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CITY OF SACRAMENTO

OFFICE OF THE TREASURER

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THOMAS P. FRIERY
TREASURER

DONALD E. SPERLING
ASST. TREASURER

August 26, 1985

Budget and Finance Committee
Sacramento, California

Honorable Members in Session:

SUBJECT: Recommended Reserve for Issuance of Tax Allocation (TA) Bonds by SHRA

SUMMARY

The attached report discusses the recommendation for establishment of a risk reserve fund and maximizing issuance size of Tax Allocation (TA) bonds by SHRA.

RECOMMENDATION

That the Budget and Finance Committee forward to Council the attached report for approval.

Respectfully submitted,

Thomas P. Friery

THOMAS P. FRIERY
City Treasurer

RECOMMENDATION APPROVED:

Solon Wisham, Jr.

Solon Wisham, Jr.
Assistant City Manager

September 17, 1985

Attachment

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THOMAS P. FRIERY
TREASURER
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ASST. TREASURER

CITY MANAGER'S OFFICE
RECEIVED
SEP 9 1985

August 26, 1985

Sacramento City Council
Sacramento, California

SUBJECT: Recommended Reserve for Issuance of Tax Allocation (TA) Bonds by SHRA

SUMMARY

On April 29, 1985, City Council approved a staff report to proceed with the permanent financing plan for the Sacramento Light Rail Project. Section IX of that report dealt with the City of Sacramento subordinating their repayment from SHRA (associated with the light rail financing) to permit SHRA to maximize their borrowing capacity on future TA bond issues.

However, in order to mitigate the risks associated with this arrangement (subordination), a written recommendation to the City Council from the City Manager, City Treasurer and City Attorney was required. The purpose of the required recommendation was to establish a prudent reserve to minimize the risk of the City being unable to recover debt service payments for the light rail financing from the Agency.

Further, Sections 3.01 and 3.02 of the Repayment Agreement between the City and SHRA requires the City Council to approve the issue of any bonds or other form of long-term indebtedness prior to the SHRA incurring such obligations. The SHRA will soon seek approval to issue TA bonds for projects of the Agency.

We recommend City Council authorize the Agency to maximize their TA borrowing capacity in their first TA bond issue. However, we further recommend that the SHRA establish an acceptable degree of risk reserve of $500,000.00 prior to maximizing their borrowing capacity in order to mitigate financial risks to the City for the light rail project under the repayment agreement.

BACKGROUND

Under statutory authority, TA bond issues require a debt service coverage of 1.25 x (times). Effectively, the debt service coverage limits the amount of tax increment stream (TI) that a Redevelopment Agency may issue TA bonds against.

The intent of the excess debt service coverage (.25 x) is to provide bondholders with a prudent surplus of TI revenues from the Redevelopment Agency in the event such revenues are not collected as estimated. Types of events that may impact TI revenues are failure of Redevelopment Agency property owners to pay taxes timely, declines in the market value of Redevelopment properties, catastrophes in a redevelopment area or changes in Redevelopment law.

It should be considered that at the conclusion of each year that excess debt service coverage is not needed, such excess may be spent by the Redevelopment Agency for legal purposes. Therefore, the intent of the debt service coverage is to produce an annual cushion of revenues to meet debt service obligations to bondholders which, if met, permits the Agency to spend such reserves on a cash basis as opposed to incurring term indebtedness obligations.

Further, it must be considered that it is not possible to establish in advance the absolute amount of TA bonds that may be issued by a Redevelopment Agency. Market conditions at time of sale dictate the amount of monies that actually may be raised from a TA revenue stream. Therefore, the debt service coverage or prudent reserve is a more efficient safeguard to minimize the risk of overborrowing by a Redevelopment Agency as opposed to defining a bond issue size.

FINANCIAL

Project Areas 2A, 3, 4 and 8 of the SHRA currently generate approximately $6.5 million in annual TI revenue stream. Under current Redevelopment law as it pertains to debt service coverage of 1.25 x (times) (see Background section) the Agency would be required to establish $1,300,000 as an annual reserve, or amount for which bonds could not be issued. Stating this another way, the Agency could only incur annual debt service payments of $5,200,000.00 ($6.5 million - $1.3 million) had the repayment contract associated with the light rail project not been incurred. However, at the time the repayment contract was developed, the City Treasurer had recommended that as a result of the subordination agreement on the Light Rail COP issue that the Redevelopment Agency establish a reserve at 1/2 (one-half) of the required reserve or $650,000.00 ($1.3 million ÷ 2).

