Office of the Independent Budget Analyst

Deferred Capital Bond 3 and the Paramount Infrastructure Issue

Presentation to the

City Council

January 14, 2014

Item 335

Deferred Capital Bond 3

- Our office issued report 14-02 on Jan. 9, 2014, which discusses the proposed authorization of $120 million for DC 3 as part of the Five-Year Deferred Capital Funding Plan, known as Enhanced Option B.
- Council's adoption of Enhanced Option B in March 2012 was very important since it was the first Five-Year Deferred Capital Funding Plan in the City and provided a significant new investment and source of funds to begin to address the estimated $898 million deferred capital backlog.

Deferred Capital Bond 3

- Enhanced Option B provided a mix of lease revenue bond funding for capital projects and cash funding for ongoing maintenance & repair (M&R) and was anticipated to slow the rate of deterioration of assets to 5-10% over the five-year period.
- Although the plan did not provide the level of funding desired by Council or necessary to stop the deterioration, it was determined to be the most realistic and fiscally sound approach.
- The first bond issuance as part of Enhanced Option B (known as DC 2) was issued in June 2012 for $75 million.

Deferred Capital Bond 3

- The City Council approved an additional bond issuance for capital improvement projects (known as DC 2a) for $35 million in FY 2013 that was not part of the original deferred capital bond schedule.
- The scheduled third deferred capital bond issuance (known as DC 3) of $80 million was delayed from FY 2013 to reduce debt service for the General Fund.
- As part of the Five-Year Financial Outlook (FY 2015-2019), the City anticipated increasing DC 3 from $80 million to $120 million.
- The proposed authorization of $120 million for DC 3was approved by the Infrastructure Committee on October 28, 2013.

Deferred Capital Bond 3

- The $120 million bond issuance for the DC 3 and remaining on track for planned future bond issuances will put the City within $800,000 of the Council-adopted Enhanced Option B and $106.8 million of the Status Quo Option by the end of FY 2017.

$ in millions	FY 2012	FY 2013	FY2014	FY 2015	FY 2016	FY 2017	TOTAL
Preventing Further Deterioration (Status Quo Option) (Staff analysis reported in March 2012)							
Deferred Capital Net Bond (Capital Projects)	$ 105.5	$ 105.2	$ 105.2	$ 105.2	$ 105.2	$ 105.2	$ 631.5
Maintenance & Repair (previously called O&M)	59.1	53.8	54.9	56.0	57.1	58.2	339.1
Total	**$ 164.6**	**$ 159.0**	**$ 160.1**	**$ 161.2**	**$ 162.3**	**$ 163.4**	**$ 970.6**
Council-Approved Plan (Enhanced Option B) (March 20, 2012)							
Deferred Capital Net Bond (Capital Projects)	$ 75.0	$ 80.0	$ 81.0	$ 90.0	$ 84.2	$ 84.2	$ 494.4
Maintenance & Repair (previously called O&M)	59.1	54.1	50.0	62.0	66.0	79.0	370.2
Total	**$ 134.1**	**$ 134.1**	**$ 131.0**	**$ 152.0**	**$ 150.2**	**$ 163.2**	**$ 864.6**
Difference (Enhanced Option B minus Status Quo)	**$ (30.5)**	**$ (24.9)**	**$ (29.1)**	**$ (9.2)**	**$ (12.1)**	**$ (0.2)**	**$ (106.0)**
Five-Year Outlook (FY 2015-2019)							
Deferred Capital Net Bond (Capital Projects)	$ 75.0	$ 35.0	$ 120.0	$ 90.0	$ 84.2	$ 84.2	$ 488.4
Maintenance & Repair (previously called O&M)	59.1	54.1	55.2	62.0	66.0	79.0	375.4
Total	**$ 134.1**	**$ 89.1**	**$ 175.2**	**$ 152.0**	**$ 150.2**	**$ 163.2**	**$ 863.8**
Difference (Five-Year Outlook minus Status Quo)	**$ (30.5)**	**$ (69.9)**	**$ 15.1**	**$ (9.2)**	**$ (12.1)**	**$ (0.2)**	**$ (106.8)**

Deferred Capital Bond 3

- We believe following through with planned Enhanced Option B bond issuances is essential, particularly considering that this funding level is anticipated to slow, but not stop, the rate of deterioration.
- Splitting DC 3 into two issuances is a fiscally sound approach, although it raises some concerns relating to:
  - Public Works' and other departments' capacity to expeditiously implement capital projects and spend bond funds
  - The potential for the next planned bond issuance to be delayed beyond FY 2015
- <u>However, we do not believe the potential concerns related to DC 3 are significant nor should they be the primary focus.</u>

Transitional Period in 2014

- The deferred capital bond program continues to be an important source of funding for infrastructure, but <u>2014 will be a transitional period as the City gains a greater understanding of the magnitude of the infrastructure problem.</u>
  - Ongoing condition assessments for facilities (including some park assets) and sidewalks will be used to update the deferred capital backlog, which is expected to significantly exceed the current $898 million estimate. *(anticipated report date Jan. 2015)*
  - The development of the City's first Multi-Year Capital Improvements Plan as part of the FY 2015 Budget will include needed projects for existing and new infrastructure. *(draft anticipated April 2014)*

The Paramount Infrastructure Issue

- The City clearly has significant infrastructure needs on the horizon, and it is evident from the Five-Year Financial Outlook that the City continues to face financial constraints and competing priorities for its General Fund.
- The City has used General Fund lease revenue bonds which do not require voter approval as its primary means of financing infrastructure. This source has also avoided the need to increase service fees and/or assessments to citizens.
- However, the continued exclusive use of lease revenue bond borrowing is not a sustainable solution to address the City's significant infrastructure needs.

The Paramount Infrastructure Issue

- The continued exclusive use of lease revenue bonds in not sustainable or recommended.
  - There is a limit to the essential unencumbered properties available to the City to pledge for these bonds to address the significant infrastructure needs as well as whether the City would want to pledge all of its assets.
  - <u>The bigger issue is that revenue bonds place a 30-year debt service obligation on the General Fund which essentially locks down a large portion of the fund and significantly limits discretionary spending over the long-term</u>. *(The ARC, OPEB, and the City's other existing outstanding debt will account for about 26% of General Fund Revenues in FY 2015.)*

Conclusion/Recommendation

- The paramount issue related to infrastructure - given limitations associated with lease revenue bond financing and the magnitude of infrastructure needs on the horizon, the City must consider pursuing alternative sources of revenue to more comprehensively address infrastructure over the long term.
- We believe it is critical to begin those discussions in 2014.