OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 204

Convention Center Phase III Expansion: Plan of Finance and Related Actions

OVERVIEW

After receiving conceptual information regarding a plan of finance for a proposed Convention Center Expansion Project (Project) on October 25, 2011, the City Council took the first of several actions leading to the formation of the Convention Center Facilities District (CCFD). This special district was formed to create a primary means of financing the Project. An update to the conceptual plan of finance was provided to the Council when they adopted a resolution to form the CCFD on January 24, 2012 (Attachment 1 in Report to the City Council No. 12-02). Although staff committed to providing the Council with a comprehensive financing plan in May 2012, the plan of finance is being presented for Council consideration at this time.

On October 1, 2012, the Council is being asked to adopt three resolutions for agenda item 204 to accomplish the following:

1) Approve the Plan of Finance for the Project
2) Authorize the reimbursement of eligible Project costs incurred prior to the issuance of bonds with bond proceeds.
3) Authorize the execution of a Support Agreement between the City and the Port District which, in part, details the Port's commitment to make fixed annual payments to the City totaling $60 million over a twenty year period commencing upon completion of the Project.
4) Approving a Joint Community Facilities District between the City and the Port District in order to facilitate the contemplated bond financing.
5) Authorizing the City Attorney's Office to enter into an agreement with Nixon Peabody LLP in an amount not to exceed $165,000 to provide bond and disclosure counsel services.

This report reviews key elements of the proposed plan of finance including: sources of repayment for the planned borrowings, structure of the proposed bonds, factors which can limit the General Fund's exposure and potential risks.

FISCAL/POLICY DISCUSSION

Projected Benefits Associated with the Project

As has been previously discussed by the City Council, completion of the contemplated Project is expected to result in significant economic benefits for the City. In addition to the creation of new jobs, a November 2010 economic analysis of the proposed Convention Center expansion by AECOM estimated the City would realize an additional $13.8 million in annual revenue due to additional convention business captured as a result of the expansion, including 12.7 million in additional TOT revenue.

Last January, at the request of the Council, the IBA performed a sensitivity analysis of incremental TOT revenues projected to be generated by from the Project (Report 12-02). Our analysis utilized a different methodology than AECOM and concluded that total incremental TOT revenue generated by the Project could range from $5.2 million to $9.7 million annually which we continue to support. While this analysis suggested AECOM estimates could be overstated, we acknowledged there could be other factors not considered in our limited analysis that could cause us to adjust our estimates. Irrespective of either of the above estimates, new City TOT revenue will likely exceed the City's planned annual $3.5 million contribution to the financing.

Plan of Finance

The plan of finance before the Council is generally consistent with what has previously been presented as a conceptual plan of finance. However, we now have significant additional detail about the structure of the planned borrowings and how revenues will be used to pay debt service. While the plan of finance is now better understood, it is important to note that many of the technical details (timing and size of the different borrowings, interest rates, debt service coverage levels, early bond redemption provisions, etc.) are evolving or dependent upon future bond market conditions and yet to be known Project needs. As the City gets closer to initiating Project construction and borrowing funds, more details will be known and provided.

The following are the key elements of the current Plan of Finance:

The Project: The current budget for the Project is $520 million. On October 1st, the Council will be asked to authorize execution of a Construction Manager at Risk (CMAR) contract with Clark Hunt for pre-construction services. As it has been explained to the IBA, the role of the CMAR consultant is to work with the Project architect (providing design assistance, cost estimating, value engineering and other services) to develop a Guaranteed Maximum Price (GMP) for construction of the Project. Utilizing a CMAR consultant helps ensure a cost-effective Project design. It should also provide additional assurance that the Project will come in at or below the estimated $520 million budget.

Sources of Repayment for the Planned Borrowings: The plan of finance specifies three primary funding sources - CCFD Special Tax Revenues, the Port District's support payments of $60 million over 20 years and the City's $3.5 million annual contribution. Using data derived from the Final Rate and Method of Apportionment of Special Tax, staff indicates CCFD special tax revenues would be approximately $29.8 million in FY 2013. Applying City TOT growth rates for FY 2014 through FY 2017 (5%, 5.5%, 6%, and 6%) to the $29.8 million figure for FY 2013 results in projected CCFD special tax revenue of approximately $37 million in FY 2017. Thereafter, no growth in CCFD revenue is assumed (a conservative assumption that probably significantly understates CCFD revenue over time).

