
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 336

Fiscal Year 2012 Tax and Revenue Anticipation Notes (TRANS)

OVERVIEW

The City Council is being asked to approve a resolution authorizing the issuance of Fiscal Year 2012 Tax and Revenue Anticipation Notes (FY 2012 TRANS) in an amount not to exceed \$175 million. Additionally, the resolution would authorize the City Attorney to execute an agreement with Orrick, Herrington & Sutcliffe LLP to provide bond counsel services in connection with the FY 2012 TRANS in a fixed amount equal to \$20,000, inclusive of expenses.

The IBA has reviewed the proposed FY 2012 TRAN borrowing with staff from the Debt Management and City Comptroller departments. This report comments on key elements of the proposed FY 2012 TRANS financing.

FISCAL/POLICY DISCUSSION

Purpose of the FY 2012 TRANS Borrowing

As noted in Report to the City Council #11-081 (Staff Report), TRANS address temporary cash flow shortfalls arising from fluctuations in annual tax or revenue receipts that the General Fund is dependent on to meet monthly cash flow needs during the fiscal year. The City issues TRANS at the beginning of a fiscal year in order to avoid cash deficits prior to the receipt of significant annual City revenues (primarily property tax revenues received from the County beginning in December and April). The City also issues TRANS to facilitate General Fund payment of the Annual Required Contribution (ARC) for the pension on July 1st as discussed below.

Sizing of the TRANs Borrowing

Staff is requesting City Council authorize a TRANs borrowing not to exceed \$175 million even though they only expected to borrow \$172 million when the Staff Report was released. As discussed on page 3 of the Staff Report, an additional \$3 million of authorization capacity was requested in case the need for a larger issuance were to become necessary between the date the Report was issued and the date the borrowing is expected to be executed (week of June 27, 2011).

The California Government Code and City Charter Section 92 allow for the issuance of TRANs. City Charter Section 92 limits the aggregate amount of the TRANs Borrowing to 25% of the City's total budgeted appropriations in a fiscal year (approximately \$699 million in FY 2012). This requirement is satisfied as the request is to authorize not more than \$175 million of TRANs, which is significantly below the \$699 million limit.

Internal Revenue Service regulations generally require the projected General Fund cash flow deficit (see Attachment 1) be at least 90% of the amount of the TRANs borrowing. This ensures municipalities do not borrow, at tax-exempt rates of interest, significantly more than needed to avoid cash flow deficits. The City Comptroller's Department prepared Attachment 1 to show the projected maximum General Fund cash flow deficit as of June 8, 2011 for FY 2012 without TRANs proceeds. The Total Ending Cash Balance line of the spreadsheet projects a maximum cash flow deficit of approximately \$165 million in November 2011 (the Comptroller has informed the IBA that the projected maximum deficit may be further reduced due to recent cash flow adjustments – if so, staff indicates there will be a corresponding reduction in the amount of the borrowing). Since \$165 million is approximately 94% of the proposed \$175 million maximum TRANs borrowing for FY 2012, the City is compliant with this IRS regulation.

Although the projected maximum General Fund cash flow deficit for FY 2012 is approximately \$165 million, staff anticipates borrowing \$172 million. The additional \$7 million provides the City with a reasonably sized cushion to avoid unanticipated revenue shortfalls that could increase the projected maximum cash flow deficit in FY 2012. The City typically borrows slightly more than the maximum projected General Fund cash flow deficit in accordance IRS regulations.

Benefits Associated with the Issuance of TRANs

As mentioned above, TRANs provide a source of funds for municipalities to address temporary cash flow shortfalls. In addition to helping the City avoid short-term cash flow deficits, the proceeds from the FY 2012 TRANs enable the City to make the pension ARC payment at the beginning of the fiscal year rather than paying it (by financing it) throughout the year. As noted in the Staff Report, this will save the City's General Fund approximately \$5.8 million because of the interest rate differential between interest paid for the TRANs borrowing (approximately .62%) and interest paid to the pension fund (approximately 7.75%) if the ARC were to be paid throughout the year rather than at the beginning of the year.

Repayment of the FY 2012 TRANs

The FY 2012 TRANs have been structured in three series of notes, each with a different amount and maturity date (January 31, 2012, April 30, 2012 and May 31, 2012). The TRANs are general obligations of the City, payable from the unrestricted taxes, income, revenue, cash receipts and other General Fund monies attributable to FY 2012 (defined as "Unrestricted Revenues"). This repayment obligation is provided on page 10 of the Accompanying Document to the Resolution.

