



THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: June 4, 2008 REPORT NO: 08-083  
ATTENTION: Council President and City Council  
Agenda of June 9, 2008  
SUBJECT: Fiscal Year 2009 Tax and Revenue Anticipation Note

REQUESTED ACTION(S):

Authorize the execution of the Fiscal Year 2009 Tax and Revenue Anticipation Note (FY 2009 TRAN) financing in an amount not to exceed \$147 million and the related financing documents to fund the projected seasonal cash flow deficit of the City's General Fund in Fiscal Year 2009. The related financing documents include a Note Purchase Agreement between the City and Bank of America, N.A. (BofA) and an Accompanying Document to the Financing Resolution.

Authorize the Financial Advisory Services Agreement between the City and Public Resources Advisory Group, Inc. (PRAG) to provide financial advisory services for the FY 2009 TRAN for an amount not to exceed \$30,000, plus reasonable out-of-pocket expenses not to exceed \$2,500. Also, authorize the City Attorney to enter into an agreement with Stradling Yocca Carlson & Rauth to provide bond counsel services for the FY 2009 TRAN in a fixed amount totaling \$40,000, including out of pocket expenses. In addition, authorize the City Comptroller's office to pay costs of issuance fees consisting of BofA's counsel fees in the amount of \$37,500 and the California Debt and Investment Advisory Commission reporting fee of \$200.

STAFF RECOMMENDATION: Approve the requested actions.

SUMMARY:

**I. BACKGROUND**

Tax and Revenue Anticipation Notes ("TRANs") address temporary cash flow 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 California Government Code (Article 7.6, Chapter 4, Part 1, Division 2, Title 5) and City Charter Section 92 specifically authorize the City to issue short-term notes in any fiscal year in anticipation of the collection of taxes and revenues of such fiscal year. A TRANs issuance is authorized by the legislative body of the issuer through the adoption of a resolution (the "Financing Resolution"), and is a general obligation of the issuer, payable from unrestricted taxes, income, revenue, cash receipts, and

other monies of the issuer attributable to the upcoming fiscal year. The issuer is not authorized to levy or collect any additional tax for the repayment of the TRANs.

Traditionally, the City has issued TRANs 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. 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 financings on or around July 1 in order to be able to meet the pension Annual Required Contribution ("ARC") to be prepaid at the beginning of the fiscal year. Due to the immediate need for the TRAN funds, the FY 2009 TRAN borrowing has been structured as a private placement. It is anticipated that any General Fund cash flow borrowing for FY 2010 would be met through a public offering, including an offering statement, which staff would begin preparing in January, 2009.

The amount of borrowing is based on the General Fund's projected cash flow deficit in the upcoming fiscal year. Pursuant to Internal Revenue Service regulations, the size of the borrowing cannot exceed the projected deficit as certified by the City's Chief Financial Officer and the City Treasurer.

## **II. DISCUSSION**

Under the proposed structure, the FY 2009 TRAN offering would be privately placed with Bank of America N.A. (BofA), a subsidiary of Bank of America Corporation. Due to the private nature of the borrowing, an offering statement is not required. BofA would be required to represent, among other things, that it: (1) has sufficient knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment in the FY 2009 TRAN; (2) has been supplied with or been given access to information that it deems necessary to make an informed investment decision; (3) is purchasing the FY 2009 TRAN for its own account, and not with a view to resell the investment; (4) acknowledges that there are restrictions on the transfer of the FY 2009 TRAN; and (5) understands that the City is not current with its financial statements.

BofA has conducted its credit due diligence based on the financial information it receives from the City as the lender for the current year TRAN (FY 2008), and information that was provided for this financing and in the context of other recent financing transactions. A bring down due-diligence session will be conducted prior to pricing. The resale restrictions placed on the transaction specify that the FY 2009 TRAN may not be syndicated, participated out, or transferred to any other party prior to maturity of the TRAN.

### **Borrowing Size and Pricing**

Upon the City Council's approval of the financing, the City will enter into a Note Purchase Agreement ("NPA") with BofA, pursuant to which BofA would agree to purchase the FY 2009 TRAN from the City.



Based on the projected cash flow needs, it is currently expected that \$140 million would be borrowed on July 1, 2008. The borrowing amount is derived by calculating the maximum deficit projected for Fiscal Year 2009 as indicated by the projected General Fund monthly cash flow schedule prepared by the City Comptroller's Office (see Attachment 1). The cash flow projections are based on the Fiscal Year 2009 Proposed General Fund Budget and items included in the Mayor's May Budget Revision.