In March 2012, Tourism Marketing District (TMD) representatives pledged to use TMD revenue to cover any annual debt service deficiencies after the above cited revenue sources had been exhausted; however, this pledge is no longer considered to be legally viable. Given this development, and to the extent the three identified repayment sources are insufficient, the City's General Fund will be responsible for debt service deficiencies, if any.

Short Term Notes: The City's Project Manager indicates a need for $40 million (of the $520 million Project budget) to fund 18 months of design and pre-construction costs. The major components of the $40 million for design and pre-construction costs include: Consultants - $21.7M; Utility Relocation & Street Improvements - $10M; Contingencies - $5.6M; Permits & Capacity Fees - $1.5 million; CMAR Preconstruction Services - $.5M; Testing Services - $.5M; and Other City Charges - $.2M. The plan of finance also calls for borrowing approximately $1 million to recover costs incurred to form the CCFD ($496,000) and pay for costs of issuance ($547,000) on the short-term notes.

The plan of finance envisions a CCFD issuance of $41 million of short term revenue anticipation notes (Notes) for a term of up to two years. Interest on the Notes would be payable from CCFD special tax revenues and principal would be payable either from special tax revenues or proceeds from long term bonds (expected to be issued in July 2014). The General Fund would not be obligated in any way to the Notes. The Notes could be issued as soon as February 2013 and staff is planning to bring the offering documents for the Notes to Council for approval in November 2012.

The use of short term Notes prior to the long term borrowing 1) accelerates reimbursement of funds advanced by the City for the Project and 2) allows initial CCFD special tax revenues to be accumulated to fund an internal City Stabilization Fund and Project Equity (discussed below). Special tax revenue accumulation for these purposes is possible because initial special tax revenues are expected to significantly exceed interest and principal payments on the Notes.

Long Term Bonds - CCFD Revenue Bonds (Primary Bonds): In order to finance the Project, the City plans to issue enough long term bonds to realize approximately $508.5 million in proceeds. This amount coupled with approximately $11.5 million of Project Equity equals the $520 million estimated budget for the Project. The plan of finance anticipates issuing long term bonds in July 2014.

Approximately two-thirds ($333.2 million) of the total planned long-term borrowing ($508.5 million) will be accomplished with Primary Bonds. These bonds will be issued by the City on behalf of the CCFD. Debt service for these bonds will be entirely dependent CCFD special tax revenues and Port District payments in accordance with the provisions of the Support Agreement. <u>The General Fund will not be obligated in any way to the Primary Bonds</u>.

The plan of finance contemplates splitting Primary Bonds into two tiers - "Tier 1" and "Tier 2" bonds. Primary Bonds will have first priority on CCFD special tax revenues. Because there will be significantly more projected special tax revenue than needed to cover debt service on the Primary Bonds, they can be structured in a way to achieve higher credit ratings thereby reducing total borrowing costs.

Based on current market conditions, Tier 1 bonds could be structured to be entirely dependent on CCFD revenue with special tax revenue equal to as much as 200% of the annual debt service on the bonds – resulting in a higher credit rating and a lower borrowing cost. Tier 2 bonds would be structured to be dependent on CCFD revenues and Port payments with these combined revenues equal to 150% of the debt service. Market conditions and investor preferences closer to the time bonds will be issued will ultimately determine bond sizing, timing and debt service coverage details. It is important to note that details provided in the current plan of finance may change to meet market/Project conditions and achieve the lowest cost of borrowing.

Long Term Bonds - Lease Revenue Bonds (Gap Bonds): By using higher debt service coverage to achieve the lowest cost of borrowing, the plan of finance attempts to maximize the amount of Primary Bonds issued on behalf of the CCFD. Once Primary Bonds have been cost efficiently maximized, the Plan of Finance calls for the issuance of lease revenue bonds or Gap Bonds to raise the remainder of the proceeds (approximately $175.3 million) required to complete the Project.

