

THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: June 14, 2011 REPORT NO: 11-081
ATTENTION: Council President and City Council
SUBJECT: Fiscal Year 2012 Tax and Revenue Anticipation Notes

REQUESTED ACTION(S):

Authorize the execution of the City's Fiscal Year 2012 Tax and Revenue Anticipation Notes ("FY 2012 TRAns") borrowing in an amount not to exceed \$175.0 million and the related financing documents to fund the projected seasonal cash flow deficit of the City's General Fund in Fiscal Year 2012. The related financing documents are a Note Purchase Agreement between the City and Wells Fargo Bank, N.A., and an Accompanying Document to the Financing Resolution.

Authorize the City Attorney to execute an agreement with Orrick, Herrington & Sutcliffe, LLP to provide Bond Counsel services in connection with the issuance of the FY 2012 TRAns in a fixed amount totaling \$20,000. In addition, authorize the payment of other costs of issuance estimated to total \$37,650 as set forth in the Note Purchase Agreement.

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 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 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 approved 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 General Fund monies of the issuer attributable to the upcoming fiscal year. The issuer is not authorized to levy or collect any additional taxes for the repayment of the TRAns.

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 pay the pension Annual Required Contribution (“ARC”) at the beginning of the fiscal year. Payment of the pension ARC at the beginning of Fiscal Year 2012 compared with paying throughout the year will save the General Fund approximately \$6.6 million on a gross basis and approximately \$5.8 million on a net basis (i.e., net of the estimated interest cost of the FY 2012 TRANs). The amount of the TRANs borrowing is based on the General Fund projected cash flow deficit in the fiscal year; pursuant to Internal Revenue Service (“IRS”) regulations, the General Fund deficit should generally be at least 90% of the size of the borrowing.

II. DISCUSSION

Taking into account the time-line for the availability of the City’s audited Comprehensive Annual Financial Report (“CAFR”) for Fiscal Year 2010, a private offering of the FY 2012 TRANs emerged as the most viable funding vehicle to support the City’s Fiscal Year 2012 cash flow needs. As structured, the private offering does not require an Offering Statement for the TRANs from the City. Wells Fargo Bank, N.A. (“Wells Fargo”) is an institutional investor and will directly purchase the FY 2012 TRANs and hold the notes on the balance sheet of the bank or its affiliates. The notes will not be publicly offered to general investors. Wells Fargo has conducted its credit due diligence based on the available financial information that was provided for this financing. The Disclosure Practices Working Group reviewed the borrowing and an appropriate DPWG certification will be provided to the City Council prior to the City Council hearing.

TRANs Size and Pricing

Based on the City’s projected Fiscal Year 2012 General Fund cash flow needs, it is currently expected the FY 2012 TRANs will be sized at \$172.0 million and issued on July 1, 2011. The borrowing amount is derived by calculating the maximum deficit that would occur in Fiscal Year 2012 without the issuance of the notes, based on the projected General Fund monthly cash flow schedule prepared by the City Comptroller (see Attachment 1). The cash flow projections are based on the Fiscal Year 2012 General Fund Budget approved by the City Council on June 6, 2011.

The \$175.0 million not-to-exceed amount recommended for authorization by the City Council is higher than the expected borrowing amount of \$172.0 million to provide additional authorization capacity in the event the need for a larger issuance becomes necessary between the date the information in this report was prepared for docketing and the date the borrowing is executed (July 1, 2011). For example, the projected cash flow schedule could change due to state budget actions. The not-to-exceed amount is well below the legal limit set by Section 92 of the City Charter (City Charter Section 92 specifies that the aggregate amount of the TRANs issued in any fiscal year should not exceed 25% of the City’s total budgeted appropriations for such fiscal year).

