DATE ISSUED:	April 29, 2002	REPORT NO. 02-096

ATTENTION: Honorable Mayor and City Council
Agenda of May 7, 2002

SUBJECT: Naval Training Center - Proposed Formation of Community Facilities District No. 3 (Liberty Station)

REFERENCE: Manager=s Report No. 00-134, dated June 21, 2000

SUMMARY

Issues: - Should the City Council:

1) Adopt a resolution (a) declaring its intention to establish Community Facilities District No. 3 (Liberty Station); (b) designating the name and boundaries of the district; (c) identifying the types and estimated costs of public facilities to be financed through the district; (d) declaring its intention to levy special taxes; (e) approving the Rate and Method of Apportionment of special taxes for Improvement Area Nos. 1 and 2; (f) approving the Purchase and Finance Agreement between the City and McMillin NTC, LLC; and (g) setting the time and place for a public hearing on the establishment of the district?

2) Adopt a resolution (a) declaring its intention to incur bonded indebtedness within each of proposed Improvement Area Nos. 1 and 2, within Community Facilities District No. 3 (Liberty Station), in a maximum aggregate principal amount not to exceed $30 million, to finance the purchase, construction, modification, expansion, improvement or rehabilitation of the public facilities and the incidental expenses to be incurred in connection with financing the facilities and forming and administering the district; (b) setting the time and place for a public hearing on the proposed debt issuance(s); and (c)

establishing a 4 to 1 value-to-lien ratio for the first series of bonds unless, at the time of the bond sale, (1) the security behind the payment of special taxes and (2) assurances provided by the developer to the City with respect to project completion offset the concentration of risk?

Manager=s Recommendation: The City Manager recommends that the City Council:

1) Adopt a resolution (a) declaring its intention to establish Community Facilities District No. 3 (Liberty Station); (b) designating the name and boundaries of the district; (c) identifying the types and estimated costs of public facilities to be financed through the district; (d) declaring its intention to levy special taxes; (e) approving the Rate and Method of Apportionment of special taxes for Improvement Area Nos. 1 and 2; (f) approving the Purchase and Finance Agreement between the City and McMillin NTC, LLC; and (g) setting the time and place for a public hearing on the establishment of the district as June 25, 2002 in the City Council Chambers.

2) Adopt a resolution (a) declaring its intention to incur bonded indebtedness within each of proposed Improvement Area Nos. 1 and 2, within Community Facilities District No. 3 (Liberty Station), in a maximum aggregate principal amount not to exceed $30 million, to finance the purchase, construction, modification, expansion, improvement or rehabilitation of the public facilities and the incidental expenses to be incurred in connection with financing the facilities and forming and administering the district; and (b) setting the time and place for a public hearing on the proposed debt issuance(s) as June 25, 2002 in the City Council Chambers; (c) establishing a 4 to 1 value-to-lien ratio for the first series of bonds unless, at the time of the bond sale, (1) the security behind the payment of the special taxes and (2) assurances provided by the developer to the City with respect to project completion offset the concentration of risk.

Other Recommendations: None.

Fiscal Impact: None to the City. In accordance with Council Policy 800-03, all costs related to determining financial feasibility of the proposed Community Facilities District, including financial advisory services, legal counsel, special tax consulting, appraisal services, and City staff, have been funded by McMillin NTC, LLC ("McMillin").

If the Community Facilities District is established and bonds are subsequently issued, all costs related to financing the public facilities and improvements as described in this report and all incidental expenses related to forming and administering the Community Facilities District will be borne by the district. The maximum aggregate principal amount of bonds is proposed to not exceed $30 million. It is anticipated that the bonds may be issued in two series; the first series (estimated at approximately $12.8 million) may be issued in late 2002, and the second series (also estimated at approximately $12.8 million), could occur later in the redevelopment process, assuming development takes places as projected. If both series of bonds are issued, the annual debt service would total approximately $2 million and would be funded by special taxes collected from property owners and long-term lessees within the proposed district.

