

# OPTIONS FOR FINANCING THE CIVIC CENTER



## A Workshop for the City of Rancho Palos Verdes



# OUTLINE OF PRESENTATION

1. Process steps
2. Financing options for the civic center
3. Overview of borrowing process
4. Overview of procurement processes & common models
5. Application to the City's situation, capabilities & needs
6. Estimated debt and debt service burdens for several scenarios
7. "Next steps"

## Supplemental material:

- Three "public/private partnership" examples
- A view of interest rates
- Diagram of a financing lease structure
- Example of a decision-making model for a P3



# FOR FINANCING, THIS IS ONLY THE FIRST STEP OF A PROCESS

**Tonight's presentation describes a process . . . .**

**. . . . not an event.**

There is much additional data required to enable the City and the Council to make informed financial decisions. This session emphasizes process more than it describes conclusions and assumes there will be ample opportunity for future engagement and dialogue.



# OPTIONS AVAILABLE – IN GENERAL

PAYGO

Debt  
financing

Hybrids &  
P3s

Capital  
Contribution

Attributes

- No interest cost
- Often impractical for large projects

- Interest cost is major consideration
- Easy to implement
- Typical approach

- Harder to implement
- Legally and financially complex

- No interest cost
- Benefit nexus usually present

Typical uses

- Smaller projects
- Short-lived assets

- Large, durable assets
- Long economic life

- Toll roads
- Utilities
- Parking

- Streets
- Water/wastewater
- Storm drains

Two most common types:  
“general obligation bonds” &  
financing leases  
(discussed next)



# COMPARISON OF TWO MOST COMMON TYPES

ATTRIBUTE	GENERAL OBLIGATION BONDS	LEASE-REVENUE BONDS
1. Approval process	2/3rds vote of the electorate	Majority vote of City Council
2. Pledged security	Unlimited <i>ad valorem</i> taxation on property (not, “full faith and credit”)	<u>Annual</u> appropriations of rental payments, plus available reserve funds
3. Interest rate	Usually lower than any other due to security; presently about 4.75%	Can be as much as 0.75% to 1.0% <u>above</u> GO bond rate; presently about 5.50%
4. Underwriting process	Competitive sale is required	Competitive or negotiated
5. Reserve funds	No; not permitted	Yes; always required; assume lesser of 10% of bonds or one year’s debt service
6. Casualty insurance	No	Yes; also rental interruption insurance and title insurance
7. Eligible projects	Minor differences for general law cities and charter cities, but must be “real property and improvements”	<u>Any</u> property that the public agency has the legal authority to lease. As a practical matter, usually only land and depreciable property
8. Repayment terms	Typically level total payment (principal and interest) over 30 years (40 years is maximum)	Typically level total payment (principal and interest) over 25 – 30 years, depending on the useful life of the asset

# THE NATURE OF GOVERNMENTAL FINANCE

When state and local governments borrow money the interest is exempt from Federal (and usually state) income taxes.

But, like many things where the IRS is involved, there are rules . . . .

To qualify for tax exemption, the bonds must be “governmental bonds” not “private activity bonds.”

*Private activity bonds are those where:*

More than 10% of the proceeds are used in any “private business use;” *AND,*

More than 10% of the debt service comes from private payments or a security interest in private property;

OR

More than 5% of the proceeds or \$5.0 million (the lesser of the two) is loaned to a private borrower.

This is a critical consideration for “public-private partnerships” (discussed later)

*Examples of potential private uses or activities:*

- 1. A public agency sells a building financed with tax-exempt bonds to a corporation and then leases it back from the corporation;*
- 2. Tax –exempt bonds are used to finance a cafeteria or restaurant managed under a long-term contract by Joe’s Catering in the city’s facility that shares net profits; or*
- 3. A semi-professional baseball team uses a stadium financed by tax-exempt bonds for at least 182 daily games.*

# THE VALUE OF THE TAX-EXEMPTION

Representative rates	5 yrs	10 yrs	20 yrs	30 yrs
“AA” corporate bonds	2.80	4.30	5.65	*
“AA” municipal bonds	2.00	3.50	4.35	4.85

As term increases, the value of the tax exemption becomes more meaningful. For a twenty year maturity, the governmental agency will be borrowing at rates more than 1.25% LESS than those paid by a “AA” corporation. That translates to almost \$100,000 per year in total debt service on a \$10.0 million borrowing, as an example.

*“AA” governments borrow often for 30 years; “AA” corporations do it much less frequently in that maturity*

*•(9 to 14 yrs is typical)*

# TYPICAL TIMELINE FOR PUBLIC BOND SALE



Six to twelve months is typical for this portion, once the decision is made to proceed.

