



DATE ISSUED: June 7, 2006

REPORT NO: 06-066

ATTENTION: Council President and City Council
Docket of June 12, 2006

REPORT TO THE CITY COUNCIL

SUBJECT: Fiscal Year 2006-07 Tax and Revenue Anticipation Note

REQUESTED ACTION(S):

- (1) The City Council adopt a resolution and the accompanying document authorizing the Chief Financial Officer to execute a Note Purchase Agreement, between the City of San Diego (“City”) and Bank of America, N.A. (“BofA”), and take actions as may be necessary to implement the Fiscal Year 2006-07 Tax and Revenue Anticipation Note financing.
- (2) The City Council adopt a resolution authorizing the City Attorney to enter into an agreement with Stradling Yocca Carlson & Rauth to provide bond counsel services for the Fiscal Year 2006-07 Tax and Revenue Anticipation Note in an amount not to exceed \$25,000, including \$2,500 for out of pocket expenses.

STAFF RECOMMENDATION:

Adopt the resolution to implement the Fiscal Year 2006-07 Tax and Revenue Anticipation Note financing, in an amount not to exceed \$160 million, on a private placement basis with BofA to fund the projected seasonal cash flow deficit of the City’s General Fund in Fiscal Year 2006-07.

SUMMARY:

Background

The City has issued Tax Anticipation Notes or Tax and Revenue Anticipation Notes (“TRAN”) every year since Fiscal Year 1968 (except Fiscal Year 1979) to finance the General Fund cash flow needs of the City in anticipation of the receipt of property tax revenues from the County in December and April of each year. TRAN borrowing is a standard tool accessed by localities to address temporary shortfalls arising from the 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 State of California, cities, and counties are authorized to undertake short-term borrowings pursuant to Article 7.6, Chapter 4, Part 1, Division 2, Title 5 of the California Government Code. The California Government Code, together with City Charter Section 92 authorizes the City to issue short-term notes in any fiscal year in anticipation of the collection of taxes and revenues of such fiscal year.

For Fiscal Year 2007, as has been the case for Fiscal Years 2005 and 2006, due to the unavailability of audited financial statements, the TRAN borrowing is structured as a private placement. If desired and is proven practical and economical, the privately placed note could be

refunded through a subsequent public offering of a TRAN, provided the offering occurs prior to the date of the City's maximum cash flow deficit in the last calendar quarter of 2006. For a public offering to occur, financial statements for Fiscal Years 2003, 2004, and 2005 have to be released.

Private Placement Structure and Financing Terms

The Fiscal Year 2007 Tax and Revenue Anticipation Note ("Note") offering does not involve a public offering of the Note. Rather, the Fiscal Year 2007 Note is offered to, and purchased only by a knowledgeable and sophisticated investor such as Bank of America, a major commercial bank, and makes a representation that it is capable of fully and independently evaluating the risks and merits of the investment represented by the Note. There is no private or public offering circular containing City disclosure for this transaction. In order to conduct its credit due diligence, certain unaudited financial information was provided to BofA with necessary disclaimers and limitations placed on the firm pertaining to the information provided. The loan is structured as a direct loan facility on a fixed rate basis and the Note will be held by the bank for its own investment portfolio through the maturity of the Note. BofA agrees to the requirement that the Note be non-transferable and non-assignable to any other firm or investor.

Upon the City Council approval of the financing, the City will enter into a Note Purchase Agreement ("NPA") with BofA, pursuant to which the City will agree to sell the Note in an amount not to exceed \$160 million to the bank, in return for which it will receive the right to draw moneys upfront or on an as needed basis over the agreed term on the Note. The Note will have a nominal maturity of up to 13-months (August 3, 2007) with the ability to prepay without penalty. The NPA gives the option of two alternative interest rate modes, one based on the LIBOR (London Interbank Offered Rate) Index and the other based on the Cost of Funds Rate Index, a rate quoted by BofA, which typically trends 0.02% - 0.05% higher than the LIBOR index. The City could borrow upfront at either a 12-month fixed rate (based on the LIBOR Index) or a 13-month fixed rate (based on the Cost of Funds Rate Index). The effective interest rate at the City's current General Obligation bond rating would be 62.347% of the selected index mode plus 58 basis points (0.58%). While the Note is outstanding, if the City's G.O. bond rating improves the effective interest rate would drop to 62.347% of the selected index mode plus 51 basis points (0.51%). In the event of a rating deterioration or additional suspension of ratings, the effective index mode would increase to 62.347% of the selected interest rate mode plus 66 basis points (0.66%). If the City chooses to borrow on an as needed basis, it would be at a variable rate based on the LIBOR index.