The Gap Bonds would be issued by the Convention Center Expansion Authority (Authority). The Authority is a joint powers authority between the City and the Port District. The Gap Bond financing structure requires the creation of lease arrangements between the City and the Authority. As noted on page 6 of the staff report, the subject of the lease would be the original Convention Center property (Leased Property) which is owned by the Port District. The Port District will lease the Leased Property to the Authority for a nominal rent. In turn, the Authority will sub-lease the Leased Property to the City, and the City will make annual rental payments to the Authority in the amount of the annual debt service on the Gap Bonds.

A combination of excess CCFD revenues (revenue remaining after debt service is paid in full on the Primary Bonds) and the annual General Fund payment of $3.5 million are planned to cover debt service payments on the Gap Bonds. The plan of finance also calls for the creation of an internal City Stabilization Fund equal to the highest annual debt service payment on the Gap Bonds (approximately $13.2 million). If combined CCFD and City revenues are insufficient to cover debt service in any year, the City can use funds available in the Stabilization Fund to cover the shortfall.

As with other General Fund backed lease revenue bonds, the City's General Fund is ultimately responsible for debt service payments on the Gap Bonds. If the three above referenced sources of revenue are insufficient to cover annual debt service, the City's General Fund must cover the shortfall in addition to the $3.5 million payment. As described below, the plan of finance relies upon forecasted excess CCFD special tax revenue to allay concerns about the possibility of insufficient revenue for annual debt service.

Factors Limiting General Fund Debt Service Exposure: General Fund debt service exposure on the Gap Bonds is buffered by CCFD revenues which are estimated to be greater than annual debt service payments. The Debt Management Department provided the IBA with **Attachment 1** which shows estimated debt service for the Primary Bonds (titled District Revenue Bonds) and the Gap Bonds (titled Lease Revenue Bonds). In an effort to quantify potential annual excess revenue, the IBA has developed **Attachment 2**. The rightmost column of this spreadsheet shows "potential" annual excess revenue for any given year.

The collection of CCFD special tax revenue is estimated to begin in February 2013 (note: staff reports there is a one month lag in the collection of CCFD revenue) and the issuance of long term bonds is expected to occur in July 2014. If the timing of these events is correct, the IBA estimates approximately $40.6 million of revenue would be collected between February 2013 and July 2014. Staff has informed the IBA that the plan of finance calls for using these funds to: 1) pay interest on the short term Notes, 2) establish an **Internal Stabilization Fund** in an amount equal to the highest annual debt service payment on the Gap Bonds - estimated to be approximately $13.2 million, 3) generate approximately $11.5 million of **Project Equity** (as shown in the table on page 10 of the staff report) thereby reducing the amount of long term bonds from $520 million to $508.5 million, and 4) accrue funds to make the first debt service payment on the long term bonds which is expected to be due in FY 2015.

The Internal Stabilization Fund can be drawn upon if there is insufficient revenue in any given year to make annual debt service payments. As noted on page 7 of the staff report, excess special tax revenues in subsequent years would be used to replenish the Internal Stabilization Fund to the original level. If the Internal Stabilization Fund can be maintained at its original level, it provides a buffer to General Fund debt service exposure.

There is discussion regarding the potential early redemption of bonds beginning on page 7 of the staff report. Early redemption of bonds is possible if there is excess revenue after debt service payments have been made and after the Internal Stabilization Fund is fully funded. When bonds are redeemed early, there is a corresponding reduction in annual debt service which will reduce the City's General Fund debt service exposure. There are a number of factors which can influence how prepayment provisions are structured and staff plans to evaluate and recommend these provisions going forward.

The plan of finance contemplates the early redemption of bonds in a pro rata fashion (retiring both Primary and Gap bonds). If there is interest in reducing the General Fund's debt service exposure as soon as possible, the Council may wish to ask staff about the possibility of augmenting the plan of finance to redeem the Gap Bonds first. The IBA is not aware of anything that would preclude this from consideration.

