
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Fiscal Year 2009 Tax and Revenue Anticipation Note

OVERVIEW

The City Council is being asked to approve a resolution authorizing the issuance of the Fiscal Year 2009 Tax and Revenue Anticipation Note (FY 2009 TRAN) in an amount not to exceed \$147 million. Additionally, the resolution would authorize funding for related financial advisory services, bond counsel services and lender issuance fees. The IBA has reviewed the proposed FY 2009 TRAN borrowing with City staff and bond counsel.

FISCAL/POLICY DISCUSSION

As noted in the staff report #08-083, TRANs address temporary cash flow shortfalls arising from 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 City traditionally issues TRANs at the beginning of a fiscal year in order to avoid cash deficits prior to the receipt of significant property tax revenues from the County in December and April of each year. The amount of a TRAN borrowing should closely match the maximum projected deficit for the fiscal year so as to minimize borrowing costs and adhere to IRS guidelines for sizing a TRAN issuance.

Based on calculations from the Office of the City Comptroller, the maximum deficit projected for the General Fund in FY 2009 is approximately \$136.3 million. Although additional financing capacity has been built into the requested \$147 million authorization, staff currently anticipates borrowing \$140 million. A \$140 million borrowing is just over the maximum projected deficit of \$136 million in FY 2009 and sized to avoid a negative cash balance prior to the City's first major property tax allocation of the fiscal year.

Cash Flow Considerations

Attachment 1 to the staff report shows month ending balances for the General Fund when the \$140 million TRAN borrowing has been included with the projected cash flows for FY 2009. The footnote (#1) for the beginning cash balance indicates that this cash balance is partly comprised of “other policy funds” including the General Fund Emergency Reserve Fund that is proposed to be established by Item #150 on the June 9th City Council agenda. Utilizing the proposed FY 2009 TRAN, the net ending balance line of the cash flow spreadsheet indicates that the lowest General Fund cash balances are projected for the months of October (+\$12.7M) and November (+\$7.1M).

In reviewing the spreadsheet, the IBA questioned whether the relatively low cash balances in the months of October and November would necessitate utilization of the new General Fund Emergency Reserve Fund. Comptroller staff informed the IBA that the Emergency Reserve will not be utilized.

In relation to the above question of the Comptroller, the IBA notes that temporary cash shortfalls can be addressed by inter-fund loans as provided by City Charter Section 93, which states, in part:

“The City Council may from time to time authorize the advance of moneys in the treasury as a temporary loan to any tax-supported fund, which loan shall be repaid from the first property taxes received thereafter; provided, however, that such temporary loans shall not exceed the current property taxes receivable.”

Section 5 of the Appropriation Ordinance includes the necessary authorization of the City Council to permit the Comptroller to make inter-fund loans to cover cash needs, as allowed by the Charter.

Another observation related to the cash flow spreadsheet is that the July 2008 beginning balance is shown at \$142.8 million, while the ending balance in June 2009 falls to \$133.6 million. Comptroller staff has indicated that the beginning balance includes prior year encumbrances which are then expended throughout the year, and the reduction to the balance reflects the use of these previously encumbered funds, and not a reduction to reserves.

Pricing and Cost of Borrowing

The FY 2009 TRAN will be privately placed with Bank of America, N.A. (BoFA) as three separate note portions (for terms of 6, 7 and 10 months) that will be priced at fixed rates equal to 62.347% of the London Interbank Offered Rate Index (LIBOR) rates for 6,

7 and 10 month periods plus 70 basis points (.70%). In order to hasten repayment and minimize interest expense, the FY 2009 TRAN has been structured in three term note portions that coincide with the receipt of major property tax distributions in order to facilitate immediate repayment. In the past, the City has been able to borrow at tax-exempt rates and advantageously reinvest set-aside repayment funds at taxable rates. Based on anticipated market conditions, the City's Investment Division does not expect this to be possible in FY 2009 and the transaction has been accordingly structured to aggressively repay the notes rather than opting to repay the notes at fiscal year end.

If the City can issue its FY 2007 audited financial statements and receive credit rating upgrades from the three major ratings agencies (Moody's, Fitch and Standard and Poor's) to levels specified in the Note Purchase Agreement prior to the maturity of the term note portions, the above referenced 70 basis point interest spread would be reduced by 10 to 15 basis points (.10% to .15%). In the event that an interest rate reduction is not achieved, it is currently estimated that the weighted average interest rate for the three fixed pricing terms that comprise the borrowing will yield an effective interest rate of approximately 2.56%. Total interest expense for the FY 2009 TRAN is estimated to be approximately \$2.45 million.

CONCLUSION

The IBA recommends approval of the actions related to the FY 2009 TRAN. The City has historically issued TRANs to address temporary cash shortfalls due to fluctuations in tax receipts. Based on the Comptroller's estimated cash flows, staff is proposing to borrow \$140 million on a short-term basis. The City's bond counsel (Stradling Yocca Carlson & Rauth) has informed the IBA that they support the approach used to size the FY 2009 TRAN and the validity of the proposed transaction.

The Office of the City Attorney has indicated that they will issue a due diligence and disclosure obligation memorandum this week related to the FY 2009 TRAN. This memorandum typically describes the bond financing documents and provides useful questions and answers for the City Council to consider. A certification by the Disclosure Practices Working Group should also be attached to the memorandum indicating that financial information disclosed in the FY 2009 TRAN has been reviewed to ensure accuracy.

The IBA has been informed that representatives of the entire financing team will be present for the City Council meeting on June 9, 2008. The IBA encourages the City Council to ask any questions they might have directly to members of the City's financing team including the City's financial advisor, bond counsel and even BofA as the purchaser of the FY 2009 TRAN. The availability of financing consultants to the City Council at or before City Council meetings where approval is sought for debt is a recommendation

within the comprehensive financial training program adopted by the City Council on December 6, 2006.

[SIGNED]

Jeff Kavar
Fiscal & Policy Analyst

[SIGNED]

APPROVED: Andrea Tevlin
Independent Budget Analyst