



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: April 18, 2012 REPORT NO: 12-043
ATTENTION: Budget & Finance Committee
SUBJECT: Fiscal Year 2013 Tax and Revenue Anticipation Notes

REQUESTED ACTION(S):

Forward the authorization of the City's Fiscal Year 2013 Tax and Revenue Anticipation Notes ("FY 2013 TRANs") borrowing to fund the projected seasonal cash flow deficit of the City's General Fund in Fiscal Year 2013. The City Council will be requested to approve related financing and disclosure documents for the FY 2013 TRANs financing at the City Council meeting of May 21/22, 2012.

STAFF RECOMMENDATION:

Forward the requested action for the City Council's consideration and approval.

SUMMARY:

I. BACKGROUND

Tax and Revenue Anticipation Notes ("TRANs") address temporary cash flow shortfalls arising from the fluctuations in annual tax and revenue receipts that the General Fund is dependent on to meet monthly cash flow needs during the fiscal year. The California Government Code (Article 7.6, Chapter 4, Part 1, Division 2, Title 5) and City Charter Section 92 specifically allow the City to issue short-term notes in any fiscal year in anticipation of the collection of taxes and revenues of such fiscal year.

The City has issued TRANs to finance the General Fund cash flow needs in anticipation of the receipt of property tax revenues from the County in December and April of each year. TRANs are sold in late June so that funds are available for General Fund disbursements that must be made commencing on July 1 of each year. Historically, the City has closed its TRANs on or around July 1 in order to pay the pension Annual Required Contribution ("ARC") at the beginning of the fiscal year. The size of TRANs borrowing is based on the General Fund projected cash flow deficit in the fiscal year. Pursuant to Internal Revenue Service ("IRS") regulations, the size of the borrowing cannot exceed the projected deficit as certified by the City's Chief Operating Officer.

The Fiscal Year 2012 Tax and Revenue Anticipation Notes were issued via a private placement with Wells Fargo Bank, N.A., in three series for a total amount of \$161.0 million. The effective interest rate was 0.62%. As of May 31, 2012, the two remaining outstanding FY 2012 note series will be paid off.

II. DISCUSSION

Based on preliminary projected Fiscal Year 2013 General Fund cash flow needs, it is currently expected the FY 2013 TRANs will be sized in the range of \$140 - \$150 million, to be issued on July 2, 2012. The borrowing amount is derived by calculating the maximum deficit that would occur in Fiscal Year 2013 without the issuance of the notes, based on the projected General Fund monthly cash flow schedule prepared by the City Comptroller's Office. The cash flow projections are based on the Fiscal Year 2013 Proposed General Fund Budget. The projected FY 2013 cash flows are expected to be updated prior to City Council authorization of the FY 2013 TRANs financing.

Structuring Considerations

Method of Sale

The FY 2013 TRANs will be structured as a public offering and is expected to be sold competitively, a process where interested investment banks bid on the interest rate of the TRANs and the investment bank(s) with the lowest interest rate bid or bids will be awarded the FY 2013 TRANs. Current market conditions of strong investor demand and healthy short-term fixed income market generally make it advantageous for TRANs to be sold on a competitive basis. While subsequent to the financial crisis virtually all notes were sold on a negotiated basis, more issuers have begun to use competitive sales for short term borrowings again. Strong short-term market conditions combined with the expectation to receive the highest short-term rating offer the City the opportunity to conduct the FY 2013 TRAN as a competitive sale. The City's recent publicly offered TRANs were sold on a negotiated basis, a process where the City selects an underwriting syndicate prior to the sale date and negotiates the terms of the note sale with the syndicate before the notes are sold to investors. In case of a negotiated sale, the form of the Note Purchase Agreement, an agreement between the issuer and the underwriting syndicate, pursuant to which the issuer agrees to sell, and the underwriters agree to buy the notes, is approved by the City Council. For a competitive sale there would be no Note Purchase Agreement. A Notice Inviting Bids released to the market by the City would set the bidding parameters for the competitive sale. The form of the Notice Inviting Bids will be included for City Council approval with other the financing documents. Both methods of sale will have a preliminary official statement from the City which provides information pertinent for the investors to make an informed decision.

Single Series or Multiple Series

Under certain market conditions, TRANs can present an opportunity to realize arbitrage, i.e., net investment earnings whereby the taxable rate in which the City reinvests the proceeds and/or the amounts set aside to repay the TRANs is higher than the tax-exempt borrowing rate on TRANs. Depending on the reinvestment rates achievable, the FY 2013 TRANs can be issued with a single maturity date for up to 13 months or as three series with maturities based on when property tax

receipts become available. If the City issues the FY 2013 TRANs with a single maturity, it would still set-aside funds in a repayment account on or by the same maturity dates as in a multiple maturity structure.

In recent years, given the relationship between the tax-exempt TRANs rates and the taxable investment rates, it was more economic to pay down the notes soon after the property taxes were received by the City and the TRANs were issued in up to 3 smaller series with repayment on predetermined maturity dates based on the projected cash flow capacity.

