Meeting Date: **4/22/2014**

City of SACRAMENTO

14

Report Type: Staff/Discussion

City Council Report

915 I Street, 1st Floor
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Report ID: 2014-00288

Title: Overview and Explanation of Entertainment and Sports Center Debt Financing Plan

Location: Citywide

Recommendation: Receive and file.

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Presenter: Russ Fehr, City Treasurer, (916) 808-5832, Office of the City Treasurer

Department: City Treasurer
Division: City Treasurer
Dept ID: 05001011
Attachments:
1-Description/Analysis
2-Overview of ESC Debt Finance Plan

City Attorney Review

Approved as to Form
Joseph Cerullo
4/21/2014 1:45:35 PM

Approvals/Acknowledgements

Department Director or Designee: Russell Fehr - 4/16/2014 2:15:56 PM

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Description/Analysis

Issue Detail: The City's capital contribution to the ESC includes $212.5 million of debt financing through the issuance of lease-revenue bonds. This report provides an overview of the plan and structure for the issuance of these bonds, including a description of the revenue sources to support the debt. This is an overview report and is not intended to go into the details at this time; nor does it include copies of the final financing documents that are currently being completed. The full debt-financing plan will be presented to the City Council for action on May 13, 2014. Financing documents will be posted on the City website for public review on May 1, 2014.

Policy Considerations: The ESC debt-financing plan has been developed in accordance with the direction of the City Council and the preliminary term sheet approved by the City Council on March 26, 2013. The policy purpose for this report is to provide the public with a preview of the financing structure and revenue streams that will support the repayment of the debt.

Economic Impacts: Not applicable at this time.

Environmental Considerations: Review of this report and discussion of the ESC project without formal action is not subject to review under the California Environmental Quality Act (CEQA).

Sustainability: Not applicable to this report.

Commission/Committee Action: Not applicable.

Rationale for Recommendation: The recommendation is to receive and file the report**.**

Financial Considerations: The ESC debt-financing plan involves issuing $212.5 million in debt for the ESC project and additional amounts for debt-service reserves, interest during construction and the costs of issuing the debt. Annual debt-service payments will be made with revenues generated by the City parking system, facility-lease fees, and hotel taxes.

Local Business Enterprise (LBE): There are no LBE considerations at this time.

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Overview of ESC Debt Financing Plan

The City has entered into a public-private partnership with the owners of the Sacramento Kings, Sacramento Basketball Holdings (SBH) and their affiliates, to design, construct, and operate a new state-of-the-art arena, public plaza, practice facility, and team office. This report is intended to assist the Council and the public to understand the general structure of the financing for the Entertainment and Sports Center (ESC), and the potential options to ensure that the ESC can open by October 2016.

General Background

The City and SBH have developed a coordinated financing plan for the $477-million ESC project. This includes an additional $30 million to be invested by SBH for enhancements to the public plaza, practice facility, and team offices. SBH will make a cash contribution of approximately $254 million and the City will make a cash contribution of approximately $223 million. The City's cash contribution to the ESC project consists of the following:

- $212.5 million from the issuance of the lease-revenue bonds that are the focus of this report.
- $5.0 million from downtown economic-development funds (MOPA)
- $5.63 million from the parking-infrastructure fund.

(An overview of additional non-cash contributions, terms, agreements, and planning entitlements can be found in a separate report on this Council agenda.)

Lease-Revenue Bonds

The City will raise $212.5 million of its cash contribution by issuing taxable lease-revenue bonds to be repaid over a 36-year period. The repayment sources include ESC lease payments, parking-system revenues, hotel taxes, and revenues generated by the development of the ESC. Long-term-risk protection is achieved by establishing and maintaining a liquidity reserve in the finance plan. This reserve would hold revenues that would otherwise be devoted to debt-service payments during ESC construction. In addition, hotel-tax revenue would provide for the initial capitalization of the fund. These funds would be held in reserve to mitigate risk of future revenue shortfalls. After revenues for debt service stabilize, the reserve could be released.