Potential Risks: The rightmost column of Attachment 2 illustrates significant "potential" annual excess revenue; however, the plan of finance cannot predict future events and there are risks which could significantly reduce or even eliminate projected annual excess revenue. Some of these considerations/risks are presented in the staff report beginning on page 11. The IBA highlights and briefly comments on a few of the risks below:

> Interest Rate Risk - Bond interest rates are at historically low levels and the plan of finance calls for the issuance of long term bonds in July 2014 - and it is possible that date could be extended depending upon other factors. A relatively small increase in interest rates can significantly increase debt service costs and reduce projected annual excess revenue. The staff report indicates that an increase of 1.6% would cause staff to revisit the plan of finance with their financial advisors.
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> Unexpected Downturns in Tourism - The plan of finance is largely driven by CCFD special tax revenues. **Attachment 3** was provided by the Debt Management Department and shows TOT growth rates since 1990. Average annual growth has averaged between 4.2% and 6.2% in the long term and 2% or less in the short term. The plan of finance assumes no growth in CCFD revenues beyond FY 2017. While there is a downside risk, the IBA believes CCFD revenue projections are conservative and acknowledges the significant long term upside potential.
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> Potential Increases in Construction Costs - As noted in the staff report, the Project is in the conceptual validation stage of the design process. Final Project costs and the cost of construction materials/labor could increase before construction begins. There is a good discussion of these risks and methods for reducing the risks beginning on page 11 of the staff report.
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> Project Delays - There are a number of factors that could delay the Project as planned. Perhaps the greatest impact of Project delays is that there is potentially more market risk (interest rates, materials costs, labor rates, etc.) the longer it takes to borrow funds and construct the Project.

CONCLUSION/RECOMMENDATION

On October 1, 2012, the Council will be asked to approve three resolutions to approve a plan of finance and other related actions. This report reviews key elements of the proposed plan of finance including: sources of repayment for the planned borrowings, structure of the proposed bonds, factors which can limit the General Fund’s exposure and potential risks.

The plan of finance contemplates issuing approximately $41 million of short term Notes to fund 18 months of design and pre-construction costs. The Notes would be repaid with CCFD revenues and would not be an obligation of the City's General Fund. Additionally, the plan of finance calls for the issuance of long term bonds to include Primary Bonds (to be repaid with CCFD and Port District revenues) and Gap Bonds (General Fund backed lease revenue bonds to be repaid with CCFD revenues and a $3.5 million annual contribution from the General Fund). As with other General Fund backed lease revenue bonds, the City's General Fund is ultimately responsible for debt service payments on the Gap Bonds.

This report discusses elements of the financing plan that could help reduce the General Fund's exposure to debt service payments beyond the planned annual $3.5 million contribution – notably "potential" annual excess revenue, the establishment of an Internal Stabilization Fund and the potential for early bond redemption. The receipt and availability of excess special tax revenue will determine if the General Fund's contribution can be limited to $3.5 million annually.

The plan of finance contemplates the early redemption of bonds in a pro rata fashion (retiring both Primary and Gap bonds). If there is interest in reducing the General Fund's debt service exposure as soon as possible, the IBA recommends the Council ask staff about the possibility of augmenting the plan of finance to use potential excess revenues to redeem the Gap Bonds first. The IBA is not aware of anything that would preclude this from consideration.

The plan of finance before the Council uses reasonable assumptions that, if realized, will result in significant excess special tax revenue and limit the General Fund's exposure to the planned $3.5 million annual contribution. However, assumptions in the plan of finance involves future actions (borrowing, construction, revenue) that are dependent upon factors (market rates, project/labor costs, tourism activity) which cannot be perfectly predicted in advance – so the plan of finance is not without potential risk. This report, and the staff report, identifies those risk factors for consideration.

It is important to note that this is a "plan" of finance. It does not commit the City to issue any debt at this time (although a request to approve the short term Notes is planned for November 2012). Many of the detailed borrowing provisions (i.e., debt service coverage on the Primary Bonds or early bond redemption options) depend on market conditions and have yet to be evaluated. These borrowing provisions will be recommended for Council approval closer to the issuance date.

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Attachments: 1. Estimated Debt Service for Long Term Bonds
2. Potential Annual Excess Revenue
3. Historical TOT Growth Rates FY1990-FY2012