Similar to last year, the FY 2012 TRANs is structured so that the notes are repaid as property tax receipts become available. Therefore, the notes will be issued in three note portions, each with its own maturity date. The maturity dates for the three note portions, as listed below, were determined based on the timing of the receipt of property tax revenues and by analyzing the coverage ratios for each note portion (i.e., the amount of revenues available in the month the applicable note portion matures divided by the amount of principal and interest due on that maturity date), to ensure the coverage level for each note portion is adequate.

<u>Note Portion (est.)</u>	<u>% of Total Borrowing</u>	<u>Maturity Date</u>
\$ 54,600,000	32%	January 31, 2012
\$ 47,000,000	27%	April 30, 2012
<u>\$ 70,400,000</u>	41%	May 31, 2012
\$172,000,000		

Each of the three note portions will be borrowed on July 1, 2011 at a fixed rate. The Note Purchase Agreement between the City and Wells Fargo specifies that the City's rates of borrowing will equate to 70.0% of the 7, 10, and 11 month LIBOR¹ rates for the 7, 10, and 11 month note portions, respectively, plus 19 basis points for the 7 month note portion and 18 basis points for each of the 10 and 11 month note portions. The effective or weighted interest rate is estimated to be 0.61%, based on the interest rate index level as of June 10, 2011.

(ESTIMATE)

<u>Maturity Date</u>	<u>Estimated Interest Rate*</u>	<u>Note Portion/ Principal</u>	<u>Interest</u>	<u>Total</u>
1/31/2012	0.51%	54,600,000	164,361	54,764,361
4/30/2012	0.61%	47,000,000	241,467	47,241,467
5/31/2012	0.65%	<u>70,400,000</u>	<u>422,874</u>	<u>70,822,874</u>
Total		\$172,000,000	\$828,702	\$172,828,702
Effective interest rate	0.61%			

* Rates as of June 10, 2011

Based on the FY 2012 TRANs market to date, the rates for publicly issued TRANs similar to the City's have ranged between 0.24% - 0.38%, depending on the date of sale, note maturity date, and name of the issuer. As shown above, the base rate for the City's private offering is estimated to be 0.61%.

The City's FY 2012 TRANs realized certain savings in costs of issuance due to the private nature of the note issue. A public offering entails additional costs for preparing offering statements, credit ratings, and underwriter's takedown to sell the notes to investors. For example, the costs of issuance for the City's publicly issued FY 2011 TRANs totaled approximately \$315,000, while the costs of issuance for the proposed private offering are estimated to total approximately \$86,000, or 73% lower than the FY 2011 TRANs costs of issuance. When taking into account these significantly lower costs of issuance for the private offering, the net interest rate

¹ LIBOR Index is the London Interbank Offered Rate Index, and is used for short term borrowing.

differential between publicly issued TRANs and the private offering is estimated to range between 0.09% and 0.18% (9 – 18 basis points).

Financing Team

The City's Financing Team for the FY 2012 TRANs includes the Chief Financial Officer, Debt Management, the Comptroller's Office, the City Treasurer's Office, Financial Management, the City Attorney's Office, and outside consultants, including Public Resources Advisory Group ("PRAG") as independent Financial Advisor, and Orrick, Herrington, & Sutcliffe, LLP as Bond Counsel. PRAG was selected from an as-needed list of financial advisory firms generated by a request for proposals process based on the firm's experience on note offerings and the fee estimate. The City Attorney's Office identified Orrick, Herrington, & Sutcliffe, LLP through a request for proposals process.

In May 2011, a request for proposals was issued to solicit proposals from firms qualified to serve as direct lender/purchaser for the FY 2012 TRANs. The City received six proposals, and Wells Fargo was selected for submitting the lowest bid, and meeting the City's requirements to issue the notes as a direct purchase offering. Wells Fargo has submitted information on the bank's Community Reinvestment Activities which is included in the docket material.

