THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Convention Center Phase III Expansion: Authorizing Short Term Financing and Modifications to the Plan of Finance

OVERVIEW

On October 1, 2012, the City Council adopted a resolution approving a Plan of Finance for the Convention Center Phase III Expansion (Project). The Plan of Finance called for the Convention Center Facilities District (CCFD) to issue approximately $41 million of Special Tax Bond and Revenue Anticipation Notes (Notes) to fund design and other pre-construction costs.

The Council will be asked to approve two resolutions to further the Project on November 27, 2012. The first resolution authorizes CCFD issuance of the Notes in a principal amount not to exceed $54.4 million and approves the form of related financing documents. The second resolution authorizes an increase in the CIP budget to expend $53 million for Project costs to be financed with the Notes and additionally modifies the Plan of Finance as described in the staff report.

In presenting IBA Report 12-41 to the City Council on October 1st, the IBA recommended modifying the Plan of Finance to require that any surplus special tax revenues be used to first pay down the Gap Bonds in order to cap the General Fund's debt service exposure at the earliest possible date. The City Council agreed with the IBA's recommendation and requested staff to return with an equitable approach for facilitating this change.

This report reviews the purpose of the short term borrowing, highlights key characteristics of the Notes and discusses proposed modifications to the Plan of Finance.

FISCAL/POLICY DISCUSSION

Purpose of the Short Term Borrowing

The Plan of Finance presented to the City Council on October 1st calls for a short term CCFD borrowing of approximately $40 million to fund 18 months of design and pre-construction costs. The major expense components of the $40 million remain relatively unchanged except for a $500,000 reduction in overall contingencies. Another $13.5 million has now been added to purchase development rights for the expansion area from the Fifth Avenue Landing, LLC (FAL Lease Purchase). As shown on page 3 of the staff report, this increases the initial Project funding needed from $40 million to $53 million.

Additionally, $1.3 million has been added to the short term borrowing to 1) recover costs incurred to form the CCFD and 2) pay for the costs of issuance on the short term Notes. These costs are detailed in the attachment to the staff report. Adding $1.3 million to the $53 million brings the total short term borrowing request to just over $54.3 million. In order to cover these costs, the resolution before the Council authorizes the issuance of Notes in an amount not to exceed $54.4 million.

Short term financing (Notes) results in lower interest rates and allows the City to borrow just enough for initial Project costs. Proceeds from the Notes will primarily be used to complete design of the Project, develop construction plans, relocate utilities and make street improvements. Once Project plans are ready, the City will be ready to issue long term bonds to finance construction.

Although a resolution authorizing the short term borrowing is requested at this time, the Notes cannot be issued until the Council authorizes the Preliminary Official Statement (POS). The Council will not be asked to approve the POS until the City receives 1) a successful final validation judgment, including any appeals, concerning the CCFD formation and special tax levy and 2) California Coastal Commission approval of the Port Master Plan Amendment to incorporate the Project. Based on the latest information from staff, the earliest that both of these actions could occur is March 2013.

Key Characteristics of the CCFD Notes

In the staff report prepared for the October 1st Council meeting, the short term borrowing was described as "Revenue Anticipation Notes" with a final maturity of up to two years. Because the City can choose to pay off the Notes with long term bond proceeds, accumulated CCFD special tax revenues, or some combination of both, the Notes are now being defined as "Special Tax Bond and Revenue Anticipation Notes" to better reflect the City's payoff options to prospective purchasers of the Notes.

Given that the size of the short term borrowing has increased from $41 million to approximately $54.4 million, final maturity of the Notes has been extended to 2.5 years to provide additional special tax coverage. The Notes can be prepaid anytime after one year.

The staff report provides information on the legal structure of the Notes, the financing legal documents and the use of Note proceeds. The IBA would highlight the following key characteristics of the Notes to provide an overview of the requested financing:

- **Issuer:** The Notes will be issued by the CCFD.

- **Borrowing Size:** Not to exceed $54.4 million.

- **Estimated Interest Rate:** 1.18%

- **Repayment Terms:** Interest only Notes with semi-annual interest payments of approximately $300,000 and a single principal payment due at final maturity. Although these will be 2.5 year Notes, they can be prepaid anytime after one year.

- **Repayment Sources:** The Notes will be repaid with long term bond proceeds, accumulated CCFD special tax revenues, or some combination of both. Repayment of the Notes is not an obligation of the General Fund.

Modifications to the Plan of Finance

With respect to the issuance of long term bonds, the Plan of Finance calls for the issuance of **Primary Bonds** and **Gap Bonds**. Approximately $333.2 million of Primary 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. The General Fund will not be obligated in any way to the Primary Bonds.

