City of Costa Mesa
Library/Community Center/Park Improvement Project
Funding Options
September 2015

Proposed project:

The proposed project has three components. One is that the existing Dungan library would be relocated to the existing Neighborhood Community Center which would be either repurposed and renovated or replaced with a new library building. The Community Center would be relocated to the repurposed and renovated Dungan Library. Park and street front improvements would also be made. Total project cost, including soft costs, could be in the $34,500,000 range for all three components including furnishings, equipment, fees, permits and contingencies.

The City made a budget allocation of a portion (12%) of the funding for this project. The FY 14-15 mid-year budget report allocated $4,000,000 to this project from the FY 13-14 surplus. This plan outlines the options to provide the balance of $30,500,000. Funding options include a pay-as-you go strategy and two types of debt financing with an option to front-load the financing to reduce the annual debt payment.

The City's existing debt:

The City's existing debt is described in detail in the City's Comprehensive Annual Financial Report Note 8 and supporting worksheets. In summary, there are three debit issuances:

1. 2003 Refunding Certificates of Participation issued for the combined refinancing of the balances of the Municipal Center and Victoria Street projects. This debt will be the first to be retired when the final annual payment of $1,240,250 is made in FY 18-19.
2. 2006 Revenue Refunding Bonds issued for refinancing the Plaza Tower Public Improvements. This debt will be retired when the final annual payment of $212,355 is made in FY 21-22.
3. 2007 Certificates of Participation issued for construction and equipping certain Civic Center improvements including the Police Facility. This debt will be retired when the final annual payment of $2,226,870 is made in FY 26-27.

The payment schedules and principle balances are shown on Attachment 1A. A more detailed narrative description of the existing debt is included as Attachment 1B. The City enjoys a very low debt ratio. As of June 30, 2014 the net debt applicable to the debt limit was $1,800,700 compared to the debt limit of $607,508,126 or 3.75% of assessed value. Debt financing of this project would be well within the debt limit. The City has a Standard & Poors credit rating of AA.

Funding the proposed project without debt:

The City could set aside amounts from annual revenues until enough funds are accumulated to for the project. This would require annual City Council approval through the budget process. Funding sources include:

1. The existing $4,000,000 allocated in the FY 14-15 mid-year budget report.

2. Park Development Fees for part of the cost of the park improvements up to $972,000 over two years
3. Gas tax one-time allocation for a portion of the street improvements up to $300,000
4. Annual allocations of the 5% Capital Improvement Project funds ($5,587,335) and the 1.5% of the general fund for Capital Facility Improvements ($1,676,201). This leaves little to no general funds available for other capital projects for four years in the future.
5. Funds currently used for payment of existing debt (2003 Bonds) when that debt is paid ($1,240,250). Funds are available in FY 19-20.

This strategy would accumulate the necessary funding total of $34,500,000 in FY 19-20. (Attachment 1C Part 1)

Debt Financing:

If the project were to be started in FY 16-17, a debt financing option would be required. After applying the $4,000,000 already budgeted and one year of Gas Tax allocation and Park Fees, approximately $29,728,000 in debt financing would be needed. (Attachment 1C Part 2) For rough pricing purposes for each, we have assumed 30 year financing of $29,728,000 at 4.5% interest with an annual payment of $1,807,529. (Attachment 1D)

There are two primary options for funding with debt. These are lease revenue bonds (COPS) or general obligation bonds. These options are discussed below.

1. Issue lease revenue bonds, also known as Certificates of Participation (COP). COP financing sets up a lease-leaseback structure with a third party entity e.g. the City's Public Financing Authority or other entities such as the California Statewide Communities Development Authority (CSCDA) available to League of California Cities members. The city would covenant to annual lease payments that serves to retire the debt. This option requires City Council approval; no voter approval is required. It requires unencumbered leasable assets to secure the debt or an additional cost to capitalize interest during the facility construction period.

2. Issue capital improvement general obligation bonds secured by a special property tax assessment. This would be a special additional percent of assessed value or fixed dollar amount per parcel. An election would be required with a 2/3 voter approval threshold. Advantages of this financing method include possible lower interest rates and a new revenue source with which to repay debt. Disadvantages of this financing include time, expense and uncertainty of an election process and a property tax increase. This financing is typically used for projects with broad community support.