BACKGROUND

I. The Redevelopment Project

In 1993, the Federal Base Closure and Realignment Commission recommended closure of the Naval Training Center (NTC) located along Rosecrans Street between Lytton Avenue and North Harbor Drive, west of the San Diego International Airport (Lindbergh Field). The City was subsequently designated the Local Redevelopment Authority responsible for preparation of a reuse plan. A multi-year public planning process led to the development and adoption of the NTC Reuse Plan in 1998.

In 1999, after a competitive proposal process, the Redevelopment Agency of the City (the "Agency") authorized the Executive Director of the Agency to negotiate a Disposition and Development Agreement (DDA) with the McMillin Company in order to implement the Reuse Plan and redevelop a portion of NTC. The Agency negotiating team, which included representatives of the Agency, the City Attorney's office, and a consulting financial advisor, among others, negotiated a DDA, which was approved by the City Council and the Agency in June 2000. The DDA contemplates the development of a mixed-use project involving construction and installation of public infrastructure improvements, the rehabilitation and reuse of existing buildings, and construction of new buildings and improvements. The DDA also generally established financial terms and conditions under which McMillin, the master developer, would complete the redevelopment of NTC. Concurrently, the City and the Agency also executed a Cooperation Agreement, which included provisions to facilitate the implementation of the NTC Reuse Plan and the DDA.

In addition, the NTC Precise Plan and Local Coastal Plan have also been approved by the City and certified by the California Coastal Commission. The City has also approved: an amendment to the Peninsula Community Plan and the Progress Guide and General Plan; the application of zoning to the site; a Vesting Tentative Map; and, a Planned Development Permit. A number of Final Maps have also been approved and recorded.

McMillin=s proposal during the master developer selection process included possible Mello-Roos Community Facilities District financing, to be structured in accordance with City policy, to fund transportation and park improvements. The DDA and the related City Manager=s Report (City Manager's Report No. 00-134) contemplated that McMillin would submit an application for Mello-Roos Community Facilities District bond financing to fund acquisition of public facilities and improvements. In addition, the Cooperation Agreement provided that the City and Agency would consider in good faith implementing public financing mechanisms as may be appropriate to carry out the method of financing described in the DDA. (Mello-Roos financing is a public financing mechanism.) As anticipated, subsequent to the approval of the DDA, McMillin submitted an application for Mello-Roos Community Facilities District financing to the City.

II. Mello-Roos Community Facilities District Financing

The Mello-Roos Community Facilities Act of 1982 (the AAct@) was enacted by the California State Legislature to aid growing areas of the State in the financing of certain essential public facilities which normally accompany major development projects. The Act permits a city to create a defined area within its jurisdiction and, by a two-thirds majority vote within the defined area, impose special taxes on area residents for the purpose of financing needed public improvements. The Act defines the area subject to a special tax as a Community Facilities District (CFD), and the qualified electors to be the registered voters residing within a district. If there are fewer than twelve registered voters within the proposed district, the qualified electors are defined as landowners within the proposed district, with each landowner entitled to one vote per acre, or portion thereof. The Act was subsequently amended in order to facilitate military base reuse such that a public agency may be considered a landowner for the purposes of CFD formation. (Currently, the land proposed for inclusion in the CFD is in City ownership. At the time of formation of the proposed CFD, it is anticipated that title to parcels within the proposed district will be held by the City, the Agency, McMillin, or some combination of the three entities.)

Once a CFD is formed, the district is empowered to levy a special tax that may be utilized to directly finance certain public facilities and services, or pledged to support debt service on Mello-Roos CFD bonds issued to finance the acquisition of needed public facilities. Special taxes are calculated and levied against each non-exempt (i.e., taxable) assessor=s parcel within the district pursuant to an analysis known as a Rate and Method of Apportionment. The special tax is levied on an annual basis, and is collected in the same manner as ordinary ad valorem property taxes.

In general, each taxable asssessor's parcel becomes security for the payment of the special tax levied against it. Mello-Roos CFD financing is a form of land secured financing, and is typically issued without a credit rating. As a result, investors rely heavily on the ratio of the value of land and improvements within the district to the amount of debt secured by liens on the property. This ratio is known as the value-to-lien ratio and is an essential indicator of credit worthiness of the bond issue. Prior to the sale of bonds, the value of land and improvements within the district is determined through an independent appraisal. Because of this reliance, the value-to-lien ratio is a critical factor in establishing the marketability of the bonds. Weak or minimal value-to-lien ratios result in higher interest costs, greater transaction fees, a more limited universe of bond buyers, and, sometimes, in more restrictive bond terms.