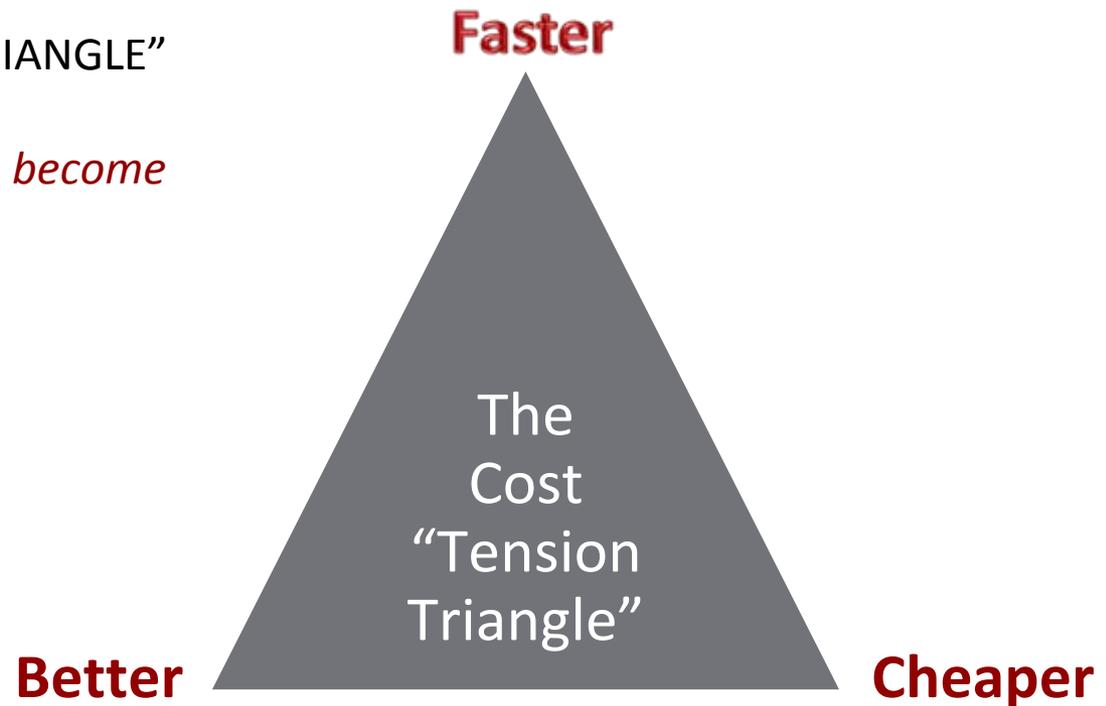


# THE COST TENSION TRIANGLE – BALANCING THE IMPERATIVES

START WITH THE COST “TENSION TRIANGLE”

*Premise: Speed, quality and cost can become mutually exclusive factors.*

Engineers often use this graphic tool to demonstrate the complexity of balancing cost, speed and quality of a particular project.



The value of the cost “tension triangle” is to remind us of the complexity present in any project that must balance the three factors.

# MANY PROCUREMENT ALTERNATIVES – HYBRIDS & P3S

What is a “public-private partnership” and how could it help the City?

They are NOT “privatizations” . . .

British divestiture of coal, oil, steel and electricity business of the 1980s. (replacement theory)

Office of Management and Budget Circular A-76: *There is no government ownership and control. (definition)*

Do not need to be combined in any particular fashion in a P3

They ARE “partnerships” . . .

California Legislative Analyst: “. . . *the involvement of the private sector in providing goods and services that otherwise might be directly provided by governments.*”

These responsibilities might include:

- ✓ design
- ✓ development
- ✓ construction
- ✓ operation
- ✓ ownership
- ✓ financing
- ✓ maintenance

# COMMON P3 OR HYBRID MODELS

More like a "procurement"

More like a "P3"

Contracted services for  
specific needs

Construction Management

Integrated Project Delivery  
(many forms)

Design-Build (DB)

Design-Build-Operate  
(DBO)

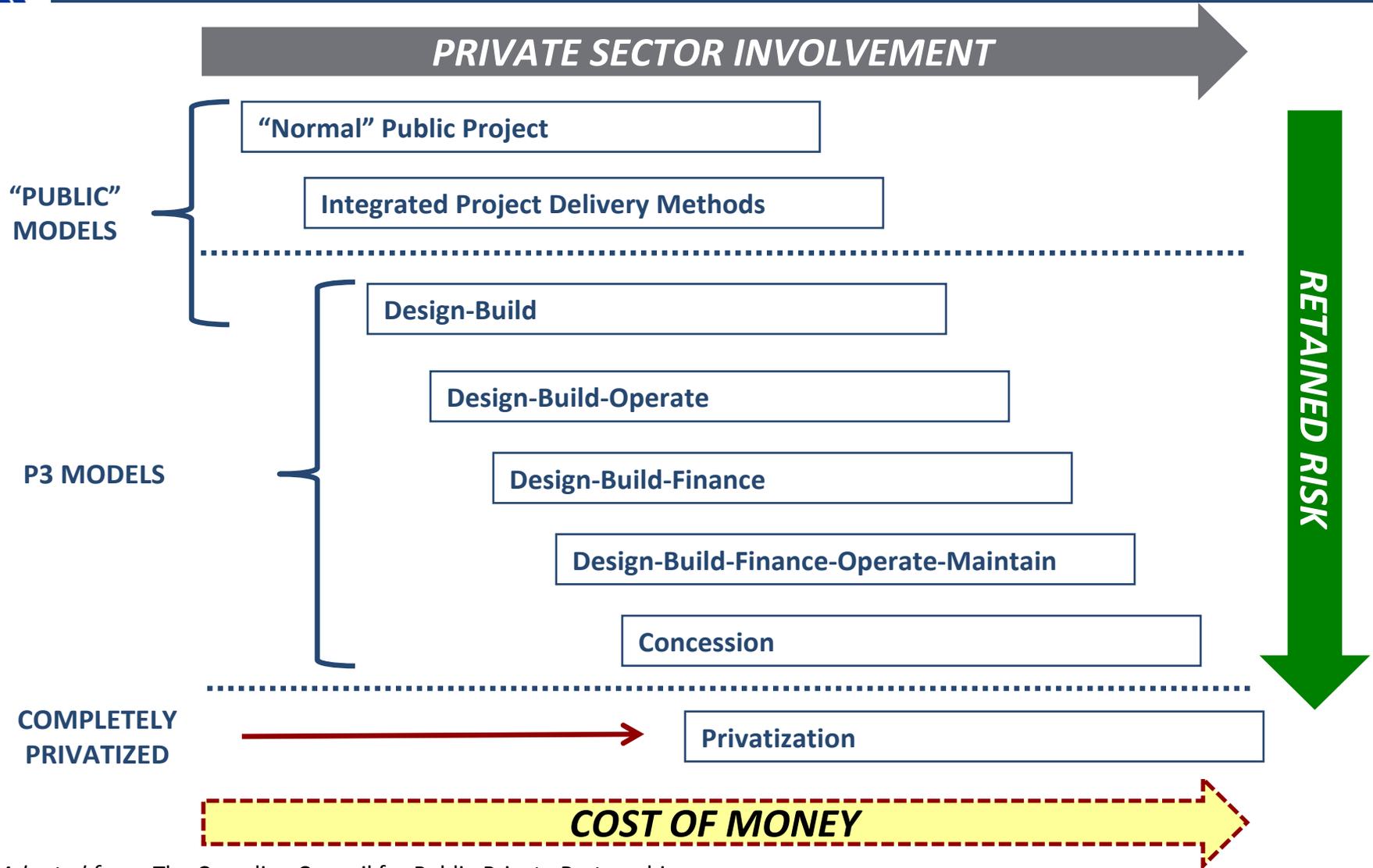
Design-Build-Finance (DBF)