In assessing this debt service coverage or reserve at this time, the City Treasurer has concluded that $500,000 would be an acceptable degree of risk reserve that would mitigate the risks to the City under the subordination clause in the repayment agreement associated with the light rail project and still maximize the borrowing capacity of SHRA greater than would have been had not the light rail financing project been implemented. The difference between what would have been the required reserve ($650,000) and what has been defined as an acceptable degree of risk reserve ($500,000) is $150,000. By not requiring this $150.000.00 be maintained in debt service coverage will permit at this time the SHRA to borrow approximately 10 x (times) more this amount in their first bond issue (approximately $1,500,000.00) than they would have been able to had the light rail project and subordination clause not been enacted.

It should be considered that at this time for every one dollar ($1.00) in reserve less than $500,000.00 recommended that the SHRA could borrow approximately ten dollars ($10.00) more in their TA bond issue. However, it should be considered that rating agency analysts who evaluate the credit risk of the City will view less favorably the City's credit worthiness since the margin of safety to the City may be perceived as too small. It is our judgment from discussions with the City's Financial Advisor that a reserve of $500,000.00 would not cause the rating agencies to downgrade the City's credit rating.

Further, it is brought to Council's attention that the recommended acceptable degree of risk reserve could be established from the TI revenue stream of the Agency. However, to require such reserve be established from the TI revenue stream would reduce the SHRA bonding capacity approximately $5,000,000.00.

Therefore, it is our further recommendation to establish such reserve first from other potential sources of revenue to SHRA as opposed to their TI stream. To accomplish this it will be necessary for City Council to approve:

1) Paying the interest income from the Reserve Fund of the light rail financing with the Trustee to SHRA starting December 1, 1987 as opposed to depositing such monies in the City LRT/RACS account.

   When the light rail financing was structured, staff was successful in having the interest income earnings from the maximum annual debt service fund to be deposited in the Construction Fund for the light rail project during the construction period if not needed for other authorized purposes. This arrangement resulted in a smaller light rail financing issue size.

   Further, at the completion of construction (starting December 1, 1987) this interest income was to flow to the City of Sacramento LRT/RACS account as was approved by City Council.

   Presently, the gross income from this maximum annual debt service reserve fund is estimated at approximately $300,000 annually. However, expenses to the Trustee, etc. are estimated to approximate $50,000 annually leaving only approximately $250,000 to be deposited in the LRT/RACS account. Should City Council direct these revenues instead be paid to SHRA as opposed to the LRT/RACS account after construction, then they can be used to offset the reserve required for the TA bond issue. Further, this will also reduce the LRT/RACS account an equal amount, approximately $250,000 annually starting December 1, 1987.

2) SHRA staff directing the financial advisor to structure the proposed TA bond issue(s) in a manner that permits the interest income earned on the maximum annual debt service reserve fund(s) to be paid back to SHRA.

SHRA staff will soon be recommending TA bond issues for Project Areas 4 and 8. In order to market these bonds it will be necessary to establish a maximum annual debt service reserve fund for each issue to pay bondholders for one year in the event of unforeseen financial problems. Current indications are that such reserve funds may total $2,187,500.00 and at 8% would earn $175,000 annually in income which would be maintained in the Debt Service Fund. However, by directing this income flow back to the Agency as opposed to remaining in the Debt Service Fund, then these revenues could be used by SHRA to meet the acceptable degree of risk reserve.

3) SHRA not bonding approximately $75,000 of TI revenue stream in Project Area 4 or Project Area 8 to bring the acceptable degree of risk reserve to $500,000.00.

The interest income earnings to SHRA should Council approve points 1 and 2 above are described as follows:

ACCEPTABLE DEGREE
OF RISK RESERVE

A)	Interest Income from LRT Reserve Account	$ 250,000
A)	Interest Income from TA Reserve Accounts	175,000
A)	Total actual SHRA revenue that could be approved by City Council	425,000
	Bonding Capacity in Project Area 4 or 8 Not Used	75,000
	Total Acceptable Degree of Risk Reserve	$ 500,000

RECOMMENDATIONS

It is recommended that the City Council:

-- Require that SHRA establish an acceptable degree of risk reserve fund of $500,000 prior to issuing TA bonds. Such reserve shall be funded as follows: (see next page)

A) At the present time, the actual interest earnings are not known. However, it is envisioned that in total $425,000 in combined interest earnings is conservative.

-- $250,000 annually from the Maximum Annual Debt Service Reserve Fund income for the COP light rail financing starting December 1, 1987, and

-- $175,000 annually from the Maximum Annual Debt Service Reserve Fund(s) associated with the TA bond issue(s), and

-- $75,000 of TI revenue stream from Project Area 4 or 8 not be bonded, and

-- Authorize SHRA to maximize their TA bonding issue after establishing the acceptable degree of risk reserve fund.

Respectfully submitted,

THOMAS P. FRIERY
City Treasurer

RECOMMENDATION APPROVED:

WALTER J. SLIPE, City Manager

September 17, 1985
All Districts

TPF/lv:shrati