Council Policy 800-03 (the "Council Policy") allows the use of CFDs to finance improvements which are a requirement of development permits or agreements, or tentative subdivision maps, provided that the facilities eligible for financing must be large in scope, such as regional parks and major (not local) streets, as well as collector streets that are determined to have benefit outside the applicant's development. The proposed district must also provide some other extraordinary benefit which otherwise would not be realized through the normal subdivision process. According to the Council Policy, examples of this type of benefit would be the provision of improvements in a more timely fashion, facilitating a project that multiple properties or developments are responsible for providing, facilitating a City-adopted redevelopment project, or some similar benefit that the City Council finds acceptable. The Council Policy also provides that the requirement that the district provide some other extraordinary benefit may be satisfied by reference to an earlier discretionary approval.

Notably, the Council Policy also provides that the City Council's consideration of a developer=s request for CFD financing will only be made following completion of an overall feasibility analysis. Activities relating to review of McMillin's application, discussions regarding possible formation of the CFD and potential structuring of the financing, and related preparation of an overall feasibility analysis have been conducted by the City's financing team, which includes representatives from the Office of the City Treasurer and City Attorney's Office, and the City's team of outside consultants (bond counsel, special tax consultant, financial advisor, and underwriter).

DISCUSSION

I. Public Facilities and Improvements

It is contemplated that the proposed CFD would finance the acquisition of the following public facilities and improvements: Preliminary cost estimates also follow.

a. Rosecrans Street and Lytton Street improvements (approximately $4,962,500);
b. improvements to Rosecrans Street and Nimitz Boulevard (approximately $707,200);
c. improvements to Harbor Drive at Lee Street (approximately $514,600);
d. construction of the 46-acre regional park as required of McMillin pursuant to the terms of the DDA and related agreements, including related demolition of existing structures (approximately $14,779,800); and
e. improvements to Laning Road (approximately $200,000).

These improvements are conditions of the City=s approval of the land uses in that area, pursuant to the DDA and related agreements, and the Vesting Tentative Map for the project. The improvements also fulfill the Council Policy criteria related to the types of facilities that are eligible for CFD financing.

II. Public Improvement Costs and Maximum Bond Issuance Size

At the time the DDA was approved, the total estimated cost of all public infrastructure relating to the NTC Redevelopment Project was estimated at approximately $62 million. McMillin's fiscal obligation for construction of the specified transportation and regional park improvements, which are proposed to be acquired utilizing CFD bond proceeds, is limited to approximately $20.8 million, with certain adjustments, as specified in the DDA. Of this amount, approximately $6.0 million pertains to transportation improvements and approximately $14.8 million pertains to the regional park. Pursuant to the DDA, certain additional costs relating to the transportation and regional park improvements, if any, are the responsibility of the Redevelopment Agency. Preliminary cost estimates for these improvements, which total approximately $21.2 million, and which are specified above, were prepared by McMillin and verified by City engineering staff. Though preliminary cost estimates ($21.2 million) are slightly higher than the amount proposed for CFD financing (approximately $20.8 million), these improvements are in various stages ranging from pre-design to permit review. As such, final, actual costs may be somewhat higher or lower than preliminary cost estimates.

McMillin has requested CFD financing to cover its total fiscal obligation relating to the specified transportation and regional park facilities (approximately $20.8 million). Based on estimated current interest rates for this type of financing, and after funding a required debt service reserve fund, providing proceeds to fund interest payments due during the period from the bond issuance date to the first special tax payment date ("capitalized interest"), and funding the costs of issuance, a bond issuance size of approximately $25.6 million would yield net acquisition proceeds of approximately $20.8 million. However, the total bond size needed to produce approximately $20.8 million in net acquisition proceeds would be determined at the time the bonds are sold, and would be dependent primarily on interest rates at that time and the number of interest payments made prior to the first special tax payment date. City Council authorization to incur bonded indebtedness within the CFD must include a not to exceed limitation. To provide a cushion for interest rate fluctuations and any increase to the capitalized interest period, it is recommended that the City approve a bond size not to exceed $30 million.

