

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 330

Subject: Line of Credit with San Diego National Bank for the Affordable Housing Opportunity Fund and the City Heights and Naval Training Center Project Areas

OVERVIEW

The City Council is being asked to approve Redevelopment Agency execution of a \$70 million non-revolving line of credit (LoC) with San Diego National Bank. The Redevelopment Agency plans to use the proposed LoC for various housing and non-housing projects in four redevelopment project areas (City Heights, Naval Training Center, North Bay and North Park). This report comments on the LoC and information within the staff report.

FISCAL/POLICY DISCUSSION

Background

In December 2006, the Redevelopment Agency issued a Request for Proposals (RFP) to 20 commercial and investments banks for six separate non-revolving lines of credit in an aggregate amount of \$70 million. The Redevelopment Agency received two bids in response to the RFP and selected San Diego National Bank as the preferred lender, citing lower costs and greater flexibility. The lines of credit are available for three years at taxable rates tied to the 3-year U.S. Treasury rate or the 30-day LIBOR rate, plus a stipulated basis point spread. The staff report indicates that, as of May 2, 2007, the interest rate on the LoC would be 6.46% based on the 30-day LIBOR rate. LoC funds would be drawn down on an as-needed basis and repaid quarterly on an interest-only basis.

The Proposed Borrowing

The Redevelopment Agency requires funding for a number of existing and pending projects/commitments. Unable to access the public bond markets at this time and in order to proceed with redevelopment activities, the Redevelopment Agency has sought and been offered a LoC borrowing facility from San Diego National Bank.

Understanding the Redevelopment Agency's inability to access the bond markets and their need to finance redevelopment projects/commitments, the IBA supports a financing strategy that seeks to utilize a LoC in the short-term and subsequently refinance the LoC with less expensive, long-term bonds when they become available. The Redevelopment Agency's financial advisor estimates that bond financing probably will not be available sooner than the spring of 2008.

As provided in the staff report, approximately \$29 million of the \$70 million LoC would be available to the Housing Opportunity Fund for affordable housing projects, including 8 projects totaling \$40 million that are currently under review. Another \$5 million of the LoC would be available to City Heights housing programs and the NTC Homeless Assistance Agreement. Owing to private sector participation in development, affordable housing projects typically must be financed with taxable debt.

The remaining \$36 million of the LoC would be available for non-housing projects in the City Heights project area (\$20 million for property acquisition, public facilities and a loan repayment) and the NTC project area (\$16 million for loan repayment, public improvements and NTC Foundation funding). As most of these projects/commitments appear to be solely for public purposes, the IBA asked if some the projects would be eligible for less expensive, tax-exempt financing. Tax-exempt rates are roughly 180 to 255 basis points (1.8% to 2.55%) cheaper than taxable rates for the same term; however, San Diego National Bank was unable to offer a tax-exempt LoC at this time.

The Redevelopment Agency's financial advisor has indicated that it is a recommended redevelopment financing practice to not use tax-exempt proceeds to acquire property that might be resold to a private party in the future for private uses. That leaves approximately \$16 million of non-housing projects/commitments in the NTC project area and \$5 million of non-housing projects in the City Heights project area that may be eligible for tax-exempt financing. The Redevelopment Agency's bond counsel would have to evaluate each project/commitment to ascertain eligibility for tax-exempt financing.

While the IBA is raising the possibility that cheaper, tax-exempt financing may be available for a few of the projects/commitments identified for financing by the LoC, Redevelopment Agency staff has also informed us of circumstances and considerations that might offset the benefits of acquiring cheaper financing. These include the following:

- The rates on San Diego National Bank's taxable LoC bid were lower than the cover bid for loans terms of more than 1 year. However, the IBA would note that the rates on the alternate bidder's taxable LoC bid were 20 basis points lower for terms of less than one year.
- The outstanding McMillin loan that would be paid-off with the LoC accrues interest at the prime rate plus 0.5% (currently 8.75%) which is considerably higher than the estimated taxable LoC rate of 6.46%.
- Most of the projects to be financed with the LoC are only eligible for taxable financing.
- The requested LoC will expediently facilitate pending redevelopment activity that might otherwise be delayed if financing is not accessed at this time.

Interest Rates / Termination of the LoC

The proposed LoC is offered at taxable rates tied to the 3-year U.S. Treasury rate or the 30-day LIBOR rate, plus a stipulated basis point spread. Page 2 of the staff report indicates that the lesser of these two rate options was the 30-day LIBOR rate plus 110 basis points on May 2, 2007, or 6.46%. On page 7 of the staff report, there is a reference to an effective annual rate of borrowing estimated to be 4.20%. After discussing this rate with Redevelopment Agency staff it is clear that this estimate attempts to measure the fact that the entire \$47 million would not be borrowed for a full year; however, the LoC rate of interest on borrowed funds should be approximated by the 30-day LIBOR plus 110 basis points calculation (6.46%), irrespective of the term of the borrowing.

As has been noted on page 7 of the staff report, the IBA would call attention to the fact that the Redevelopment Agency intends to fully repay and terminate the LoC with a public offering of long-term tax allocation bonds within one year. The LoC is available to the Redevelopment Agency for three years. If the Redevelopment Agency is unable to issue bonds when the LoC expires in three years, the Agency would have to renew the LoC, or negotiate with a bank for a new LoC, or repay the line with a private placement. The Redevelopment Agency's financial advisor has indicated that one or more of these options would be available in the event that Agency bonds could not be issued.

CONCLUSION

The IBA reiterates its support for a financing strategy that seeks to utilize a LoC in the short-term and subsequently refinance the short-term borrowing with less expensive, long-term bonds when they become available. We have noted that there may be a more cost-effective means of financing some of the identified projects/commitments with a tax-exempt borrowing; however, we acknowledge that there may be offsetting circumstances or considerations that impact this decision. Alternatively, there may be another way to expediently access tax-exempt financing without significantly delaying needed funds for redevelopment projects/commitments, which we encourage staff to respond to.

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