Design-Build-Finance-  
Operate-Maintain  
(DBFOM)

Concession model

"Normal"  
limits for  
general  
law cities

# VISUALIZING RISK TRANSFER THEORY & SCALE IN A P3



Adapted from: The Canadian Council for Public-Private Partnerships

# WHEN IS A P3 OR HYBRID THE “RIGHT” CHOICE?

If used as a procurement strategy, when the desired outcome is:

- ✓ Reduced cost
- ✓ Avoidance of certain construction risks
- ✓ Streamlined process
- ✓ Staff augmentation

Used as an operating strategy, when the desired outcome is:

- ✓ Outsourcing services
- ✓ Transfer technology or obsolescence risk
- ✓ Off-balance sheet financing



# APPLICATION TO THE CITY'S SITUATION

## Hypothesis:

The City's need is for a "real estate" asset

P3s require a reliable, steady revenue source to obtain financing

The City's lease payments would constitute a reliable, steady revenue source

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## Areas for additional inquiry:

- The City's need isn't for an "enterprise" asset (water treatment, parking, sewer, toll road, etc.); is a P3 viable?
- P3s are private entities – they do not have access to tax-exempt financing
- Occupancy costs would be paid for a long period of time – long enough to enable the City to furnish its own financing



# PUBLIC PROJECT VS. HYBRID OR P3 APPROACH?

## Public approach pros & cons

- ✓ The City's staff is familiar with, and has the skill to execute, public projects
- ✓ The City's combined team has experience with similar projects and requirements
- ✓ Financial planning is straightforward
- ✓ Process is transparent
- ✓ Reliable methodology

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- ✓ Takes more time
  - ✓ "Time" can become "money"
  - ✓ Legal process inflexible

## Hybrid approach pros & cons

- ✓ Greater flexibility
- ✓ Offers the possibility of taking less time
- ✓ The City's combined team has experience with similar projects and delivery models

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- ✓ Reductions in construction cost might come at the expense of financing costs
  - ✓ P3s are evolving constantly – appetites may change

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- ✓ Financial planning is more complicated
  - ✓ Process is less transparent

# “WHAT-IF” THE CITY WERE TO . . . .

## DEVELOP THE SITE AS FOLLOWS:

1. Cultural center: 30,000 sq. ft., two levels, stone façade, block back-up, steel frame, 12 foot story height – **guess** of \$350 per sq. ft. (land excluded)
2. Community center: 20,000 sq. ft., two levels, decorative concrete block, 10 foot story height, steel frame – **guess** of \$280 per sq. ft. (land excluded)
3. Village green: 1.7 acres, improvement costs undefined; not yet known – **guess** \$3.0 million
4. City hall replacement: 36,000 sq. ft., two levels, stone façade, block back-up, steel frame, 12 foot story height – **guess** of \$375 per sq. ft. (land excluded)

Private funding

\$5.6 million

\$3.0 million

\$13.5 million

\$22.1 million

***Note: site preparation, engineering and certain design costs are not included in overall estimates.***

*Sources: Deloitte Commercial Square Foot Building Costs, 2010 edition; RSMMeans –Reed Construction Data, 2010 Market Insights*

# RESULTS OF THE “WHAT-IF”

Cheapest (usually)

Most Expensive (usually)

See important assumptions on page 17.

	GO Bonds	Financing Lease	P3s		
			DB	DBF	DBFOM
Development costs:	\$22,100,000	\$22,100,000	\$22,100,000	\$22,100,000	\$22,100,000
Carry costs:	1,077,375*	1,270,750	1,768,000	1,768,000	1,768,000
Amount to be financed:	23,177,375	23,070,750	23,868,000	23,868,000	23,868,000
Term (years):	30	30	30	20	20
Borrowing Rate:	4.875%	5.75%	5.75%	7.00%	7.00%
Reserve fund:	no	yes	yes	no	no

Total Debt Amount:	\$23,650,000	\$25,705,000	\$26,305,000	\$24,355,000	\$24,355,000
Annual Debt Service (net):	\$1,516,650	\$1,781,225	\$1,872,820	\$2,298,950	\$2,298,950

\*Carry costs for general obligation bonds are for illustration only; interest may not be capitalized on this borrowing.

