail electric system serving over 65,000 residential, commercial and industrial customers within the city's 23-square mile area. A mature community located 10 miles northeast of downtown Los Angeles, the city possesses a diverse employment base with above-average wealth and education levels.

The majority of PWP's energy sales are derived from residential (29%) and commercial and industrial customers (68%) and, to a smaller extent, wholesale sales (2.7%). Preliminary fiscal 2015 results show a continued decline in energy sales, as a result of the utility's conservation program and a continued decrease in wholesale sales. PWP has been actively managing its energy resources to avoid oversupply, which has led to less market purchases and a reduction in off-system sales.

DIVERSIFIED RESOURCE MIX

The electric system is fully integrated and includes generation, transmission and distribution facilities. In addition to its owned and operated generating units, PWP receives a majority of its total energy needs through ownership participation in various joint power agencies (JPAs). Of its 347 MW of capacity, approximately 6.3% is locally-owned steam and gas generation and 82.4% is from a variety of long-term JPAs, including coal-fired, hydroelectric and nuclear-generating units.

The Intermountain Power Project (IPP) is PWP's largest source of power, and accounted for approximately 50.4% of PWP's energy load in 2014, but it is also the utility's largest source of carbon emissions. The IPP agreement is set to expire in 2027 and California mandate prohibits renewal if the resource continues to be coal based. Discussion is underway to transition from coal to gas-based generation at the IPP site. PWP is evaluating its options as to how it will participate in the repowering.

The GT5 Repowering Project, in which PWP is building a 71 MW (65 MW net) combined cycle plant to replace the existing Broadway 3 steam plant, is currently underway. The project is on schedule and on budget, with construction expected to be completed in February 2016 and commercial operation beginning in May of that year.

The series 2013 bonds provided $60 million in initial funding for the project and a line of credit has been used to fund ongoing additional costs. Management anticipates issuing approximately $70 million-$80 million in debt after GT5 is in operation, expected in late spring to early fall 2016, to take out the short-term debt and fund some additional distribution system capex.

STRONG HISTORICAL PERFORMANCE

Financial performance for 2014 is somewhat weaker than historical levels, as anticipated, but still remains strong compared to 'AA' rated peer-medians. The decrease in coverage was expected and in conjunction with a large debt issuance to fund the construction of the utility's new combined cycle power plant. Projections show DSC remains relatively stable, inclusive of current and anticipated debt, through 2018.

INCREASING COST OF ENVIRONMENTAL REGULATION

PWP implemented its IRP in 2009, which was adopted by city council and was vetted with the citizens and ratepayers of Pasadena. The IRP was updated in 2012 and more recently, in 2015. Fitch views PWP's proactive approach to garner ratepayer support of its environmental program as a credit strength and positive attribute of the IRP. The IRP calls for PWP to derive 40% of its power supply from renewable resources by 2020 (more conservative than the state's previous energy mandate of 33%) and 50% by 2030 to stay compliant with recently enacted state goals. PWP achieved several of the IRP's midway targets in 2010 and has been compliant with the state's renewable portfolio standard (RPS) targets, achieving 28% RPS in calendar year 2014.

The replacement of traditional, carbon-emitting resources with renewable energy will potentially increase the utility's costs. This could strain retail rate flexibility. However, ratepayers and the city council are supportive of the IRP and PWP's environmental goals. It is expected that there would be support for timely rate increases in the future.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864007

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FITCH AFFIRMS PASADENA, CA'S WATER REV BONDS AT 'AA+'; OUTLOOK STABLE

Fitch Ratings-Austin-20 October 2015: Fitch Ratings has affirmed its 'AA+' rating on the following bonds issued by the city of Pasadena, CA on behalf of Pasadena Water and Power (PWP):

--$72.5 million outstanding water system revenue bonds, series 2007, 2010A, 2010B and 2011A.

The Rating Outlook for all bonds is Stable.

SECURITY
Bonds are payable from net revenues of the city's water fund and gross revenues of the capital improvement charges, which are a portion of the bill designated to fund the Water Master Plan, including debt service.

KEY RATING DRIVERS

MATURE SERVICE AREA: The city of Pasadena is a strong and mature service area centrally located within the greater Los Angeles region. Growth in customers is less than 1% annually.

STRONG COVERAGE DESPITE DECLINES: Debt service coverage (DSC) has been historically high at over 3.4x for the past five years. Lower revenues resulting from state mandated lower water sales to address the drought will reduce margins but DSC is expected to remain strong at over 2x.

RATE INCREASES EXPECTED: Pasadena is engaged in a full cost-of-service study. Rate redesign and rate increases beginning in fiscal 2017 are expected to absorb the revenue impact from lower water sales. Competitive rates and a strong community planning process should provide Pasadena with the rate flexibility to implement any needed rate action.