City staff and the City's Financial Advisor believe that, if formation of the proposed CFD is approved, the values, tax revenues, and economics of the project may support a bond issuance size sufficient to fund the acquisition of $20.8 million in improvements. However, it is also contemplated that the bonds would be issued in series, with a first series of bonds issued in late 2002 in the approximate amount of $12.8 million, and, assuming an updated feasibility study and appraisals support the issuance of additional bonds, a subsequent issuance of potentially similar size sometime in late 2003 or early 2004. A $12.8 million issuance size would result in approximately $10.4 million in net acquisition proceeds. The precise amount of bonds to be issued would be determined later, and financing documents related to the issuance would be presented for City Council approval. The amount of bonds to be issued would be significantly predicated on appraisals of the property and long-term leaseholds within the proposed CFD that would be subject to the payment of the special taxes.

III. CFD Boundaries and Improvement Areas

The boundaries of the proposed CFD are shown in Attachment 1. The new residential, educational, office, research and development, and certain mixed use areas, and the hotel leaseholds, and golf course buildings (excluding service areas) would be subject to the payment of special taxes as detailed in the proposed Rate and Method of Apportionment documents.

Due to the diverse nature of the proposed private improvements and the anticipated timing associated with certain components of the development project, (e.g. new residential construction is expected to occur earlier than other aspects of the development), the CFD is proposed to include two discreet improvement areas (Improvement Area No. 1 and Improvement Area No. 2). An improvement area may be thought of as a district within a district. Improvement Area

No. 1 is proposed to include new residential construction.   Improvement Area No. 2 is proposed to include the educational, office, research and development, mixed use, golf course, and hotel sites**.**

Determination of the value of the land devoted to McMillin's new residential development should be fairly straightforward, and would support a first series of bonds. Similarly, completed buildings (either new or rehabilitated) in Improvement Area No. 2 are expected to be taxed in support of the initial issuance of bonds. Based on the current, anticipated timing of the new residential development, and development or rehabilitation of certain buildings in Improvement Area No. 2, the initial issuance of bonds (currently estimated to total approximately $12.8 million) could occur later in 2002.

The issuance of a second series of bonds, which would also be secured by special taxes levied within Improvement Area No. 1 and Improvement Area No. 2, could occur later in the redevelopment process. However, a second issuance of approximately $12.8 million to cover the acquisition of the remaining improvements assumes that development required under the Reuse Plan and the DDA, including the development related to Improvement Area No. 2, is financially feasible, is correctly positioned in the market, and will provide sufficient value to support a second series of bonds. At this time, the development plans for Improvement Area No. 2 (e.g., the hotel plans, including financing and operator arrangements) lack sufficient definition to enable an analysis of the feasibility of the second issuance. If any of the material assumptions in the McMillin development plan are not realized, the second issuance of bonds could be affected. As such, the issuance of a second series of bonds could be delayed, decreased, or eliminated, depending on the status of development, and especially on the economics of the group of properties that will comprise the second improvement area. If the bond size of the second series of bonds is decreased, or the issuance eliminated, McMillin would still be responsible for development of the remaining facilities pursuant to the DDA, and would need to pursue other financing options.

IV. <u>Special Tax Rates – Rate and Method of Apportionment</u>

Under the Act and the Council Policy, the apportionment of special taxes is not required to be based on a "special benefit" received by property from the proposed improvements relating to the CFD. However, the Act and the Council Policy do require that the tax formula be reasonable. The City hired David Taussig & Associates, Inc. as the special tax consultant to assist with development of a special tax methodology for the proposed CFD. The methodology is reasonable in that the costs for the road and park facilities were generally allocated to each land use based on benefit principles (e.g., estimated park usage and average daily trips). This methodology has been used in other jurisdictions, and is supported by legal precedent.