Financing Documents

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

- A. Financing Resolution** – The Financing Resolution authorizes the issuance of the FY 2012 TRANs, 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 2012 TRANs.
- B. The Financing Documents** – The financing documents include the Accompanying Document to the Financing Resolution, and the Note Purchase Agreement.
 - 1. Accompanying Document to the Resolution – The Accompanying Document to the Resolution provides supporting information relating to the Fiscal Year 2012 TRANs, including the legal authority to issue the notes, the TRANs sizing, and information regarding the amount and term of the FY 2012 TRANs, the use of note proceeds, and the nature of the security for the notes.
 - 2. Note Purchase Agreement (NPA) – The NPA is an agreement between the City and Wells Fargo, pursuant to which Wells Fargo agrees to purchase the FY 2012 TRANs from the City, and the City agrees to deliver the FY 2012 TRANs to Wells Fargo. The agreement details the representations, warranties, and agreements of the City and Wells Fargo in connection with the transaction. Under the NPA, Wells Fargo is 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

2012 TRANs; (2) has been supplied with or been given access to available information that it deems necessary to make an informed investment decision; (3) is purchasing the FY 2012 TRANs 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 2012 TRANs; and (5) understands that the City's audited FY 2010 CAFR is not yet available.

Financing Schedule

The pricing of the FY 2012 TRANs will occur the week of June 27, 2011 with the closing and receipt of proceeds to occur on July 1, 2011.

III. FISCAL CONSIDERATIONS

Borrowing Size and Interest Rate

Based on the Fiscal Year 2012 Projected Cash Flows, it is currently expected that the FY 2012 TRANs will be sized at \$172 million to be issued on July 1, 2011. Interest will be payable on each of the note maturity dates of January 31, 2012, April 30, 2012, and May 31, 2012. The effective, or weighted average interest rate on the borrowing is estimated to be 0.61%, based on interest rates as of June 10, 2011, and the gross interest payable on the notes is expected to total \$828,702 through the final maturity date of the notes (May 31, 2012). The interest due on the TRANs is budgeted in the Tax Anticipation Notes Revolving Fund (the "TRANs Fund"), and the principal portion is provided for in the General Fund.

Debt Management will provide a closing memorandum to the City Council after the pricing of the notes specifying the actual borrowing size and interest rate on the notes.

Costs of Issuance

The costs of issuance estimated to total \$86,150, will be paid from the TRANS Fund. These costs include (i) bond counsel fees totaling \$20,000, including expenses; (ii) financial advisory services in an amount not to exceed \$28,500, including expenses; (iii) lender counsel fees not to exceed \$37,500, and (iv) California Debt and Investment Advisory Commission Reporting fees totaling \$150.

Revenue Pledge

Under the terms of the financing documents, the FY 2012 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 2012. The notes are secured by a pledge of the first revenues received by the City in Fiscal Year 2012, on or after January 1, 2012, April 1, 2012, and May 1, 2012 in an amount equal to the principal and interest payable on the series of notes next due after each such set-aside date. The City is not authorized to levy or collect any tax for the repayment of the notes.

IV. ALTERNATIVES

The FY 2012 TRANs is necessary to fund the projected seasonal cash flow deficit of the City's General Fund in Fiscal Year 2012 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

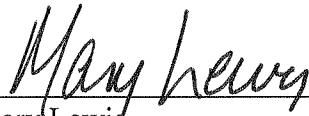
The Tax and Revenue Anticipation Notes Fund is incorporated into each of the City's annual budgets, and is included in the City's budget public review and discussion process.

VII. KEY STAKEHOLDERS AND PROJECTED IMPACTS

Business entities involved in this transaction include Wells Fargo Bank, N.A. (Lender/Purchaser); White & Case, LLP (Lender/Purchaser's Counsel); Orrick, Herrington, & Sutcliffe, LLP (Bond Counsel); and Public Resources Advisory Group (Financial Advisor).



Lakshmi Kommi
Debt Management Director



Mary Lewis
Chief Financial Officer

Attachment(s): 1. Fiscal Year 2012 Projected Monthly General Fund Cash Flow Schedule