Given the current market conditions, the City expects to draw the entire loan upfront for the full term (13-months) and reinvest the unutilized proceeds, reducing the net interest payment costs. The effective interest rate on the borrowing is estimated to be 3.98% based on the interest rates as of week of May 22, 2006. The interest rate will be fixed at the time of the pricing of the Note. The interest payments on the Note are due quarterly. For comparison purposes, as of the week of May 22, 2006, the interest rate on an equivalent public offering fixed rate TRAN borrowing (13-month, "A" rated) is estimated at 3.60%.

The City currently expects to borrow \$142 million on July 3, 2006. This is based on the

maximum deficit projected for Fiscal Year 2007 as indicated by the projected monthly cash flow statement (see Attachment 1). In the event that actual cash flows in Fiscal Year 2007 lead to a deficit of higher than \$142 million, upon confirmation by the City Auditor and the Acting City Treasurer of an additional cash flow deficit in a manner consistent with the Tax Certificate executed in connection with the issuance of the Note, the City can borrow the necessary additional amount up to \$160 million, which is the not-to-exceed amount recommended for authorization by the City Council. This not-to-exceed amount is well below the legal limit set by Section 92 of the City Charter, which limits the total amount of the TRAN borrowing issued in any fiscal year to an amount, in the aggregate, not more than twenty-five (25) percent of the City's total budgeted appropriations for such fiscal year (which is approximately \$253 million based on the Fiscal Year 2007 Proposed Budget).

The Note will be secured by a pledge of the taxes and revenues to be collected in Fiscal Year 2006-07. The Note structure requires that specified portions of the property taxes be set aside on specific dates during the fiscal year for the repayment of the loan.

Financing Team

The engagement of BofA as the lender for this transaction was made through a competitive process. A Request for Proposals ("RFP") was issued on April 10, 2006 to 28 investment firms/commercial banks/mutual fund managers. The City received 6 responses; Bank of America was selected based on the most competitive bid and flexible structuring options offered.

Lamont Financial Services Corporation was selected as the financial advisor through a Mayoral Action for a fee not to exceed \$75,000 plus \$5,000 for out of pocket expenses. The City Attorney's Office has identified Stradling Yocca Carlson and Rauth ("Stradling") to serve as bond counsel through an RFP process. Stradling has proposed to provide such services for a fee in an amount not to exceed \$25,000, including \$2,500 in out of pocket expenses.

Financing Documents

The financing documents being submitted for the City Council approval include the forms of the NPA and the Accompanying Document to the Resolution. A brief description of the financing documents follows:

- Note Purchase Agreement – An agreement between the City and BofA, pursuant to which BofA agrees to purchase the Note from the City and the City, agrees to deliver it to BofA. The agreement details the representations, warranties, and agreements of the City and BofA in connection with the transaction.
- Accompanying Document to the Resolution – A document presenting all the supporting documents for the Fiscal Year 2006-07 TRAN financing, including the Cash Flow Deficit Report.

Transaction Time Line

May 30, 2006	Review of the financing structure by the City's Disclosure Practices Working Group
June 12/13, 2006	City Council approval of financing documents
Week of June 26, 2006	Pricing of the Note
July 3, 2006	The Note closing and receipt of Note proceeds

FISCAL CONSIDERATIONS:

As determined by the Fiscal Year 2007 Projected Cash Flow Deficit Report, the City expects to draw \$142 million on July 3, 2006 from the BofA loan facility. Based on the effective rate of borrowing of 3.98%, the gross interest payments on the loan are estimated to be approximately \$6.2 million. The unused loan amount and the set aside amounts from the property taxes will be invested until the final maturity of the Note (August 3, 2007); these interest earnings are estimated to total approximately \$3.0 million (based on an assumed rate of return of 4.87%). The net interest costs of this borrowing (net of investment earnings) are expected to be in the range of \$3.0 - \$3.5 million.

The fees related to consultants for this transaction will be paid from the Tax Anticipation Notes Revolving Fund (Fund No. 65013). These fees include (i) the bond counsel fees in an amount not to exceed \$25,000; (ii) the financial advisory services in an amount not to exceed \$80,000; and (iii) the BofA counsel fees in an amount not to exceed \$30,000.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

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

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

None

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Business entities involved in this transaction are - Banc of America Securities LLC., a subsidiary of Bank of America Corporation (Lender); White & Case, LLP. (Bank's counsel); Stradling Yocca Carlson & Rauth (bond counsel); and Lamont Financial Services Corporation (financial advisor).

Gail R. Granewich
Acting City Treasurer

Jay M. Goldstone
Chief Financial Officer

[Attachment\(s\): 1. Fiscal Year 2007 Projected Monthly Cash Flow Schedule](#)