The Council Policy also provides that, as a general rule for residential projects, total taxes and special assessments collected through the property tax bill should not exceed 2.0% of the assessed value of the property, including improvements. Based on information furnished by McMillin, the annual special tax burden under the proposed CFD is projected to be less than 2.0% of the total value for residential property, and would, therefore, be in compliance with the Council Policy.

V. Public Property and Exemptions

City Manager=s Report No. 00-134, related to the DDA, also contemplated that Agency and City-owned property would be exempt from the payment of special taxes, except for property that might be the subject of future, long-term, leases (e.g., the hotel sites and some areas of the historic core), in which case future leasehold interests could potentially be made subject to the payment of special taxes. The Rate and Method of Apportionment documents were developed in a manner that is generally consistent with the intent to exclude Agency and City-owned property from the payment of special taxes as follows.

a. Certain property included within the NTC project is not included in the boundaries of the proposed CFD, and is therefore exempt from the payment of special taxes, (e.g., the future regional park and the Metropolitan Wastewater lab site).

b. In addition, certain property included within the boundaries of the proposed CFD would be exempt from the payment of special taxes, including the area relating to the future Regional Public Safety Training Institute and the estimated acreage of public property, which is primarily comprised of the acreage of all streets within the CFD.

c. A portion of the Civic, Arts, and Cultural Precinct (CACP), which is to be managed by the Naval Training Center Foundation (the "Foundation"), is located within the boundaries of the proposed CFD. Due to the quasi-public nature and purposes of the tenants that are envisioned to locate within CACP, the Foundation's commitment to public access and preservation of historic, civic and cultural resources, and the fact that this area is not within McMillin's project, this area is not proposed to be subject to the payment of special taxes.

d. As noted, certain City or Agency-owned properties (e.g. the hotel sites and some areas within the historic core) are to be conveyed to McMillin pursuant to long-term leases. For these properties, the special taxes supporting the bonds would be payable by the lessee, or future assignees (if any). The proposed Rate and Method of Apportionment documents have been structured such that the Agency will not be obligated to pay special taxes and their interest in the land and the lease(s) would not be security for the payment of special taxes. An amendment to the Cooperation Agreement would be necessary to implement this aspect of the proposed financing. The amendment would include provisions designed to generally create a continuity of taxable interests so that in the event the Agency were to terminate a lease, a new lessee would be put in place simultaneous with termination. This is intended to avoid any gap in the special tax revenue payment stream.

A proposed amendment to the Cooperation Agreement will be presented for City Council and Agency consideration at the time of the upcoming public hearing related to formation of the CFD.

e. A proposed First Implementation Agreement to the DDA ("Agreement") is expected to be presented for Agency consideration, and is necessary to implement the proposed Mello-Ross CFD financing (see report RA 02-07). In general, the proposed Agreement will allow the Agency to subordinate its right of reverter (a tool in redevelopment law that allows a redevelopment agency to take property back if not developed as agreed) to the lien of special taxes created by CFD formation. Therefore, if the Agency exercises its right of reverter, it would take a property back subject to the payment of special taxes until such time as the property could be sold or leased to another developer. The proposed Agreement mitigates the risk to the Agency by requiring that McMillin deliver an unconditional direct pay letter of credit equal to 200% of the annual special tax levy on all parcels subject to the right of reverter not later than the issuance of any bonds secured by such special tax lien.

In general, it should be noted that if the City or Agency ever reacquires title to property within the district after conveying it in fee to McMillin or any third party, it would remain taxable and, therefore, subject to the payment of special taxes.

VI. Policy Considerations and Recommendations

Due to the unique nature of the NTC Redevelopment Project, as compared to more typical development projects that utilize Mello-Roos CFD financing (e.g., development occurring on raw land in newer, developing areas) a few issues of a policy nature arose with respect to the proposed CFD. A brief summary of these issues and associated recommendations are described below.

a. Bond Issuance Size - City Manager=s Report No. 00-134, related to the DDA for the project, contemplated McMillin would submit an application for Mello-Roos CFD bond financing to fund approximately $13.0 million in public improvements. A bond issuance size of approximately $15.0 million to $16.0 million would be required to produce net acquisition proceeds of $13.0 million. The bond size referenced in City Manager=s Report No. 00-134 was considered, at the time of the report's issuance, to be an estimate of bonding capacity based upon conservative assumptions related to property value and taxing capacity.