The \$147 million not-to-exceed amount recommended for authorization by the City Council is higher than the expected borrowing amount of \$140 million to provide additional authorization capacity in the event the need for additional borrowing is identified between the date of this report and the date the borrowing is executed (July 1, 2008). For example, the cash flow schedule could be impacted if there are changes related to City Council budget deliberations, and/or changes resulting from the Fourth Quarter Adjustment. This not-to-exceed amount is well below the legal limit set by Section 92 of the City Charter. Section 92 specifies that the aggregate amount of the TRAN borrowing issued in any fiscal year should not exceed 25% of the City's total budgeted appropriations for such fiscal year. Based on the Fiscal Year 2009 Proposed Budget, the maximum amount of TRANs that may be issued is approximately \$297 million.

Similar to the Fiscal Years 2007 and 2008 TRANs borrowings, and to adhere to the City Council's policy of borrowing on a fixed rate basis, the City would draw the entire loan upfront. As has been the case for the last two fiscal years, the up front borrowing would allow the City to make its entire ARC on July 1, 2008.

In past years, it has been economically advantageous to repay the TRANs at maturity, and to set aside funds for repayment and invest them in taxable securities, as permitted under IRS regulations. In these years, the City's Investments Division had projected that, based on market conditions existing at the time the prior year TRANs were issued, the expected investment rate on the set-aside funds would be greater than the borrowing rate on the TRANs, thereby allowing the City to earn positive net investment earnings. This year, however, based on current interest rate conditions, it appears unlikely that the City could earn positive net investment earnings on the set-aside amounts. Therefore, the more cost effective approach would be to repay the note as soon as funds (i.e., property tax receipts) become available. In order to facilitate this, funds will be borrowed on July 1 in three note portions in the following amounts and with the following maturity dates:

<u>Note Portion</u>	<u>% of Total Borrowing</u>	<u>Maturity Date</u>
\$35,000,000	25%	December 31, 2008
\$44,800,000	32%	January 31, 2009
<u>\$60,200,000</u>	<u>43%</u>	April 30, 2009
\$140,000,000	100%	

These maturity dates coincide with the timing of the receipt of property tax revenues.

Each of the three note portions will be borrowed on July 1, 2008 at a fixed rate. The NPA specifies that the City's rate of borrowing would equate to 62.347% of the 6, 7, and 10 month LIBOR<sup>1</sup> rates for the 6, 7, and 10 month note portions, respectively, plus 70 basis points (0.70%). BofA's borrowing terms, as provided in the NPA, permit an adjustment to the interest rate spread if the City's underlying credit rating receives an upgrade during the term of the FY 2009 TRAN. Specifically, while the note is outstanding, and after the City's FY 2007 audited CAFR has been provided to BofA, if the City's General Obligation Bond rating improves compared to the existing levels, the spread over the 62.347% of the LIBOR rates (as established on the date the FY 2009 TRAN is initially priced) would drop from 70 basis points to 60 or 55 basis points (0.60% or 0.55%), depending on the magnitude of the rating improvement. The adjusted interest rate would be effective from the day after the ratings action is announced through the remaining term of the FY 2009 TRAN. As of May 15, 2008, the City's General Obligation Bond ratings from Moody's, Fitch and Standard and Poor's are: "A3", "BBB+" and "A", respectively.

The effective, or weighted average interest rate on the borrowing is estimated to be 2.512%, based on interest rates as of May 16, 2008 (see table below). The interest rate for the FY 2009 TRAN will be fixed at the time of the pricing, which is anticipated to occur during the last week of June, 2008. Due to the fact that TRAN borrowings typically occur in June, as of the date of this report, there is no publicly priced TRANs data available for comparison purposes; however, should any data become available by the time the financing is presented to the City Council, staff will include such information in its presentation.

<u>Maturity Date</u>	<u>Projected Interest Rate*</u>	<u>Note Portion/ Principal</u>	<u>Interest</u>	<u>Total</u>
12/31/2008	2.474%	35,000,000	442,571	35,442,571
1/31/2009	2.492%	44,800,000	666,748	45,466,748
4/30/2009	2.549%	<u>60,200,000</u>	<u>1,295,798</u>	<u>61,495,798</u>
Total		\$140,000,000	\$2,405,117	\$142,405,117
Effective interest rate	2.512%			

\* Rates as of May 16, 2008

The maximum interest rate established in the financing resolution is 5.00%. It is not currently expected that the actual pricing will result in a rate of 5.00%; however, should that occur, the projected interest cost is estimated to be approximately \$4.8 million.

### **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 March 10, 2008, to solicit proposals from financial institutions to execute a direct purchase of the FY 2009 TRAN. The City received two responses, and BofA was selected for submitting the lowest bid and offering the most flexible structuring options.