A financing team would need to be assembled in order to properly conduct these financings. The team would consist of the City Finance Department, bond counsel, underwriter, financial adviser, trustee, rating agency and bond insurer. There would be fees associated with each of these that would either be paid directly or through the financing.

A cost recovery reimbursement resolution is recommended if debt financing is considered. This resolution would qualify early project related expenditures to be included in the financing.

The debt financing option could employ a strategy of accumulating funds for a year in order to reduce the amount of debt required. After applying the $4,000,000 already budgeted, one year of Gas Tax allocation and Park Fees, all of the capital facilities 1.5% funds and half of the capital improvement 5% funds, approximately $25,258,131 in debt financing would be needed. (Attachment 1C Part 3) The annual payment would be reduced to $1,535,751.

Debt repayment options:

There are several funding sources the City could use to pay the annual debt service. The calculations for these are presented in Attachment 1E. They include:

1. All of the annual 1.5% Capital Facility general fund budget allocation up to $1,676,201 per year.
2. Part of the annual 5% CIP general fund budget allocation.
3. Funds currently used for existing 2003 COP could be used for this project's payments when that debt is paid off. This would be an annual amount of $1,240,250 available beginning in FY 19-20 that would free up the same amount of the Capital Facility funds for other Capital Facility projects such as Fire Station #1 discussed below.
4. Transient Occupancy Tax (TOT) increase. Currently the TOT is an 8% base rate set by City Ordinance 10-18 (December 2010) plus an additional 3% in the business improvement area (BIA). A 2% increase in the base rate would yield an additional $2,000,000. Voter approval is required for the City to increase TOT.
5. Impose a property tax rate increase (up to an additional 0.0133%) or parcel assessment. An amount of about $77 to $83 per parcel per year would be needed to provide for the annual debt payment. Voter approval is required for the City to make either of these increases.
6. A sales tax increase at the smallest allowable increment of 0.125%. In this City, such an increase would yield over $6,250,000 per year; far in excess of what is required for this project. Voter approval is required for the City to increase sales tax. This option is not recommended for a project this size.

Attachment 1E shows the impact of the lower debt option on these debt repayment options. For example, the property tax increase would be $66 per year per parcel rather than $77.

Other considerations:

The City has other large capital projects in the planning stages. One of these is the design and construction of a new Fire Station #1 estimated to cost $8,500,000. The FY 15-16 budget includes $1,676,201 for this project leaving a financing need of $6,823,799. Inclusion of this project in a potential debt financing would increase the annual payment by $414,902. (Attachment 1D) and require a combination of several of the funding options analyzed above (Attachment 1E). Should the City increase or implement new Fire service fees, they could be directed to help fund the annual debt service. The balance could be paid from the annual 1.5% Capital Facilities budget allocation. Attachment 1E illustrates the impact to the repayment options of adding Fire Station #1 to the debt issuance.

The City is in the process of updating its five-year financial plan. Completion of this plan is recommended before making any final decisions on any of these potential major capital projects and acquisitions.

<u>Recommendations</u>:

1. Accumulate funding over the next fiscal year in order to reduce the annual debt payment to about $1,535,751 to be paid initially from the 1.5% Capital Facilities funds; shifting in FY 19-20 to use the funds freed up by the completion of the 2003 COP.
2. Include Fire Station 1 in the funding plan with and annual payment of $414,902 funded by a combination of new Fire service fees and the balance of the 1.5% Capital Facilities funds.
3. Send this funding plan to the Finance Advisory Committee for review and comment.
4. Complete the five-year financial plan to analyze the impact of other issues not considered in this report that may affect the City's ability to afford this project.
5. Prepare a cost recovery reimbursement resolution in order to qualify early project related expenditures to be eligible for inclusion in the debt financing.

Attachment 1A: Existing Debt Payment Schedule
Attachment 1B: Existing Debt Narrative Description
Attachment 1C: Funding Options
Attachment 1D: Loan Payment Calculation
Attachment 1E: Debt Repayment Options