As indicated above, McMillin has requested that the bond issuance size relating to the proposed CFD cover the cost (approximately $20.8 million) of certain transportation and regional park improvement costs for which it is responsible. The proposed CFD does contemplate a series of bond issuances that could result in net acquisition proceeds of approximately $20.8 million, which translates into a total bond issuance size of approximately $25.6 million based on current interest rates. As more fully described above, it is contemplated that the bonds would be issued in phases, with a first series of bonds issued in the near term in the approximate amount of $12.8 million, and, assuming an updated feasibility study and pertinent property appraisals support the issuance of additional bonds, a subsequent issuance of potentially similar size. As further indicated above, the issuance of a second series of bonds could be delayed, the bond size decreased, or eliminated depending on the outcome of the updated feasibility study and appraisals.

b. Educational Users – The educational precinct of NTC includes approximately 515,241 square feet of building area. The NTC Precise Plan allows for a broad range of uses including: educational and vocational training; traditional and non-traditional classroom instruction; corporate training; charter schools; private for-profit and non-profit institutions; incubator businesses; bookstores; art stores; computer stores; copying facilities; eating establishments; transient occupancy facilities; office; research and development; and warehousing operations for small start up companies. In addition, educational users may choose to locate in other areas of the project including the mixed use, office, and research and development areas. Further, the nature of educational users that could potentially locate within leased areas could change over time from public to private and the reverse. If the educational precinct, or other areas of the project where educational users may choose to locate, was exempt from the payment of special taxes, the effect would be to substantially and perhaps unnecessarily reduce bonding capacity. Due to the broad range of uses allowed and the inherent difficulty in quantifying the amount of future public educational uses, if any, the proposed Rate and Method of Apportionment documents subject educational uses, whether private or public, to the payment of special taxes.

Taxing properties in the educational precinct is permissible under Mello-Roos law, but contrasts somewhat with the application of Mello-Roos CFD financing in newer areas, where land use plans ordinarily identify future public school sites and the specific site is either removed from the district or exempt from the payment of special taxes.

Since taxable property or leaseholds with the CFD boundaries would be made subject to the tax before entering into public ownership, prospective public entities and lessees would be made aware of, and may consider, the obligation to pay special taxes in connection with their sale and lease negotiations.

c. Demolition Costs – Early this year, McMillin completed demolition associated with the regional public park site; the estimated cost incurred by McMillin to complete this portion of the park is $2.6 million. McMillin requested reimbursement of these costs from the first available bond proceeds, which is prior to completion of park construction. However, the Council Policy specifies that CFD bond proceeds may be utilized to acquire developer improvements after they have been constructed by the developer (e.g., completed and functional road or road improvements, and parks). In a more typical CFD financing, reimbursement of a portion of a project would not be recommended. For example, reimbursing the cost of grading for a new road prior to acquisition of the completed, functional road would not be recommended since grading alone has little utility or value; in this example, purported value could be diminished over time due to development plan modifications that could result in change to road alignment.

Although a completed, functional park, or park phase, will not have been acquired, it is recommended that McMillin receive partial reimbursement of demolition costs (not to exceed $1.0 million) after delivery and acquisition of another significant improvement for the community, specifically, widening of and improvements to Rosecrans. Some value has been created by the demolition and removal of obsolete improvements on the park site that were of questionable value and a potential nuisance. Through its demolition activities, McMillin has improved, or added value to, City property (this contrasts to a more typical CFD whereby the land would be owned by a developer), and, as such, it is unlikely that the value provided would be diminished. Also, the City's Financing Team has determined that bondholder credit issues would not be raised if McMillin is partially reimbursed for the demolition costs at the time the City receives another significant improvement to the community. In addition, this proposal would not establish new policy or practice for future CFD=s. The remaining portion of the demolition costs (approximately $1.2 million to $1.6 million), would be reimbursed from bond proceeds upon completion and acquisition of a first functional park phase, as defined and approved through the park planning process. (Final park design and phasing will be in accordance with the Park Agreement between the City and McMillin, the DDA, the General Development Plan for the park, and other approvals required for the park.)

