



DATE ISSUED: April 11, 2007

REPORT NO: 07-060

ATTENTION: Council President and City Council
Docket of April 11, 2007

REPORT TO THE CITY COUNCIL

SUBJECT: Lease-Purchase Agreement with IBM Credit LLC

REFERENCE: Enterprise Resource Planning System Core Project, Report No: 07-027

REQUESTED ACTIONS:

1. Authorize the Mayor to enter into lease-purchase agreement with IBM Credit LLC (IBM) for the implementation of the Enterprise Resource Planning (ERP) System Core Project in the amount not to exceed \$29.5 million.
2. Declare the City's intent to use funds made available from the lease-purchase agreement with IBM to reimburse itself for eligible ERP system project expenditures advanced by the City.
3. Authorize the establishment of an ERP Fund (50071) and the transfer of up to \$3.5 million from the City's A-List Fund (50066) to the ERP Fund.

STAFF RECOMMENDATION:

Approve the requested actions.

SUMMARY:

In conjunction with the Audit Committee's recommendation (Kroll Report) to replace the legacy software systems currently in use by the City's Departments of Finance and Business & Support Services, the City has initiated the implementation of the Enterprise Resource Planning (ERP) System. Attachment 1 is the Report to City Council No: 07-027 for further details on the merits of the ERP system.

The ERP system receives citywide sponsorship and the selection of the system will be based on a review of current needs and an assessment of capabilities that may be required in the future. In addition to providing core support to the Departments of Finance and Business & Support Services, the ERP system will be used by all City departments for day-to-day business operations and human resource needs. It is expected that the ERP system will support the City's Information Technology (IT) needs for the next 15+ years, and that it will be the foundation for the City's new IT application architecture.

ERP System – Procurement and Implementation

The City will obtain the system through San Diego Data Processing Corporation (SDDPC), which will act as the purchaser for the City. The City will be identified and designated as the licensee. The initial phase, software acquisition by SDDPC, is expected to occur by April 2007, while the implementation phase of these systems is expected to begin in the summer of 2007 and take 18 – 24 months to complete. The total cost of the ERP system is estimated at \$36.5 million, of which approximately \$7 million is expected to be cash funded, with the remaining to be financed under the proposed lease purchase agreement with IBM Credit LLC. The initial outlay of approximately \$4.5 - \$6 million will be for the associated hard costs (software/hardware), while the remaining integration costs will be drawn down in a more linear fashion throughout the integration period.

On January 5, 2007, SDDPC issued a Request for Proposals (“RFP”) for the ERP System software. Two (2) qualified proposals were received by the proposal due date of February 9, 2007. The evaluation includes review of the written proposals, vendor demonstrations, and site visits. The vendor demonstrations began on February 26, 2007 and concluded on March 22, 2007. Site visits to local government organizations using the proposed products are scheduled to conclude on April 9, 2007.

The ERP System Evaluation and Selection Committee are expected to make a vendor recommendation to the ERP System Core Project Executive Steering Committee in the third week of April 2007. Following the selection of the software vendor, an RFP will be issued for a System Integrator. The System Integrator is expected to be selected in June 2007.

ERP System Financing - Master Lease Agreement with IBM Credit LLC

A lease-purchase option is proposed for the funding of the ERP System for up to \$29.5 million. An RFP was issued through the City’s Purchasing Division on January 9, 2007, to solicit financing proposals.¹ IBM Credit LLC (IBM), a wholly owned subsidiary of IBM responded to the RFP expressing interest in financing all components of the ERP system (hard and soft costs).

The master lease agreement between the City and IBM will be for a not-to-exceed amount of \$29.5 million. The master lease agreement will allow for the City to borrow amounts to meet the cash flow requirements of the project on an as needed basis. It is anticipated that these draw downs will occur on a quarterly basis. The lease purchase agreement will be for a 7-year term with the interest rate fixed when the ERP system vendors are paid or the City places the reimbursement requests with the Lessor (IBM). The interest rate will be set at 100% of the 7-Year Treasury Note rate. As of March 16, 2007, the 7-year US Treasury Note rate is 4.47%.

Reimbursement Resolution

In the event that the City needs to advance the project related expenses, the City must adopt a reimbursement resolution in accordance with section 1.150-2 of Treasury Regulations

¹ City issued an RFP to solicit financing proposals for 2 separate projects- acquisition of motive equipment and implementation of the Enterprise Resource Planning System. The financing proposal being brought forward for City Council approval at this time is for the ERP system implementation.

(“Regulations”) in order to be reimbursed for those costs. By adopting a reimbursement resolution, City will satisfy the Official Intent Requirement under the Regulations and be able to reimburse project related expenses using funds available from the lease-purchase agreement with IBM. Adoption of the reimbursement resolution will not obligate the City to expend any funds; it merely enables the City to get reimbursed for all qualified project related expenses that the City advanced in implementing the ERP System.

FISCAL CONSIDERATIONS:

Total cost of the ERP system is estimated to be \$36.5 million (Table 1) of which \$29.5 million is anticipated to be financed via the proposed lease-purchase agreement with IBM and the remaining \$7 million to be cash funded. Those labor costs and non-personnel expenses (NPE) related to the ERP system implementation that are determined to be non-capitalizable by the Comptroller’s office will be cash funded in order to minimize the borrowing costs².

