AN OVERVIEW OF DEBT FINANCING OPTIONS

General Obligation Bonds

General Obligation bonds are backed by a pledge of the full tax-raising power of the issuing entity. The security for the bonds, and the source of repayment, is the power and obligation of the local government to levy property taxes at whatever rate is required to pay the debt service on the bonds (i.e., above and beyond the basic 1.0% rate). In California, as in most states, such taxes are *ad valorem*, based on the value of property. Also in California, all General Obligation bonds must be approved by a two-thirds vote.

Because General Obligation bonds are considered the strongest credit of an issuer, they carry the lowest interest rate, and therefore are the cheapest source of new capital financing. General Obligation bonds are also cost efficient in terms of the total issuance size required to meet a specific financing goal, since they can be issued without a debt service reserve fund requirement, which is traditionally equal to one year of debt service payments and funded from bond proceeds.

Based on current assumptions regarding the factors that would impact a General Obligation bond (i.e., applicable interest rates and total assessed valuation), it is estimated that a 30-year bond sufficient to generate $200 million in net proceeds would result in an annual level debt service requirement of approximately $13.1 million. Based on FY 2003 assessed valuation, the tax rate required to generate $13.1 million is estimated at $13.06 per $100,000 of net secured valuation. Note that the tax rate would decline in future years, contingent upon growth in assessed valuation.

Lease Revenue Bonds & Certificates of Participation

Lease Revenue bonds and Certificates of Participation are generally based on lease agreements, with the borrower serving as the lessee and another entity, usually in the form of a specially created public entity or non-profit corporation, serving as the lessor and the issuer of the bonds. As lease obligations, Lease Revenue bonds and Certificates of Participation are not considered to be “indebtedness” subject to the California’s voter approval requirements governing general obligation bonds.

The lease, or leases, may be based on the new facility being financed and/or existing facilities owned by the issuing entity. The lease payments appropriated annually are used to pay the principal and interest on the lease obligations. Unlike General Obligation bonds, which are supported by increases in the ad valorem property tax rate, lease obligations are usually supported by existing general purpose revenues (i.e., revenues not legally earmarked for a specific purpose) deposited in the issuing entity’s General Fund, or various Special Revenue Funds. Revenues generated by the financed project may also be used to pay debt service. The annual payments on a Lease Revenue bond issuance sufficient to generate $200 million in net proceeds is estimated at $16.6 million.

As noted above, these financing vehicles, as lease obligations, are generally not considered “debt” as defined in the State Constitution, and, as such, not subject to voter-

approved. However, if the issuing entity chooses to levy a special tax to pay the annual lease payments, rather than relying on an annual appropriation using existing revenues, then a two-thirds voter approval would be required under the voter approval requirement for all special taxes. San Diego has employed lease revenue obligations to finance a number of capital projects, most notably the convention center and the new ballpark.

Revenue and Limited Obligation Bonds

Revenue bonds are a traditional municipal debt instrument to finance utility improvements from user fees and other enterprise revenues. State courts have concluded that such bonds do not require voter approval under the debt limits of the State Constitution, because they are repaid out of limited revenues, and not general taxes. A number of similar "limited obligation bond" instruments are common in California, including redevelopment tax allocation bonds, and Mello-Roos, special assessment districts and other special tax-secured bonds. Some form of limited obligation bonds could be sold to leverage any new revenue source that was not a property tax override dedicated to General Obligation Bonds or General Fund revenue.

Redevelopment Tools

- Redevelopment Tax Increment Financing – Attachment 1
- Infrastructure Financing Districts (IFDs) – Attachment 2