The proposed City Resolution and the Accompanying Document to the Resolution require the City Comptroller to deposit, from the first Unrestricted Revenues received by the City, an amount equal to the principal and interest due for each of the three series of notes. Staff estimates total interest payable on the FY 2012 TRANs to be approximately \$830,000. The FY 2012 Proposed Budget included approximately \$1.4 million in the Tax and Revenue Anticipation Notes debt service fund to cover this interest expense.

On page 5 of the authorizing resolution before the City Council, the net interest rate on the FY 2012 TRANs is limited to not exceed 5.00%. The Debt Management Department currently estimates the combined net interest rate for the three series of notes to be approximately 0.62% which is well below this maximum interest rate authorization.

Private versus Public Offering/Borrowing Costs

Citing the current unavailability of the City's audited FY 2010 CAFR, staff is recommending a private rather than a public offering of the FY 2012 TRANs. Following a competitive RFP process, Wells Fargo Bank was selected to be the direct purchaser of the FY 2012 TRANs. Staff currently estimates the City's private borrowing rate with Wells Fargo Bank to be approximately 0.62% (effective rate for the three series of notes).

On page 3 and 4 of the Staff Report, staff indicates rates for publicly issued TRANs similar to the City's have ranged between 0.24% and 0.38%; however, they cite significantly lower costs of issuance associated with the privately placed TRANs planned for FY 2012. Factoring in these lower costs of issuance, staff concludes the net interest rate differential between publicly issued TRANs and the proposed FY 2012 private offering with Wells Fargo Bank to range between 0.09% and 0.18%. Based on estimates from the Debt Management Department, the City's inability to publicly offer the FY 2012 TRANs results in additional interest expense ranging from approximately \$200,000 to \$325,000.

City Council Responsibilities under the Federal Securities Laws

This is the first borrowing request the City Council is being asked to approve since it received training on Disclosure Responsibilities under the Federal Securities Laws on June 14, 2011. It is important to note that the proposed FY 2012 TRANs borrowing is a private placement with Wells Fargo Bank. During the recent Council training, the emphasis was on public offerings and the responsibilities of the City and the City Council with respect to the federal securities laws are quite different in the context of a private placement. As is typical with a private placement, there is no official statement or

disclosure document associated with the FY 2012 TRANs. Wells Fargo, as the purchaser of the TRANs, is expected to conduct its own due diligence.

As discussed in the Office of the City Attorney's June 22, 2011 memorandum on the City Council's securities law responsibilities with respect to the TRANs, Wells Fargo will make a variety of representations regarding their due diligence process and the financial information they received from the City. In addition to discussing City Councilmember responsibilities related to the proposed borrowing, the memorandum provides questions and answers the City Council may wish to review in advance of the Council meeting.

Despite the fact that this is a private offering, the City's Disclosure Practices Working Group (DPWG) discussed and reviewed the proposed FY 2012 TRANs borrowing on June 8, 2011. Included as an attachment to the City Attorney's memorandum is a DPWG Certification providing that the DPWG "found that (i) there was no disclosure document provided to the purchaser relative to the issuance of the Notes, (ii) the information provided by City is in accordance with its obligations under federal and state securities laws."

CONCLUSION

Based on our review of the proposed borrowing with the City staff, the IBA recommends approval of the resolution authorizing the issuance of not more than \$175 million of FY 2012 TRANs. The proposed FY 2012 TRANs are appropriately sized in accordance with applicable City Charter provisions and IRS regulations. In addition to helping the City avoid short-term cash flow deficits, proceeds from the FY 2012 TRANs enable the City to make the pension ARC payment at the beginning of the fiscal year rather than financing the payment at higher rates of interest throughout the fiscal year. Staff estimates paying the pension ARC at the beginning of the fiscal year will save the City's General Fund approximately \$5.8 million.

The Office of the City Attorney issued a memorandum on the City Council's Responsibilities under Federal Securities Laws for the proposed FY 2012 TRANs dated June 22, 2011. In addition to discussing City Councilmember responsibilities related to the proposed borrowing, the memorandum provides questions and answers the City Council may wish to review in advance of the Council meeting.

Involved City financing staff along with the City's financial advisor, bond counsel and a representative from the lender (Wells Fargo Bank) will be present for the City Council meeting on June 28, 2011. The IBA recommends the City Council ask any questions they might have directly to members of the City's financing team including the City's

financial advisor, bond counsel and/or the lender. The availability of financing consultants for the City Council at or before City Council meetings is an encouraged practice.

[SIGNED]

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APPROVED: Andrea Tevlin
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Attachment: FY 2012 Projected General Fund Cash Flow Statement (without TRANS)
from City Comptroller's Department dated June 8, 2011