<sup>1</sup> LIBOR Index is the London Interbank Offered Rate Index



Pursuant to Council Policy 900-09, BofA has submitted Community Reinvestment Activities (“CRA”) of its community banking operations in the San Diego region. Specific information related to CRA provided by BofA and the 2006 San Diego Reinvestment Task Force information is included in Attachment 2.

Public Resources Advisory Group, Inc. (“PRAG”) was identified to provide financial advisory services in support of the FY 2009 TRAN from an as-needed list of financial advisory firms generated by an RFP process. PRAG’s fee for this issuance will not exceed \$30,000 plus \$2,500 for reasonable out of pocket expenses. The City Attorney’s Office has identified Stradling Yocca Carlson and Rauth (“Stradling”) to serve as bond counsel for a fixed fee totaling \$40,000, including out of pocket expenses.

### **Financing Documents**

The Financing Resolution and documents that would be approved through the requested actions are described below:

- A. Financing Resolution** – The Financing Resolution authorizes the issuance of the FY 2009 TRAN, the approval of the Financing Documents (as described below), and any other actions of the Mayor and his designees that may be necessary to execute the FY 2009 TRAN.
- B. The Financing Documents** – The financing documents include the Accompanying Document to the Financing Resolution and the NPA.
  - 1. Accompanying Document to the Resolution – The Accompanying Document to the Resolution presents all the supporting documents for the Fiscal Year 2009 TRAN financing, including the Cash Flow Deficit Report. It also includes information regarding the amount and term of the FY 2009 TRAN Note, the use of note proceeds, and the nature of the security for the note. In addition, it sets forth the transfer restrictions pertaining to the note.
  - 2. Note Purchase Agreement (NPA) – The NPA is an agreement between the City and BofA, pursuant to which BofA agrees to purchase the FY 2009 TRAN 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.

### **Transaction Time Line**

May 16, 2008	City's Disclosure Practices Working Group performed disclosure assessment
June 9/10, 2008	City Council approval of financing documents via Resolution
Week of June 23, 2008	Pricing of the FY 2009 TRAN (interest rate setting and signing of the NPA)
July 1, 2008	FY 2009 TRAN closing and receipt of note proceeds

### **III. FISCAL CONSIDERATIONS**

Based on the Fiscal Year 2009 Projected Cash Flow Deficit Report, the City expects to draw \$140 million on July 1, 2008 from the BofA loan facility. Based on the estimated effective rate of borrowing of 2.512%, the gross interest payments on the FY 2009 TRAN are estimated to be approximately \$2.4 million. Property Tax receipts would be used to pay down the principal on the respective maturity dates of the three note portions.

The fees related to consultants for this transaction, totaling \$110,000 will be paid from the Tax Anticipation Notes Revolving Fund (Fund No. 65013). These fees include (i) bond counsel fees totaling \$40,000, including expenses; (ii) financial advisory services in an amount not to exceed \$32,500, including expenses; and (iii) BofA counsel fees totaling \$37,500. Other costs of issuance include a \$200 reporting fee payable to the California Debt and Investment Advisory Commission (CDIAC).

### **IV. ALTERNATIVES**

Do not approve the requested actions necessary to issue the FY 2009 TRAN. This is not recommended because the FY 2009 TRAN is necessary to fund the seasonal cash flow deficit of the City's General Fund in Fiscal Year 2009.

### **V. PREVIOUS COUNCIL and/or COMMITTEE ACTION**

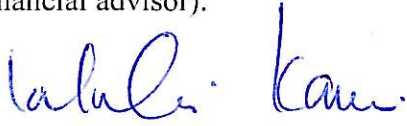
The City has annually issued TRANs to fund the General Fund seasonal cash flow deficit.

### **VI. COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS**

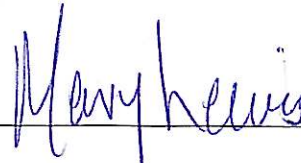
None.

**VII. KEY STAKEHOLDERS AND PROJECTED IMPACTS**

Business entities involved in this transaction include Bank of America, N.A., a subsidiary of Bank of America Corporation (Purchaser/Lender); White & Case, LLP (BofA's counsel); Stradling Yocca Carlson & Rauth (bond counsel); and Public Resources Advisory Group, Inc. (financial advisor).



Lakshmi Kommi  
Debt Management Director



Mary Lewis  
Chief Financial Officer

- Attachment(s):
1. Fiscal Year 2009 Projected Monthly General Fund Cash Flow Schedule
  2. BofA's Community Reinvestment Activities Report