IMPORTED WATER SUPPLY DEPENDENCE: Pasadena is dependent on an imported water supply, as is much of the region, which is subject to availability challenges and cost pressure.

RATING SENSITIVITIES

PRESSURE FROM STATEWIDE DROUGHT: Reduced financial margins at Pasadena Water and Power beyond levels currently expected could result if water sales fall below assumed levels or if planned rate increases do not occur. These factors would result in downward rating pressure.

CREDIT PROFILE

Pasadena Water and Power, an enterprise of the city of Pasadena, provides retail services to 37,974 water system customers within the city limits and in the community of Altadena, with around 6,500 of its customers outside the city limits. The city is a mature community covering 23 square miles in Los Angeles County, 10 miles northeast of downtown Los Angeles. The built-out nature of the service area limits growth pressure from the standpoint of water supply demand and new infrastructure investment. There is limited customer concentration with the 10 largest customers accounting for around 10% of water sales.

The majority of the city's water supply is provided by the Metropolitan Water District (MWD; revenue bonds rated 'AA+' by Fitch), the regional wholesale provider of imported water which

serves communities in the region. The city's purchases from MWD have hovered between 55% and 68% in recent years. The cost of the city's own treated groundwater is significantly lower than purchasing treated water from MWD but there are limitations on how much Pasadena can pump from the Raymond Basin, an adjudicated water basin.

REVENUES DECLINES EXPECTED FROM MANDATORY CONSERVATION

The city's water sales declined around 22% between the years 2007-2012, which is consistent with other regional utilities as a result of the economic recession, conservation efforts, and variable weather conditions. Water sales increased in the initial years of the drought with increases of 7% and 3% in 2013 and 2014, respectively, but fell 14% in fiscal 2015 with increased conservation efforts as drought severity grew.

In May 2015, as a response to the Governor's recent executive order to reduce annual water usage in the state by 25%, the State Water Resource Control Board (SWRCB) adopted rules requiring mandatory reductions in water usage for all of California's water providers. The city's required reduction is 28% over 2013 levels. To achieve this, Pasadena enacted Level 2 of its water shortage plan adopted by City Council in 2009, which is designed to achieve a 20% reduction in water usage. As of August 2015, Pasadena is reporting water sales 30% below 2013 levels.

Pasadena is conservatively budgeting for 20% lower water sales in fiscal 2016 (on top of the 14% reduction that occurred in fiscal 2015). Revenues are expected to decline with the lower sales, given Pasadena's primarily volumetric rate structure.

STRONG DSC SHOULD CONTINUE; RATE INCREASES NEEDED

Given Pasadena's strong financial position going into the drought and the legal settlement that reduced the annual transfer to the general fund beginning in fiscal 2015, financial performance is expected to be robust with continued DSC over 2.1x, even if water sales remain at the low levels assumed in fiscal 2016. This level is below Fitch's 'AA' category median of 2.5x but will be adequate to maintain the rating, assuming continued strong liquidity.

DSC has been historically strong at over 3.4x in the past five years, declining slightly to 3.2x in fiscal 2015 (estimated, unaudited) with the lower sales. The reduction of the general fund transfer from 6% of revenues to around 3% of revenues in fiscal 2015 helped preserve revenues at the utility. The 2015 transfer reflects a cost of service study done in 2014 that was accepted as the basis for the water fund's share of general fund costs. The adjustment was driven by a legal settlement regarding the legality of the transfer under California's Proposition 218 that requires water rates not exceed direct costs of providing water service. The general fund repaid $7.1 million to the water fund in fiscal 2015, which improved unrestricted cash reserves to $38.3 million, or 356 days cash on hand.

Rate increases and rate restructuring are both expected to result from the city's cost of service study taking place in fiscal 2016. Management anticipates that the rate redesign will consider options regarding further separation of revenues from volume sales.

MANAGEABLE CAPITAL SPENDING

In accordance with Pasadena's master plan outlined in 2002, capital spending has been robust since that time. Capital spending has averaged over 200% depreciation for a number of years and increased to 386% in fiscal 2014, compared to Fitch's 'AA' category median of 152%.

Five-year projected capital needs are $74 million for continued infrastructure reinvestment. Phase 1 of the city's recycled water project represents another $20 million. The recycled water project will

be constructed between fiscals 2017-2019 and will build-out the delivery system of recycled water purchased from the city of Glendale to an initial small number of large industrial and irrigation customers in Pasadena. The overall capital plan is estimated to be funded from 65% debt issuance. Pasadena's current debt burden is moderate and, while leverage will increase with possible new debt issuance in 2017, it should remain manageable.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 03 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869223

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