Preliminary analysis by the City's Investments office indicates there would be potential to structure the FY 2013 TRAN with a 13 month maturity, the maximum allowed by law, and reinvest the City's deposits to a repayment account to the maturity date of the note. The net earnings (interest cost of the borrowing minus the reinvestment earnings) would be General Fund monies and can be applied to offset the interest cost for the TRANs borrowing.

Financing Team

The City's Financing Team for the FY 2013 TRANs includes the Chief Operating Officer, Debt Management, the City Treasurer's Office, the Comptroller's Office, Financial Management, the City Attorney's Office, and outside consultants, including Public Resources Advisory Group ("PRAG") as independent Financial Advisor, Squire Sanders LLP as Bond and Disclosure Counsel, and a Paying Agent (to be identified).

Financing Documents

The financing team is in the process of developing the financing documents for the FY 2013 TRANs. The documents include the Financing Resolution which would authorize the issuance of the TRANs and related financing documents including the Accompanying Document to the Financing Resolution, the Notice Inviting Bids, the Preliminary Official Statement, the Continuing Disclosure Certificate, and the Paying Agent Agreement. The Preliminary Official Statement will be reviewed by the Disclosure Practices Working Group prior to docketing for City Council authorization. All the documents are expected to be docketed on May 7, 2012 for City Council consideration on the docket of May 21/22, 2012.

Financing Schedule

In order to execute the FY13 TRANs by July 2, 2012, the following timeline is established:

May 21/22, 2012	Approval of the financing documents and disclosure document (Preliminary Official Statement) through Council resolution
Week of June 11, 2012	Pricing
July 2, 2012	Closing, delivery of proceeds, and transfer of FY 2013 ARC payment

III. FISCAL CONSIDERATIONS

The estimated fiscal impact of the FY 2013 TRANs is based on the following assumptions:

TRANs size (est.)	\$150 million
Costs of Issuance ¹	\$200,000
Repayment Set Aside Dates and Amounts	\$46 million on January 1, 2013
(est. based on Fiscal Year 2012 TRANs)	\$41 million on April 1, 2013
	\$63 million on May 1, 2013

Based on interest rates as of April 16, 2012, the estimated fiscal impact in each of the two scenarios is presented below:

Single Series with a 13 Month Maturity

Maturity Date	August 31, 2013
Estimated Interest Rate	0.29%
Estimated Gross Interest Payment	\$480,000
Estimated Interest Earned	\$330,000
Net Interest Paid	\$150,000

Three Series with Maturities Based on When Property Tax Receipts Come Available

Maturity Dates	January 31, April 30, and May 31, 2013
Estimated Interest Rate	0.23%
Estimated Interest Payment	\$285,000

Based on current market conditions and the timing of the cash flows, it is currently economically advantageous for the City to borrow for a 13 month term with a single maturity. The Financing Resolution provides the flexibility, in the event that market conditions change, to allow for the FY 2013 TRANs to be issued as three series with maturities based on when property tax receipts come available.

In accordance with the City Council approved Debt Policy, the FY 2013 TRANs will be issued on a fixed rate basis. The actual interest rate will be set when the notes are sold and will be based on market conditions that exist at the time of pricing.

Revenue Pledge

Under the terms of the financing documents, the FY 2013 TRANs are general obligations of the City payable from unrestricted taxes, income, revenue, cash receipts, and other moneys of the City's General Fund attributable to Fiscal Year 2013. The notes are secured by a pledge of the first revenues received by the City in Fiscal Year 2013, on or after the set-aside dates. The amounts to be set-aside on each date will be determined based on the timing of the City's

¹ Costs of Issuance of totaling \$200,000 is budgeted in the City's Tax and Revenue Anticipation Notes Fund (Fund No. 100005) to pay for Financial Advisory services, Bond and Disclosure Counsel services, Paying Agent services, Rating Agency fees, and electronic filing and printing of the POS. The actual costs of issuance will be known upon completion of the TRANs.

revenues and by analyzing the debt service coverage ratio on each set-aside date (i.e. the amount of revenues available in the month the applicable note portion is set-aside divided by the amount of principal set-aside on that date). The City is not authorized to levy or collect any tax for the repayment of the notes.

IV. ALTERNATIVES

The FY 2013 TRANs is necessary to fund the projected seasonal cash flow deficit of the City's General Fund in Fiscal Year 2013 and meet the City's payment obligations in a timely manner.

V. PREVIOUS COUNCIL and/or COMMITTEE ACTION

The City has annually issued TRANs to fund the General Fund seasonal cash flow deficit.

VI. COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS

The Tax and Revenue Anticipation Notes Fund is incorporated into each of the City's annual budgets, and is included in the City's budget public review and discussion process.

VII. KEY STAKEHOLDERS AND PROJECTED IMPACTS

Business entities involved in this transaction include Squire Sanders LLP (Bond and Disclosure Counsel); PRAG (Financial Advisor).



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