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City of SACRAMENTO

City Council Report

915 I Street, 1st Floor

www.CityofSacramento.org

Title: Financing Plan for Remodeling the Community Center Theater

Location: District 4

Issue: The City Council requested a financing plan for the approximately $50 million needed for improvements and other enhancements to the Community Center Theater. This report is a summary of analysis and findings as presented by the City Treasurer.

Recommendation: Receive and file.

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Presenter: Russell Fehr, Treasurer, (916) 808-5382, Office of the City Treasurer

Department: City Treasurer

Division: City Treasurer

Dept ID: 05001011

Attachments:

1-Description/Analysis

City Attorney Review

Approved as to Form
Joseph Cerullo
10/3/2013 1:27:45 PM

City Treasurer Review

Reviewed for Impact on Cash and Debt
John Colville
9/23/2013 12:31:44 PM

Approvals/Acknowledgements

Department Director or Designee: Russell Fehr - 9/30/2013 2:37:14 PM

Description/Analysis

Issue Detail:

Summary

The City Council has requested a report on how proposed improvements to the Community Center Theater may be financed. The improvements could be financed by a combination of equity contributions and debt. The debt would be lease-revenue bonds or certificates of participation backed by the General Fund, with the General Fund being reimbursed on an unsecured and subordinate basis by the hotel tax (i.e., the Transient Occupancy Tax, or "**TOT"**). The General Fund would need to back the debt because of the fiscal status of the Community Center Fund (where the TOT currently accrues) and because the City also plans to use TOT revenue in financing the Entertainment and Sports Center ("**ESC**"). Given the deep reduction in TOT revenue during the recession and weak recovery, any debt for the theater should be issued no sooner than fiscal year 2014/15, when TOT revenue presumably will be more stable and thus more likely to be available for reimbursing the General Fund.

The Project

In 2000, the City initiated planning-and-design work for renovation of the Community Center Theater, which has not had a major renovation since opening in 1974. The project is currently estimated at $50 million. The project costs include essential elements for the remediation of disability access throughout the facility; the replacement of essential mechanical and theatrical systems of a 40-year old building; and enhancement elements to improve the experience of those attending events at the theater.

Financing Plan/Debt Issue

The City Council requested a financing plan for the Community Center Theater improvements. The improvements could be funded with a combination of long-term debt and equity contributions.

The major equity contribution to date is the $8.5 million allocated from the closeout of assessment districts. Additionally, $3.5 million has been collected and deposited in the Community Center Theater Renovation Project (project M17100100) from the facility fee assessed on all tickets sold for theater events beginning in 2009. City staff and project advocates are also seeking additional private contributions to the project.

The only realistic long-term debt option, given the fiscal status of the Community Center Fund, the recent volatility of TOT revenue, and the proposed use of TOT revenue as a credit enhancement in the ESC financing plan, is the issuance of lease-revenue bonds or certificates of participation backed by annual appropriations from the General Fund. The General Fund would be reimbursed on an unsecured and subordinate basis for the debt-service payments. This financing structure is similar to most of the City's outstanding debt other than the revenue bonds issued earlier this year for water and wastewater projects. Typically it involves two leases: first, the City leases property to a financing authority (which issues the bonds) in return for a lump-sum payment (from the bond proceeds); and second, the financing authority subleases the property back to the City in return for periodic rental payments which are pledged to pay debt service on the bonds.

For this debt issue, the Community Center Theater and the land upon which it is located would be the assets leased and would provide security for investors. The debt would be approximately $45 million; would fund approximately $40 million in project costs, a debt-service reserve, and costs of issuance; and would be rated investment grade, likely in the range of A to BBB+. At current rates, the annual debt service would be approximately $3.0 million. The debt would be serviced by a combination of ticket surcharge revenue (up to $0.8 million) and a General Fund appropriation.

<u>The General Fund as the Credit</u>

The General Fund, and not the Community Center Fund, would need to be the credit for this financing. The reasons are twofold: (1) the current fiscal status of the Community Center Fund, and (2) the proposed use of TOT revenue in the ESC financing plan.

At the broad overview level, the ESC financing plan calls for debt to be issued for much of the City share of project costs, with parking revenues to be used for debt service and TOT revenue to be used for credit enhancement, debt service coverage, and security. This structuring approach avoids use of General Fund financing sources for these purposes. For the credit enhancement to have real value, TOT revenue cannot be pledged for any programs or projects beyond its current obligations.

The TOT revenue makes up of two-thirds of all of the Community Center Fund's forecasted revenues in the current budget. In the current year, the Community Center Fund has the capacity (1) to support its current operations and its current external debt obligations, (2) to make minimal contributions to facility maintenance and internal loan repayments, and (3) to improve feasibility to pay annual debt-service payments for this project. The fund lacks current capacity, however, for funding a debt-service reserve and providing debt-service coverage as well as a fund-level reserve. TOT revenue is more volatile than other tax revenues, as its recent performance indicates. There was a 20% reduction in TOT revenue from fiscal year 2007/08 to fiscal year 2009/10. TOT revenue levels are not projected to rebound to the pre-recession level (i.e., fiscal year 2006/07) until the end of the current fiscal year or next fiscal year, which is six or seven years after the decline.