\$782,000 spread

# KEY ASSUMPTIONS

	<i>General Obligation Bonds</i>	<i>Financing Lease</i>	<i>"DB"</i>	<i>"DBF"</i>	<i>"DBFOM"</i>
<b>Debt Service Structure</b>	all scenarios use level amortization over their term				
<b>Funded Interest</b>	adds "carry cost" from pg 16 to produce "required proceeds" below				
<b>Interest rate</b> <i>(close of business 6/28/10)</i>	Delphis "96"	Delphis "92"+	Delphis "92"+	20 yr BBB (Reuters)	20 yr BBB (Reuters)
<b>Earnings Rate</b>	n/a	2.0%	2.0%	n/a	n/a
<b>Required Proceeds</b>	\$23,177,375	\$23,370,750	\$23,868,000	\$23,868,000	\$23,868,000
<b>Costs of issuance</b> <i>(limited to 2% of par value)</i>	\$473,008	\$514,047	\$526,103	\$487,102	\$487,102
<b>Amount of Reserve Fund</b> <i>(&lt; of 10% of par or debt service)</i>	\$0	\$1,817,575	\$1,911,040	\$0	\$0
<b>Par amount of bonds issued</b>	\$23,650,383	\$25,702,373	\$26,305,143	\$24,355,102	\$24,355,102
<b>Annual DSRF Earnings</b> <i>(credited to debt service)</i>	\$0	\$36,352	\$38,221	\$0	\$0



## NEXT STEPS?

- a) Refine where the City wishes to “land” on the cost tension triangle
- b) Guidance on the desire for greater private involvement, especially:
  - Charter or “home rule” issue
  - Particular benefit desired from a P3 or hybrid
- c) Clarify uses for the facilities that might create financing challenges
  - Private uses
  - Uneven revenue streams to service debt/lease obligation
  - Dependence on fundraising activities
  - Restrictions on land use imposed by deed restrictions
- d) Measure the economic/useful life of the proposed facilities and match to debt service and/or depreciation
- e) Establish level of control desired over the financing terms and conditions
- f) Assess City’s ability/willingness to absorb resulting debt service
- g) Consider competing needs for funding and reconcile

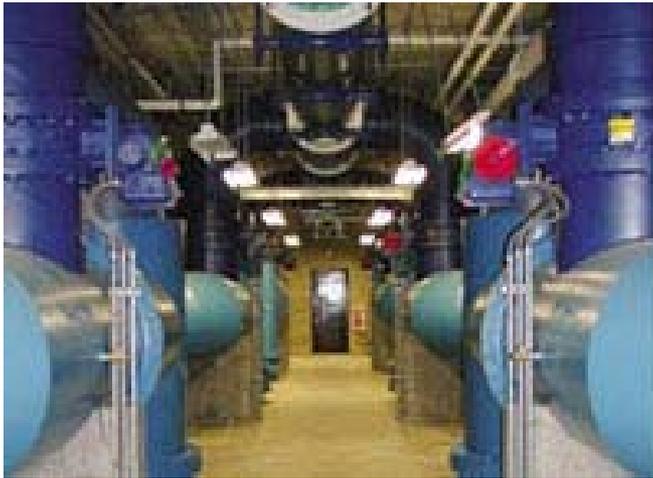


## Supplemental material:

- three “public/private partnership” examples
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# EXAMPLE: DESIGN-BUILD-OPERATE – CITY OF SEATTLE



Partner: Azurix/CDM with  
Dillingham Construction

P3 for DBO Filtration Plant  
(design, build, operate)

Seattle got:

- \$200 million new, state-of-the-art facility
- Costs savings of \$50 million (estimated)
- Reduction in start-up and testing risk
- Largest water treatment facility ever attempted in a P3

Partner got:

- Better control of the project enabling greater efficiency in pricing
- Reduction of its “profit at risk”
- Valuable experience in developing the P3
- More efficient mobilization of workforce



# EXAMPLE: DESIGN-BUILD-TRANSFER – CITY OF DALLAS



Partner: The Kroger Company

P3 for replacement library in  
barter for shared parking facilities  
(design, build, maintain)

Dallas got:

- 12,900 sq. ft. branch library to replace existing, outmoded facility
- Shared parking
- No out-of-pocket costs

Kroger got:

- More efficient use of its land
- Increased traffic from library's location
- Less costly store renovation

# EXAMPLE: DESIGN-BUILD-FINANCE-OPERATE – CALTRANS



Partner: California Private Transportation Company (CPTC)  
(a joint venture between Kiewit, Granite Construction, and Cofiroute USA)

(design, build, finance operate toll lanes on SR 91 to relieve congestion)