Source: Financing Services, Office of the City Treasurer, City of San Diego

Redevelopment

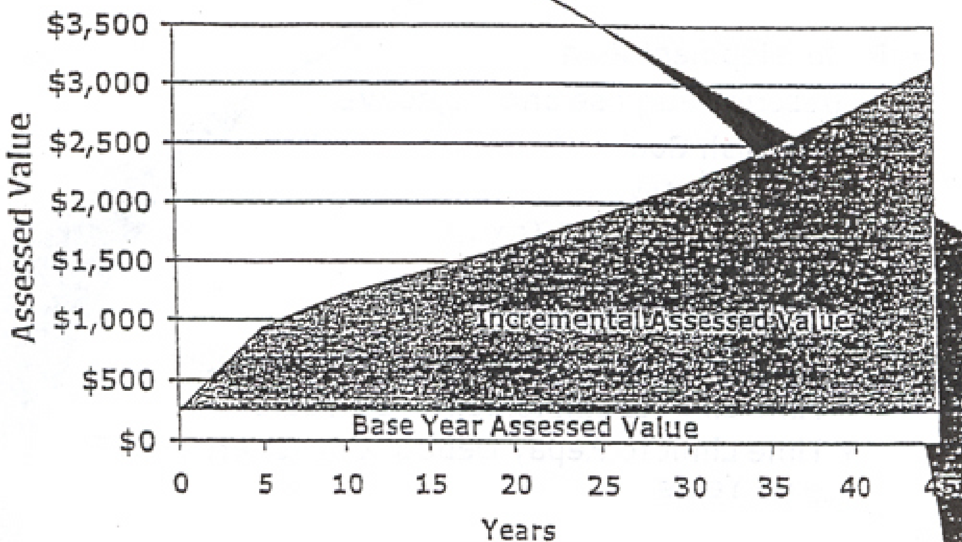
- California Redevelopment Law:
  - ✓ Adopted in the 1950's to provide cities with the means to mitigate blight
- San Diego Redevelopment Agency:
  - ✓ Members of the City Council serve as the Agency
- Redevelopment Project Area:
  - ✓ City Council makes findings of adverse and economic and physical conditions (blight)
  - ✓ Planning Commission approves the Survey Area (Project Area)
  - ✓ Project Area Committee is formed

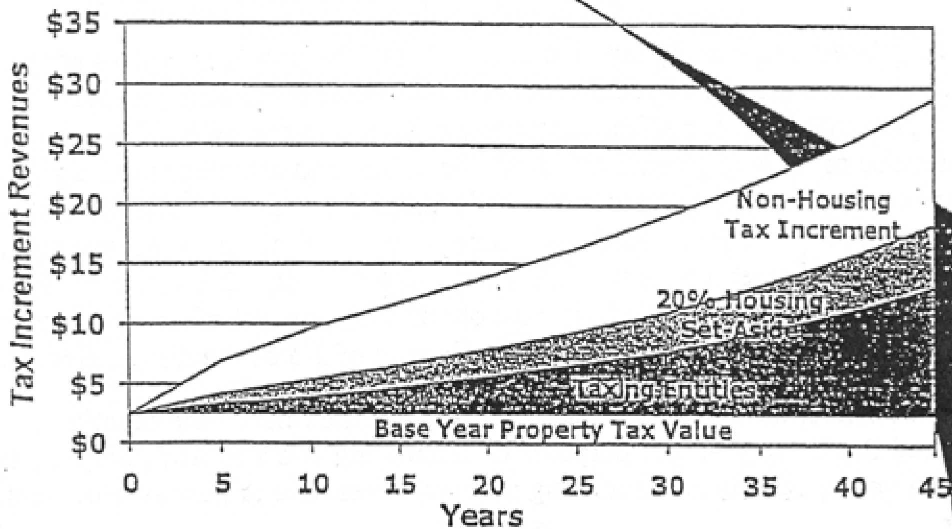
Redevelopment Plan

- Redevelopment Plan:
  - ✓ Describe Purpose and Objective
  - ✓ Establish Goals, Powers and Limitations
  - ✓ Establish Maximum Amount of Bonded Indebtedness and Tax Increment Receipts
- Plan Adoption Period:
  - ✓ Time Limit to Incur Debt – 20 to 30 Years
  - ✓ Time Limit to Implement – 30 Years
  - ✓ Time Limit to Repay Debt or Collect Property Taxes – 45 Years

Tax Increment Financing

- Tax Increment Calculation:
  Assessed Value
  (Less) Assessed Value at time of Adoption (Base Year)
  = Incremental Assessed Value
  X 1% Property Tax Rate
  = Tax Increment
- Tax Increment Allocation:
  - ✓ Affordable Housing Set-Aside - 20%
  - ✓ Years 1-10, Taxing Entities – 25% of remaining 80%
  - ✓ Years 11-30, Taxing Entities – additional 21% of incremental taxes
  - ✓ Years 31-45, Taxing Entities – additional 14% of incremental taxes





Bond Financing

- Tax Allocation Bond Consideration:
  - ✓ Long-term Allocation to Taxing Entities
  - ✓ Debt Service Coverage – 120%
  - ✓ Size of Project Area
  - ✓ Economic Diversity
  - ✓ Concentration of Tax Payers
  - ✓ Tax Exempt versus Taxable

INFRASTRUCTURE FINANCING DISTRICTS

An Infrastructure Financing District (IFD) is a mechanism for financing infrastructure improvements that combines some of the features of redevelopment and Mello-Roos financing," the financing method commonly employed by redevelopment agencies.