With the Community Center Fund not able to be the direct credit for the debt, the General Fund would have to be responsible for the annual debt-service payments and would be reimbursed for those payments by the transfer of TOT revenue from the Community Center Fund on an unsecured and subordinate basis to the extent TOT revenue is available each year. The transfer would only be made after the requirements of other outstanding debt, including debt issued for the ESC financing and the Convention Center, were met. TOT revenue would not be pledged for debt service or security in the Community Center Theater financing. The sole credit for the financing would be the General Fund, with the theater and its land serving as the asset and security for the repayment of the debt.

Community and Market Perspective

From the perspective of the performing arts community, the project is high priority; certain improvements to remediate disability access are necessary to keep the theater in operation, and, in addition, the project is necessary to sustain the operations of long-standing performing arts groups.

The market perspective on the financing, however, will be entirely different. There are few, if any, strengths associated with this proposed financing that will make it attractive to investors or rating agencies; indeed, there are many credit concerns:

- The credit will be the General Fund, which is still recovering from the recession and faces known future challenges of absorbing increasing employee-benefit costs and restoring service levels.
- The debt structure will likely be lease-revenue bonds or certificates of participation with debt-service payments dependent on annual appropriation. Since the theater financing will likely use a lease-revenue structure, there will be no direct pledge of Community Center Fund revenues.
- Credit rating agencies have already expressed concern over the combined level of the City's General Fund resources currently devoted to debt and long-term employee benefit obligations.
- The proposed debt-financed project is considered to be non-essential infrastructure of a city in California.
- Economic recovery in the Sacramento Region lags behind that in the coastal regions of the state.

The result will be credit ratings several steps lower than those for the recent utility-revenue bonds, though likely investment grade. The interest rates will be higher than on the utility-revenue bonds because of negative factors due to market changes and the less-attractive credit of the financing. Although the City will likely succeed in issuing the debt, there will be a higher overall cost of borrowing to be paid because of the nature of the debt and the project. We estimate debt service will be approximately $3.0 million per year absent a significant overall market increase in interest rates.

Annual TOT Revenue Funding Opportunity

Although TOT revenue growth cannot be used in the budget for new debt or programs because of its use in the ESC financing plan, there will still be an annual opportunity for the City Council to allocate any unobligated TOT revenue. At the end of each fiscal year, any TOT revenue not used for current operations, current debt, ESC security, and General Fund theater reimbursements will be available for one-time allocation to any lawful purpose.

The 2022 Opportunity

There will be an additional significant TOT revenue funding opportunity in fiscal year 2021/22 when debt issued for Convention Center improvements is redeemed and those annual debt-service payments are no longer included in the budget. The annual debt-service obligation of the Community Center Fund will decrease by approximately $1.5 million beginning in fiscal year 2020/21 and by approximately $6.7 million more beginning in fiscal year 2021/22, for an aggregate annual decrease of $8.2 million from the annual debt-service obligation through fiscal year 2019/20.

This represents a funding opportunity for Convention Center improvements, further Community Center Theater improvements, or other projects.

Timing of the Community Center Theater Debt Issue

Reimbursement to the General Fund of theater debt service will depend on continuing growth of TOT revenue beyond current levels. A full year of debt service at current rates is approximately $3.0 million; whether this amount will be available at the end of each fiscal year depends on the growth and stability of TOT revenue. For basic cash-flow reasons, and to mitigate any risk to the General Fund and provide some margin of comfort in the Community Center Fund, the debt for the theater financing should not be issued sooner than fiscal year 2014/15.

In addition to allowing time for TOT revenue to grow, delaying the debt issuance until at least fiscal year 2014/15 would allow additional time to raise equity contributions and reduce the size of the debt needed.

Conclusion

This report identifies how the proposed improvements to the Community Center Theater may be financed and identifies fiscal and temporal constraints associated with the financing approach. Before debt could be issued in fiscal year 2014/15 or beyond, the following steps will have to be taken:

- Approval of construction documents, which would help provide an accurate estimate of costs.
- Appropriation of $8.5 million from the assessment district closeouts to the capital improvement project.
- Incorporation of the TOT revenue study results, when completed, into both the ESC and the theater financing plans.

Policy Considerations: Not Applicable.

Environmental Considerations:

California Environmental Quality Act ("CEQA"): This report concerns action that does not constitute "approval" of a "project," as those terms are defined by

CEQA, because it does not commit the City to a definite course of action in regard to financing the improvements to the Community Center Theater (Cal. Code Regs., title 14, §§ 15352, 15378, subd. (b)(2), (4) & (5)).

Economic Impact: Not Applicable.

Sustainability: Not Applicable.

Commission/Committee Action: None.

Rationale for Recommendation: The recommendation is to receive and file as a report to Council on options and does not require Council action.

Financial Considerations: Not Applicable.

Emerging Small Business Development (ESBD): Not Applicable.