## CalTRANS got:

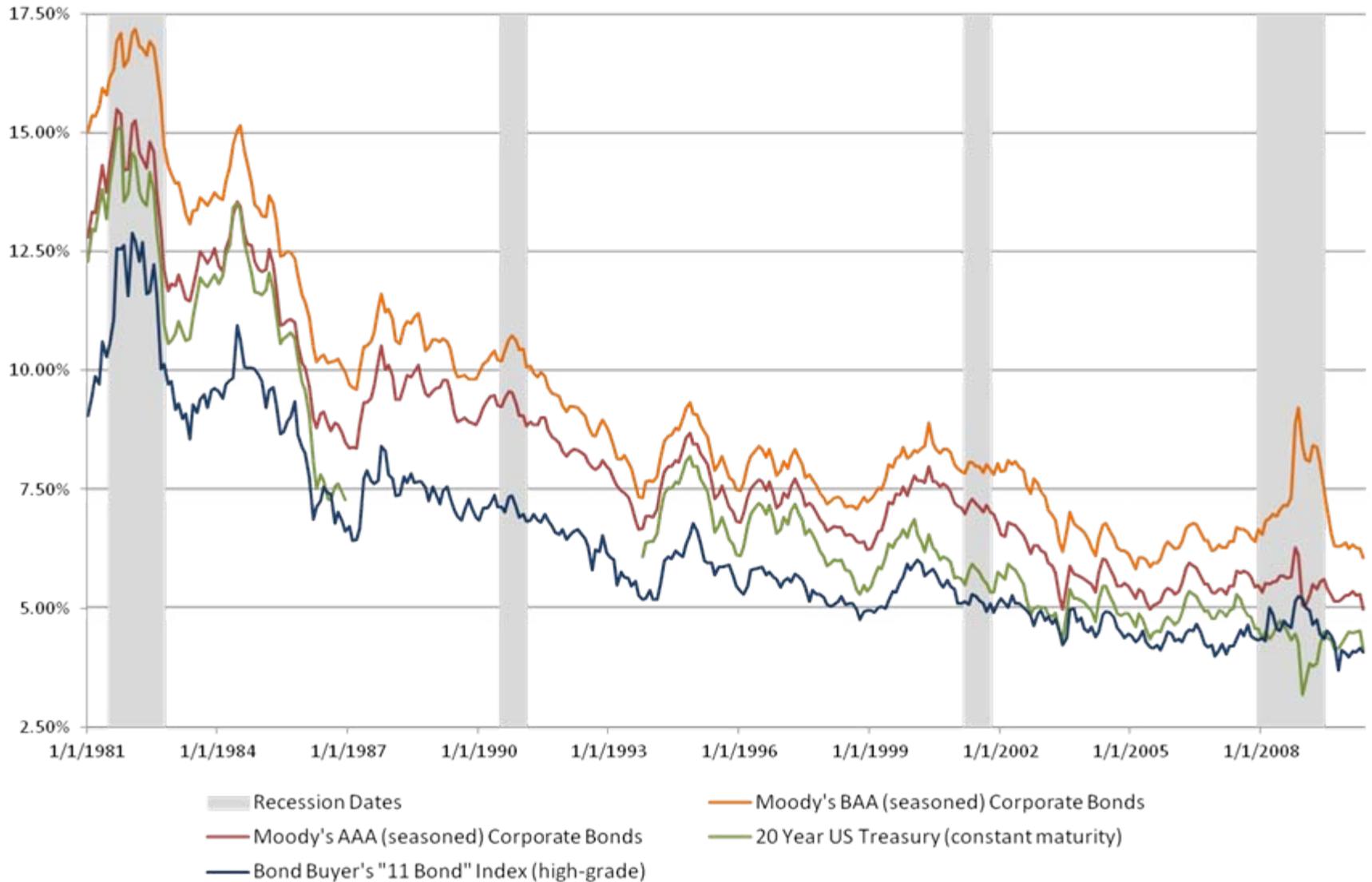
- The first privately funded toll way developed in the United States since the 1940s
- Expansion of badly-needed freeway capacity in heavily traveled corridor
- Someone else to fund the project

## CPTC got:

- Congestion pricing
- Covenant to not compete
- Valuable experience in developing the P3
- Predictable revenue stream on which it could finance the cost of the project