There is a complex process required by law to create an IFD. The process involves adoption of a "resolution of intention" by the city or county proposing to create the district; preparation of a detailed financing plan that is sent to affected property owners and taxing entities; a public hearing for the purpose of receiving comments from the public and affected taxing agencies; and a voting procedure similar to that used under the Mello-Roos Community Facilities Act (a 2/3 vote of registered voters if there are at least 12 registered voters within the proposed district, or if there are fewer than 12 registered voters within the proposed district, a 2/3 vote of property owners). If the IFD proposes to issue bonds, it must obtain the approval of a majority of the legislative body of the city or county creating the district and of 2/3 of the district electorate.

Once an IFD is established, the assessed valuation existing at the time of the adoption of the district is considered the "base year" for purposes of calculating and allocating property taxes. Growth in assessed value, and the corresponding property taxes, due to new development, property transfers, or appreciation above the "base year" valuation, accrues to the IFD as "tax increment" revenue. Property taxes due on the assessed valuation up to the "base year" valuation are allocated to taxing entities according to the proportions that would otherwise prevail.

An IFD may exist and collect revenues for up to 30 years.

An IFD may finance the purchase, construction, expansion, improvement, or rehabilitation of any real or other tangible property with an estimated useful life of 15 years or longer. The facilities financed by an IFD must be public capital improvements of a community-wide significance, providing benefits to an area larger than that of the IFD. (The City Council would need to make a finding that the capital facilities to be financed provide community-wide benefits.) Facilities purchased by the IFD must be already constructed at the time of purchase. Similar to a Mello-Roos community facilities district, financed facilities need not be located within the boundaries of the IFD. Facilities financed through an IFD may not replace existing facilities, or services, but they may supplement existing facilities and services as necessary to serve new development.

Facilities eligible for financing through an IFD include, but are not limited to the following:

- highway interchanges, bridges, arterial streets, and transit facilities
- sewage treatment plants and interceptor lines
- water treatment facilities for urban use
- flood control structures
- child care facilities

- libraries
- parks, recreational facilities, and open space,
- solid waste transfer and disposal facilities

IFDs are obligated to provide low- and moderate-income housing when they are used to construct housing and when, as a result of their activities, existing housing is demolished or removed.

There are several differences between an IFD and a redevelopment agency:

- While tax increment from redevelopment can include those taxes from above the "base year" that normally would have gone to school districts (among other taxing entities), in no case can a school district dedicate any of its property taxes (above or below the "base year") to an IFD.
- Redevelopment project areas must set aside 20% of tax increment revenues to spend on low- and moderate-income housing. IFDs are only required to commit revenues to low and moderate-income housing if an IFD is used to construct housing.
- An IFD has no power of eminent domain. Unlike a redevelopment agency, it cannot condemn property.
- An IFD cannot be established within a redevelopment area. The two financing mechanisms are self-exclusive.
- Whereas IFDs are intended for areas that are substantially undeveloped, Redevelopment occurs in largely developed areas that are "blighted."
- A two-thirds majority approval is required of the registered voters, or in some cases the property owners, within the proposed district in order to-create an IFD. Redevelopment has no popular voting requirement.
- An IFD requires the approval of 2/3 of the district electorate to issue bonds. A redevelopment project area does not have a popular voting requirement to issue bonds.
- Only one IFD has been established in California. The City of Carlsbad established an IFD to finance some of the improvements necessary for Legoland. The County of San Diego has investigated the use of an IFD in the East Otay Mesa community. The use of redevelopment is common among California cities and counties. The City currently has 15 adopted redevelopment project areas.

DIFFERENCES: IFDs & REDEVELOPMENT PROJECT AREAS

	IFD	Redevelopment
Purpose	Finance capital facilities which have a community-wide significance	Eliminate physical and economic blight
Formation	Requires majority approval of the City Council and a 2/3rds vote of registered voters/landowners within the district	Requires a majority of the City Council to approve the project area and make specific findings
Method of Finance	Incremental tax revenues above the district's base year assessed valuation	Incremental tax revenues above project area's base year assessed valuation
Allocation of Revenues	City must negotiate tax sharing agreements with the county and other taxing entities	Tax revenues are distributed among entities entitled to property taxes based upon statutory formulas
Housing Set Aside Requirement	No requirement for housing set aside.	20% of all tax increment revenues must be set aside for low/moderate income housing
Impact on Schools	School districts must receive their full share of all property taxes generated within the district (both above and below the "base year")	School districts receive their full share of property taxes below the "base year" valuation Revenues above the "base year" valuation are shared based upon statutory formulas
Bond issuance	Bonds can be issued if approved by a majority of the local legislative body and 2/3rds of the voters/landowners	Bonds can be issued without a popular vote, but must be approved by a majority of the redevelopment agency board
Property Condition	Land within an IFD should be substantially vacant/undeveloped	Redevelopment occurs in predominately developed areas that are found to be "blighted"
Eminent Domain	IFD does not authorize eminent domain	Redevelopment can authorize eminent domain within a project area