Approximately $175.3 million of Gap Bonds would be issued by the Convention Center Expansion Authority (Authority). The GAP Bonds are lease revenue bonds whereby the City will make annual rental payments to the Authority in an amount equal to the annual debt service on the bonds. Debt service payments on the Gap Bonds will be made using a combination of surplus CCFD special tax revenues (revenue remaining after debt service is paid in full on the Primary Bonds), the annual General Fund support payment of $3.5 million and an Internal Stabilization Fund (if funds are available). If these three sources of revenue are insufficient to cover annual debt service, the City's General Fund must cover the resulting shortfall in addition to the annual $3.5 million support payment.

Conservative assumptions about the growth of CCFD revenues (no growth is assumed beginning in FY 2017) suggest it is reasonable to believe there will be surplus special tax revenues in excess of debt service in any given year. The Plan of Finance presented to the City Council on October 1st called for using surplus special tax revenues to pay down both Primary and Gap bonds on a pro-rata basis. In presenting IBA Report 12-41 to the City Council, the IBA recommended modifying the Plan of Finance to require surplus special tax revenues be used to first pay down the Gap Bonds in order to limit the City's General Fund's debt service exposure, at the earliest possible date, to the $3.5 million annual support payment. The City Council agreed with the IBA's recommendation and requested staff to return with an equitable approach for facilitating this change.

One of the two resolutions before the City Council on November 27th approves the form of a Support Agreement between the City and the CCFD that would in part provide for this change. The proposed changes in response to the Council's direction are addressed in Article III of the Support Agreement. Additionally, Plan of Finance modifications and Support Agreement provisions are discussed in the staff report beginning on page 9.

On the bottom of page 10 in the staff report, staff illustrates the potential implications of a priority pay-down of the Gap Bonds <u>before</u> paying down the Primary Bonds. The Plan of Finance calls for Gap Bonds and Primary Bonds to be issued for a 30-year term through 2044. Assuming reasonable annual CCFD growth rates ranging from 1% to 3% beginning in FY 2018, staff's analysis shows the Gap Bonds may be paid off 12 to 15 years earlier than their final maturity date. <u>This means the General Fund's responsibility to cover any unforeseen revenue shortfalls (beyond the annual $3.5 million payment) may be eliminated 5 to 6 years earlier than if the City utilized a pro-rata pay-down approach</u>. The IBA believes this difference is significant and may even be understated depending on actual CCFD special tax revenue growth and bond call provisions (bond call provisions will be determined closer to the time bolds will be sold in 2016 or 2017).

The Support Agreement further provides that the City will continue to make its annual $3.5 million contribution after the Gap Bonds are paid off and only until all Primary Bonds are retired. In an effort to develop an equitable approach in response to the Council's direction, staff is recommending the City commit to make annual support payments after the Gap Bonds are paid off. This recommended commitment is conditioned on several factors that are listed in Section 3.02 of the Support Agreement. Notable conditions include 1) that CCFD special taxes be levied in the maximum amount authorized and 2) that the City's annual $3.5 million support payment be appropriated in the City Budget for any given year.

CONCLUSION/RECOMMENDATION

On November 27, 2012, the Council will be asked to approve two resolutions. The first resolution authorizes CCFD issuance of the Notes in a principal amount not to exceed $54.4 million and approves the form of related financing documents. The second resolution authorizes an increase in the CIP budget to expend $53 million for Project costs to be financed with the Notes and additionally modifies the Plan of Finance as described in the staff report.

This report reviews the purpose of the short term borrowing, highlights key characteristics of the Notes and discusses proposed modifications to the Plan of Finance. The IBA supports the issuance of the short term Notes because they result in lower borrowing costs and enable the City to borrow just enough for initial Project costs.

Staff is proposing modifications to the Plan of Finance approved by the City Council on October 1, 2012. One of the major modifications (priority pay-down of the Gap Bonds) follows a recommendation made in IBA Report 12-41 and requested by the City Council. As discussed in this report, this change means the General Fund's responsibility to cover any unforeseen revenue shortfalls (beyond the $3.5 million annual support payment) may be eliminated 5 to 6 years earlier than if the City had utilized a pro-rata pay-down approach.

Finally, staff is requesting approval for the form of a proposed Support Agreement between the City and the CCFD. The Support Agreement includes the priority pay-down approach and also recommends the City continue to make its $3.5 million annual support contribution after the Gap Bonds are paid off and only until all Primary Bonds are retired. This recommended commitment has been conceptually presented since the Plan of Finance was first discussed with the Council. The action before the Council on November 27th approves the form of the Support Agreement; however, the Support Agreement will not be executed until the City Council approves the financing ordinances authorizing the Primary and Gap Bonds (probably in 2014).

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