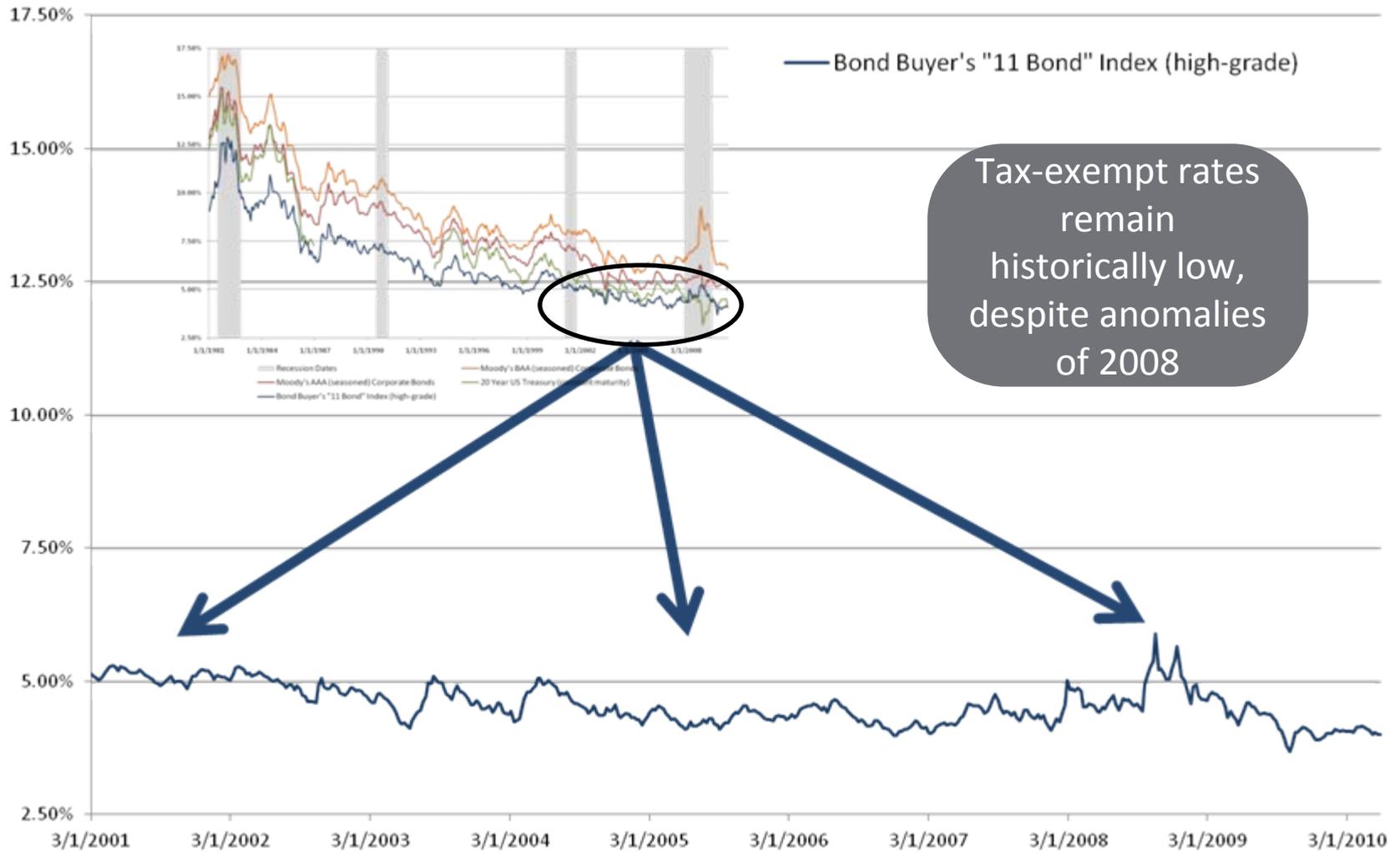


# RATE HISTORY & COMPARISONS OVER TIME – 1981 TO 2010

