City of Del Mar
Staff Report

TO: Honorable Mayor and City Council Members

FROM: Mark Delin, Assistant City Manager
Via Scott W. Huth, City Manager

DATE: February 1, 2016

SUBJECT: Consideration of Options to Structure the Loan for the City Hall/Town Hall Project

REQUESTED ACTION/RECOMMENDATION:

Review the report and provide direction on the actual loan amount for the IBank financing of the City Hall/Town Hall project and the loan structure as it relates to the selection of the leased asset for the financing.

EXECUTIVE SUMMARY

The City Council is requested to provide direction on the actual loan amount for the IBank financing of the City Hall/Town Hall project, and the loan structure as it relates to the selection of the leased asset for the financing. Based upon direction from the City Council in its November 16, 2015 meeting, staff submitted a loan application to the IBank for the estimated $17.8 million City Hall/Town Hall project cost, and directed staff to seek a recommendation from the Finance Committee on the amount of cash and debt that should be used to finance the project. In its meeting of January 5, 2016 the Finance Committee recommended that the City only borrow $16 million. In addition to City Council consideration of the Finance Committee recommendation on the amount of cash and debt used in the financing, the Council is also requested to affirm the selection of the City Hall/Town Hall as the leased asset for the financing, with the Powerhouse Community Center serving as the leased asset for the estimated two-year construction period as described in the report.

DISCUSSION/ANALYSIS:

Pursuant to City Council direction in its meeting of November 16, 2015, staff submitted a loan application to the IBank for a 30-year loan for the total project budget of $17.845 million plus a 1 percent financing fee for a total request of $18.024 million. Note that this is just an application – the City may reduce the loan amount based on the bids it receives at the time of construction, and by the amount of cash the City wishes to spend

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City Council Action:

on the project. The stated interest cost is 3.24 percent plus a .30 percent fee on the outstanding balance. This rate continues to be highly favorable in today's market. In its direction to staff, the City Council also requested that staff seek a financing recommendation on the loan sizing. The Finance Committee recommended a funding mix of $16 million in loan and $2 million in cash. For reasons explained in this report, staff recommends that the loan sizing be maintained at $18,000,000 and downsized if needed once the construction bids are received, or when construction is complete. By pursuing this strategy, the City will be at liberty at the conclusion of the project to make the decision regarding the amount of cash that it would like to use for the project, instead of being required to use a certain amount of cash due to a lack of bond proceeds. Borrowing more than what is needed, and then downsizing, would cost the City extra interest cost, fees on the loan balance and an additional component of the cost of issuance fee, which cannot be refunded if the loan size is reduced.

Loan Sizing

	100% Loan	Loan + Cash	Net Cost Difference
Project Loan Funding	$ 17,845,443	$ 15,845,443	
Cash	0	$ 2,000,000	
	$ 17,845,443	$ 17,845,443	
Cost of Issuance	$ 178,454	$ 158,454	$ 20,000
Year 1 Interest	583,974	518,526	65,448
Year 2 Interest	572,169	508,044	64,125
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Year 1 Annual Fee	54,072	48,012	6,060
Year 2 Annual Fee	52,979	47,041	5,937
Total Costs, Interest & Fees for Two Years	$ 1,441,648	$ 1,280,078	$ 161,570

As indicated in the table above, the City would incur net increased costs of about $161,570 in the first two years if it borrows the full project amount versus using $2,000,000 of its cash reserves to build the project. It is staff's opinion that financing the project total cost at the outset provides for the greatest flexibility, and offers the City Council the option to downsize the loan amount upon the completion of construction if desired, or to retain a larger cash balance which can be used for future City capital projects. Note that if the City downsizes the loan prior to two years, it would save a portion of the additional interest and fees. The table does not include the interest earnings which would accrue to the City, if it elected to retain the $2,000,000 on its balance sheet instead of spending it on construction. Current City interest earnings rates are about 0.4 percent, but are expected to increase. Note that while the IBank loan is a 30-year term, it can be prepaid in full at 102% of outstanding principal at 10 years, at 101% at 11 years, and 100% at 10 years. Thus far, the City has spent about $1.2 million on the City Hall project – these costs can be reimbursed by loan proceeds.

Leased Asset Considerations

The second issue for which City Council direction is requested relates to the selection of the leased asset for the financing. The IBank loan is structured as a lease financing (similar to what the City used to refinance the Shores Park promissory note). Lease financing is the most common municipal financing structure. Essentially, the City leases an asset to the IBank, and then, the IBank subleases the asset back to the City, and the lease payments that the City makes to the IBank serve as the debt service payments for the loan. The leased asset serves as a security for the loan. In case of default, the IBank would attempt to re-lease the asset in order to attempt to make up the debt service payment from another lessee until the default is cured. The asset itself is not at risk. The asset to be leased must be an essential City asset and must be equal or greater in value to the amount of the loan. The City has only two assets which will meet this criteria: the City Hall/Town Hall project itself, which by default will have the loan value, and the Powerhouse Community Center.

Staff is recommending that the City Hall/Town Hall project be used for the majority of the lease period, as it is logical to match the security for the loan with the project that the loan is being used to finance. However, staff is recommending that the Powerhouse Community Center serve as the leased asset during the period of construction so that the City can save the costs of capitalized interest. Capitalized interest is required by the lending agency because the project cannot be leased until it is constructed. With capitalized interest, the City essentially borrows the interest and fees that would be payable during the course of construction, and adds this amount to the size of the loan. The interest and fees are then paid by the loan proceeds while the project is being constructed. The IBank requires that the capitalized interest period be six months longer than the anticipated construction, so as the construction estimate is 18 months, the City would need to capitalize interest and fees for 24 months. At the larger $18 million loan size, capitalized interest adds almost $1.39 million to the size of the bond, and at the $16 million loan size, it adds $1.23 million to the size of the bond. Of course, the City saves cash by not having to make the loan payments itself during the construction period, but the additional interest and fees add a present value cost of about $159,000 to the larger issue, or $141,000 to the smaller issue. The substitution of the leased assets is common in financings, and is permitted by the IBank loan documents.

Staff is anticipated to return to Council in the near future with a financing resolution. In order to properly finalize the resolution and the documents for the loan, the City Council is requested to provide direction on the amount of the loan, and confirm using the City Hall/Town Hall project for the leased asset, except during construction, when the Powerhouse Community Center would be used.

FISCAL IMPACT

There is no fiscal impact from this report. The City is well equipped to enter into the financing agreements. A review by the Finance Committee has indicated that the anticipated City Hall debt service will utilize less than half of the projected City free cash flow. A sensitivity analysis presented by the Finance Committee in its January 26th meeting has indicated that the City will be able to whether economic downturns and continue to meet its debt obligations. Note that in its most recent bond issue, the City was rated AAA (the highest possible rating) by Standard and Poor's, who also noted the City's good financial management.

Once the project financing details are completed, staff will return to Council with the appropriate resolutions and financing documents, and adjustments to the Fiscal Year 2015-2016 and 2016-2017 budget.

ENVIRONMENTAL IMPACT:

None.

ATTACHMENTS:

None