VII. Financing Feasibility Study Conclusions and Recommendations

In accordance with Council Policy, the City commissioned a Financing Feasibility Study prepared by the independent financial advisory firm of Fieldman, Rolapp & Associates. This study discusses various aspects of the proposed CFD and financing mechanism, and sets forth certain conclusions and recommendations related to the City=s consideration of approving CFD financing for the project. Chief among these conclusions and recommendations are:

a. Utilization of special tax proceeds to finance the acquisition of the specified public infrastructure is appropriate and Mello-Roos CFD financing is the financing vehicle of choice for this project.

b. The proposed CFD formation generally conforms to the City=s policies and practices with respect to the use of land secured financing.

c. The City could reasonably proceed with formation of the proposed CFD at this time.

d. The issuance of a first series of bonds, in an amount estimated at approximately $12.8 million, to fund an initial acquisition of public infrastructure, appears to be supported by the values, tax revenues, and economics of the project, at this time. Determination of the precise amount of bonds to be issued will be made only after receipt of updated value information in the form of a complete narrative appraisal, which must be prepared just prior to the issuance of bonds.

e. Despite various assurances contained in the DDA and the proposed Agreement, including performance bonds for both horizontal and vertical improvements, and a letter of credit offered to protect the Agency in the event it should ever choose to exercise its right-of-reverter, the City should require a value-to-lien ratio of 4 to 1 for the initial issuance of bonds; Council Policy requires a minimum value-to-lien ratio of 3 to 1. This recommendation is due to the current limited diversity of ownership within the proposed CFD and prevailing conditions in the municipal securities market. Departure from the recommended value-to-lien ratio of 4 to 1 should be made only if the City Manager determines at the time of bond sale that the security behind the payment of special taxes, and assurances provided by the developer that the development will be completed as envisioned and on time, present very solid assurances and that such assurances offset the concentration of risk. The minimum value-to-lien ratio should be consistent with Council Policy, which is 3 to 1. Concentration of risk is important, both to the bondholder and to the City, because the effects of a failure to develop or to pay special taxes when due, although small in probability, present significant financial risk to bondholders.

f. There is not yet sufficient information available to recommend the issuance of a further series of bonds to finance the remainder of the specified public infrastructure, as proposed. When more information becomes available, the overall feasibility analysis should be updated. In addition, the value-to-lien ratio for a subsequent sale of bonds should be established at the time the City has a better indication of the underlying value of development which will come later within the redevelopment timeline.

After review and analysis of the Financing Feasibility Study, City staff and the City=s Financial Advisor are recommending that the City proceed with the formation of the proposed CFD, provided that the feasibility study recommendations summarized above, as well as additional recommendations described in the study, are implemented.

VIII. Schedule

Adoption of the proposed resolutions will begin the formal legislative proceedings for formation of the proposed CFD. The resolutions provide that a public hearing will be held on June 25, 2002, regarding the establishment of the district and the proposed debt issuance. If the CFD is formed at the completion of the public hearing, other documents would be brought forward for the City Council=s consideration prior to the sale of bonds, including, but not limited to, a bond indenture, a bond purchase agreement, the preliminary official statement, and related documents.

Pursuant to the DDA, the Agency agreed to cooperate reasonably with McMillin to pursue formation of the CFD. Consequently, a proposed First Implementation Agreement to the DDA, which would also be necessary to implement the proposed Mello-Roos CFD financing, is expected to be presented for Agency consideration.
As noted, an amendment to the Cooperation Agreement between the City and Agency will also be necessary to implement the financing as proposed. It is anticipated that the proposed amendment will be presented for City Council and Agency consideration on the same day as the public hearing regarding the establishment of the district.

ALTERNATIVE

Do not approve the aforementioned resolutions to begin the formal legislative proceedings to initiate the proposed CFD.

Respectfully submitted,

MARY E. VATTIMO	Approved: PATRICIA T. FRAZIER
City Treasurer	Deputy City Manager

VATTIMO/ELK/MLG/msi

Attachment: Proposed Community Facilities District Boundaries