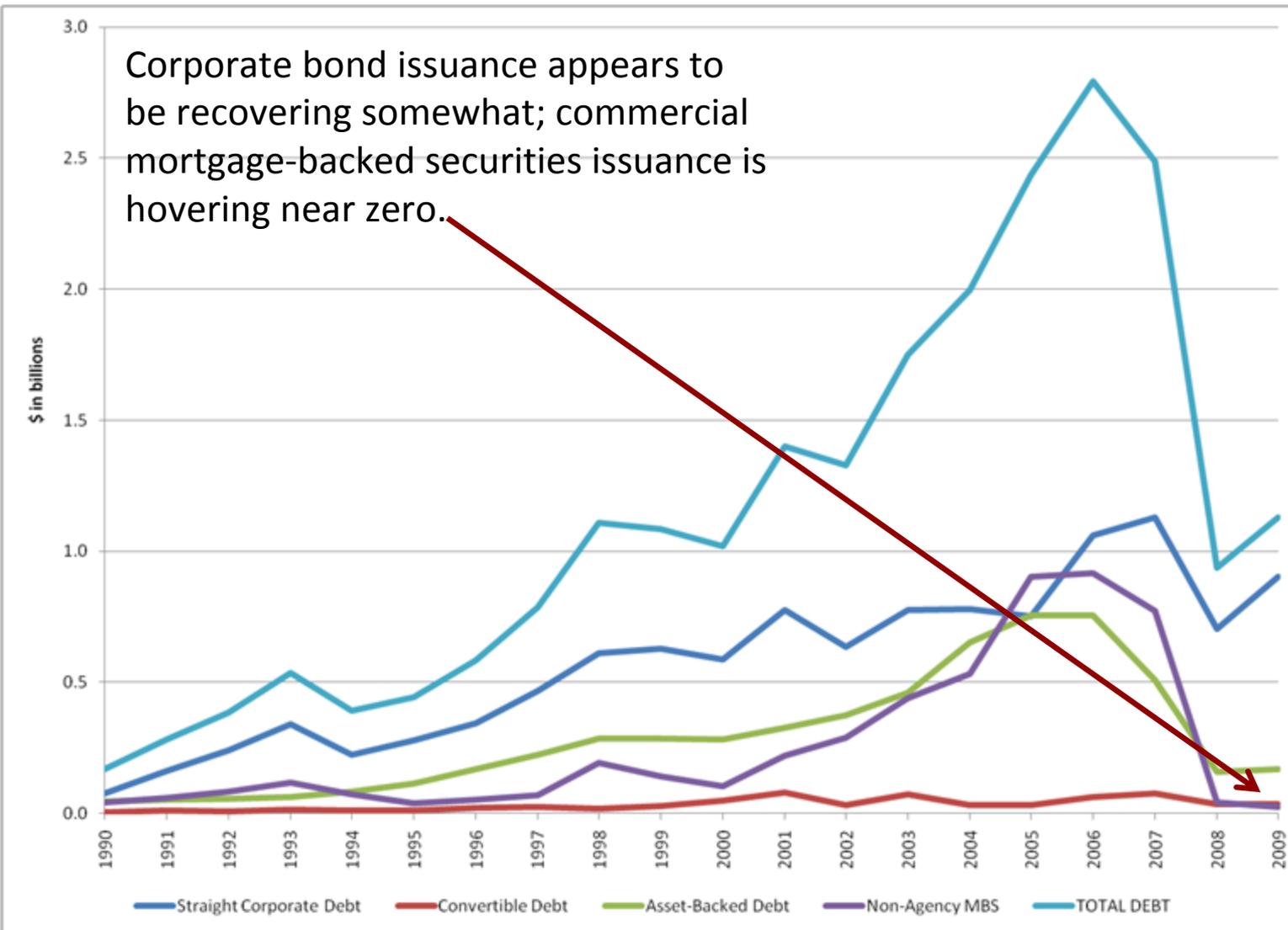




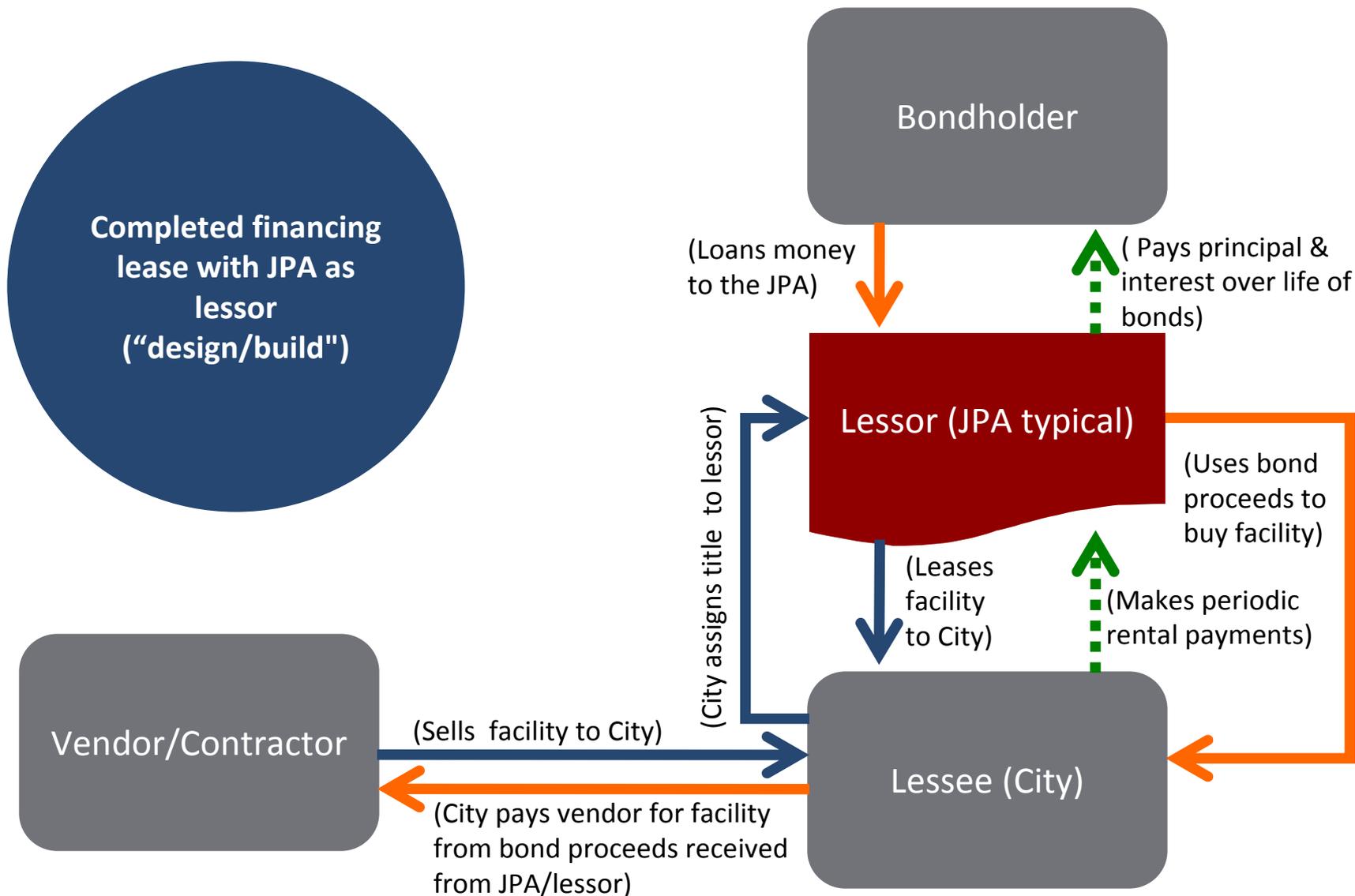
# MUNICIPAL RATES IN CONTEXT: 2001 – PRESENT