The cash contribution of \$7 million is anticipated to be funded in equal amounts by SDDPC and the City. The estimated \$3.5 million cash contribution from the City is proposed through a transfer of funds from the City’s A-List Fund (50066) to the ERP Fund (50071). The estimated \$3.5 million cash contribution from SDDPC is expected to be used to fund SDDPC labor and NPE costs over the course of the project. There will be no transfer of funds from SDDPC to the City.

Table 1

Cost Category	Cost Range
Hard Cost	\$4,500,000 - \$6,000,000
Soft Cost	\$26,500,000 - \$30,500,000
Total Cost	\$31,000,000 - \$36,500,000

Hard Costs:

- Computer Hardware & Peripheral Devices
- Computer Software License Fees

Soft Costs:

- Systems Integrator (Consulting Fees)
- Other Consulting Fees
- City Staff including: labor, fringe, and non-personnel expenses (NPE)

It is anticipated that the project costs will be incurred in Fiscal Year 2007, 2008, and 2009.

Fiscal Year 2007

Software purchase: \$5M

Labor – pre-implementation: \$1M

(Costs that cannot be financed)

Financed

Cash Funded

² Non-capitalizable costs will need to be borrowed on a taxable basis and therefore result in a higher interest expense.

Fiscal Year 2008

Labor & NPE - City, SDDPC, System Integrator: \$15.3M

Financed

Hardware: \$1 M

Financed

Labor & NPE - City, SDDPC, System Integrator: \$ 4.2M

Cash Funded

(Costs that cannot be financed)

Fiscal Year 2009

Labor & NPE - City, SDDPC, System Integrator: \$8.2 M

Financed

Labor & NPE - City, SDDPC, System Integrator: \$1.8 M

Cash Funded

(Costs that cannot be financed)

Based on the above timeline, the projected fiscal impact is as shown in Table 2. Costs related to the ERP System procurement and implementation were included in the 5-year financial outlook. Projected annual expenses will be included in future budgets and City Council approval will be obtained through annual budget process.

Estimated Fiscal Impact FY 2007 - 2016

Table 2

	Lease Payments (1)	Cash Funded		Total Payments	SDDPC Reserves & City's ERP Fund (4)	Estimated General Fund Impact (5)	Estimated Non-General Fund Impact (6)
		Labor & NPE (2)	Sales Tax (3)				
FY 07	--	\$1,000,000	--	\$1,000,000	\$1,000,000	--	--
FY 08	\$765,000	\$4,200,000	\$77,500	\$5,042,500	\$4,200,000	\$454,950	\$387,550
FY 09	\$3,477,800	\$1,800,000	--	\$5,277,800	\$1,800,000	\$1,878,012	\$1,599,788
FY 10	\$4,973,300	--	--	\$4,973,300	--	\$2,685,582	\$2,287,718
FY 11	\$4,973,300	--	--	\$4,973,300	--	\$2,685,582	\$2,287,718
FY 12	\$4,973,300	--	--	\$4,973,300	--	\$2,685,582	\$2,287,718
FY 13	\$4,973,300	--	--	\$4,973,300	--	\$2,685,582	\$2,287,718
FY 14	\$4,973,300	--	--	\$4,973,300	--	\$2,685,582	\$2,287,718
FY 15	\$4,208,400	--	--	\$4,208,400	--	\$2,272,536	\$1,935,864
FY 16	\$1,495,500	--	--	\$1,495,500	--	\$807,570	\$687,930
Total	\$34,813,200	\$7,000,000	\$77,500	\$41,890,700	\$7,000,000	\$18,840,978	\$16,049,722

(1) Total Amount Financed: \$29,500,000

- Amount Financed in FY 2007: \$5,000,000

- Amount Financed in FY 2008: \$16,300,000 (in 4 installments)

- Amount Financed in FY 2009: \$8,200,000 (in 3 installments)

(2) Labor and NPE expenses totaling \$7 million that cannot be capitalized will be cash funded

(3) \$1 million in hardware costs will incur a sales tax at 7.75%

(4) The labor and NPE expenses of the project that are cash funded will be paid in equal amounts from the SDDPC reserve and the City's ERP Fund (50071). The estimated \$3.5 million cash contribution from the City is proposed through a transfer of funds from the City's A-List Fund (50066) to the ERP Fund (50071).

(5) General Fund share is estimated at approximately 54%

(6) Non-General Fund share is estimated at approximately 46%

**Total Estimated Cost of the ERP System
Table 3**

Project Cost	\$36,500,000
Cash Funded	\$7,000,000
Financed	\$29,500,000
Interest Expense (on financed amount)	\$5,313,200
Sales Tax	\$77,500
TOTAL (est.)	\$41,890,700

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

On February 5, 2007, Council voted to accept the Mayor’s staff’s recommendation to proceed with the concept of implementing an ERP system, with the understanding that any agreement to finance such a system will be brought back to the Council.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

n/a

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Proposed lease-purchase agreement for the financing of the ERP system is with IBM Credit LLC. The vendor(s) that will supply the ERP software and system integration will be identified when the due dilligence of submitted proposals to the RFPs for respective components is completed by the Mayor’s staff.

Jay M. Goldstone
Chief Financial Officer

Rick Reynolds
Assistant Chief Operating Officer
Business & Support Services

Lakshmi Kommi
Debt Management Director

Attachment:

[Report to City Council No: 07-027: Enterprise Resource Planning System Core Project](#)