# CORPORATE BOND ISSUANCE REMAINS WEAK



# HOW A FINANCING LEASE WORKS



# EXAMPLE OF DECISION-MAKING MODEL FOR A P3

Early

The Steps to Forming Highly Functioning P3s

Late

PREPARATION	VISIONING	MEASUREMENT	COLLABORATION	NEGOTIATION
<b>GOAL:</b>	<b>GOAL:</b>	<b>GOAL:</b>	<b>GOAL:</b>	<b>GOAL:</b>
Balanced and objective information	Define ideal end result and key drivers	Analyze the right data with the right tools	Build trust and understanding of other party's constraints	Win-win
<b>OUTCOME DESIRED:</b>	<b>OUTCOME DESIRED:</b>	<b>OUTCOME DESIRED:</b>	<b>OUTCOME DESIRED:</b>	<b>OUTCOME DESIRED:</b>
Keep each other fully informed	Provide feedback to all parties on how participation will affect final decision	Work together to ensure that economics are directly and objectively reflected in the analysis	Depend on each other for direct advice and innovation in formulating solutions and incorporate each other's advice	Implement what's been decided and remain committed to solve inevitable problems over the life of the arrangement
<b>EXAMPLE:</b>	<b>EXAMPLE:</b>	<b>EXAMPLE:</b>	<b>EXAMPLE:</b>	<b>EXAMPLE:</b>
<ul style="list-style-type: none"> <li>✓ Fact sheets</li> <li>✓ Term sheets</li> <li>✓ FAQs</li> </ul>	<ul style="list-style-type: none"> <li>✓ Public comment</li> <li>✓ Focus groups</li> <li>✓ Vision statements</li> <li>✓ Frequent face-to-face interaction</li> </ul>	<ul style="list-style-type: none"> <li>✓ Feedback loops</li> <li>✓ Verifiable data</li> <li>✓ Agreed-upon procedures</li> </ul>	<ul style="list-style-type: none"> <li>✓ Participatory decision-making</li> <li>✓ Full disclosure</li> <li>✓ Translation of each other's language</li> </ul>	<ul style="list-style-type: none"> <li>✓ Workable agreement</li> <li>✓ Well-defined responsibilities</li> <li>✓ Balancing of risks</li> </ul>



# OUTLOOK FOR BOND RATES

US Treasuries						
	Fed funds	3m Libor	2y	5y	10y	30y
3Q10	0.00-0.25	0.65	1.10	2.50	3.70	4.60
4Q10	0.00-0.25	0.70	1.40	2.80	3.85	4.70
1Q11	0.00-0.25	0.85	1.80	3.10	4.10	4.80
2Q11	0.75	1.30	2.10	3.20	4.10	4.80
3Q11	1.25	1.85	2.30	3.30	4.10	4.80
4Q11	1.75	2.15	2.40	3.30	4.10	4.80

Source: Barclays Capital

# ECONOMIC FORECAST

% Change q/q saar	2009				2010				2011				Calendar year average		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011
Real GDP	-6.4	-0.7	2.2	5.6	3.0	4.5	4.0	3.5	3.0	3.5	3.5	3.5	-2.4	3.6	3.5
Private consumption	0.6	-0.9	2.8	1.6	3.5	3.5	3.0	3.0	2.5	3.0	3.0	3.5	-0.6	2.7	2.9
Public consump and invest.	-2.6	6.7	2.6	-1.3	-1.9	4.0	1.5	1.5	-0.2	-0.7	-1.0	-1.2	1.8	1.0	0.3
Residential investment	-38.2	-23.3	18.9	3.8	-10.7	20.0	30.0	30.0	25.0	20.0	15.0	10.0	-20.5	7.1	22.8
Equip. & software investment	-36.4	-4.9	1.5	19.0	12.7	15.0	15.0	10.0	7.0	8.0	15.0	15.0	-16.6	11.8	10.7
Structures investment	-43.6	-17.3	-18.4	-18.0	-15.3	2.0	4.0	6.0	8.0	8.0	10.0	10.0	-19.8	-10.0	7.1
Net exports (\$ bn, real)	-387	-330	-357	-348	-368	-384	-396	-414	-426	-432	-439	-451	-356	-391	-437
Final sales	-4.1	0.7	1.5	1.7	1.4	4.2	3.7	3.3	2.6	3.0	3.3	3.3	-1.8	2.4	3.3
Ch. inventories (\$ bn, real)	-113.9	-160.2	-139.2	-19.7	33.9	43.6	51.6	56.6	61.6	69.6	75.6	81.6	-108.3	46.4	72.1
GDP price index	1.9	0.0	0.4	0.5	1.0	1.3	1.3	1.2	1.5	1.5	1.8	1.9	1.2	0.9	1.5
Nominal GDP	-4.6	-0.8	2.6	6.1	4.1	5.8	5.4	4.8	4.5	5.0	5.4	5.5	-1.3	4.5	5.0
Industrial output	-19.0	-10.4	6.4	6.9	7.6	8.0	7.0	6.0	6.0	5.5	5.0	5.0	-9.7	6.0	6.0
Employment (avg mthly chg, K)	-753	-477	-261	-90	87	207	140	270	315	335	345	350	-395	176	336
Unemployment rate (%)	8.2	9.3	9.6	10.0	9.7	9.7	9.4	9.1	8.8	8.6	8.3	7.9	9.3	9.5	8.4
CPI inflation (% y/y)	0.0	-1.2	-1.6	1.4	2.4	1.8	1.5	1.3	1.5	1.7	1.7	1.8	-0.4	1.7	1.7
Core CPI (% y/y)	1.7	1.8	1.5	1.7	1.3	0.9	0.9	0.8	1.2	1.3	1.3	1.4	1.7	1.0	1.3
Core PCE price index (% y/y)	1.7	1.6	1.3	1.5	1.4	1.1	1.0	0.9	1.0	1.1	1.2	1.3	1.5	1.1	1.2
Current account (% GDP)	-2.7	-2.4	-2.7	-2.8	-3.0	-3.2	-3.4	-3.7	-3.9	-4.1	-4.3	-4.6	-2.7	-3.3	-4.2
Federal budget bal. (% GDP)													-10.0	-8.5	-7.0
Federal funds rate (%)	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0.75	1.25	1.75			

Note: All numbers expressed in q/q saar % unless otherwise specified. The budget balance is fiscal year. Source: BEA, BLS, Federal Reserve, US Treasury, Barclays Capital