<u>Prerequisite Conditions for Issuance of Lease-Revenue Bonds.</u> The permanent, publicly placed, long-term bonds could be issued when all of the following primary conditions are met:

1. An Environmental Impact Report (EIR) is certified (approved) by the City Council. Expected May 13, 2014.

2. SBH's financing has closed. Expected summer 2014.

3. A guaranteed-maximum-price contract (GMP) for construction of the ESC project has been awarded. Expected November 2014.

4. The City has obtained fee title for the ESC property. Expected January 2015.

Prerequisite Conditions for SBH's Financing

1. City financing is in place (i.e., bonds sold).

2. A GMP contract has been awarded for the ESC project.

Interim and Long-Term Financing. To meet the October 2016 opening date, demolition will need to commence in the summer of 2014, with construction to follow immediately thereafter. Given this construction schedule, the City is planning to provide interim financing until its permanent bonds are issued.

The interim financing would be a private placement of the lease-revenue bonds. Under a private placement, a single buyer purchases the bonds on a short-term basis. Once the primary conditions above are met, the bonds will be remarketed in the public marketplace as long-term lease-revenue bonds.

The main challenge with this interim financing is that proceeds cannot be drawn down for construction-period spending. The proceeds from the bonds will be held in a restricted escrow and invested until the bonds can be publicly remarketed. SBH would have primary responsibility for construction-period payments to the general contractor until the City remarketed the lease-revenue bonds in the public marketplace in January 2015 or soon thereafter. Any potential delay from litigation or in the award of a GMP contract could also delay the public marketing of the interim financing.

Interim Financing Options. The Treasurer's Office is exploring two options for the interim financing:

1. The first option is the two-stage process described above that involves issuing short-term lease-revenue bonds through a private placement and holding the funds in escrow until all issues are resolved. When the issues are resolved, the debt will be remarketed as long-term debt through a public sale. This would allow for the simultaneous close of the financing with SBH in July or August 2014 and the commencement of construction.

2. A second option provides for a binding forward-commitment from a financial institution to purchase the bonds in the future on a private-placement basis. This option ensures that the City will have the funding later, after all outstanding matters have been resolved.

Exercising either interim-financing option will require the City to fund the first-year interest or holding costs when the interim transaction is closed. Funds are available in the overall ESC project financial plan to cover these interest costs. The decision on the selected financing option would be based on the lowest cost and least risk to the City, as well as the ability to satisfy the conditions for a simultaneous close.

<u>Lease-Revenue Bond Debt Structure.</u> The basic structure of the ESC debt is City-backed taxable lease-revenue bonds. Issuing lease-revenue bonds for this project was made possible with the City's pending acquisition of 600 K Street and SBH's granting of the remaining land under the arena to the City. Owning the land and the ESC building gives the City a leasable asset to finance with this structure.

A lease-revenue financing structure is a better credit and offers more structural flexibility and options than the previous parking-revenue model that entailed the direct pledge of parking revenues and hotel-tax revenues to a non-profit corporation. The lease-revenue bond structure offers a more traditional municipal-debt instrument. As a result, the bonds should receive a higher credit rating, be met with better investor understanding and demand, and lead to a lower interest rate to the City.

In the lease-revenue financing, no revenues are directly linked to the debt-service payments; however, the finance plan takes into account the new revenues and the growth in existing revenues that will be available to the City. A significant contributor to the viability of this option was the restructuring of the ESC terms to provide for SBH's payment under its lease of the ESC from the City of an annual fee that starts at $6.5 million and is adjusted each year by at least 3%. The annual fee is projected to grow to at least $18 million by the end of the lease term. This greatly enhances the ESC project revenue to support the City financing. As the ESC lease payment grows over time, the use of parking revenues declines. In addition, there are other ESC-related revenues available in the finance plan, including new tax revenues generated once the ESC is completed and in operation. Hotel-tax revenue is used in the early years of the finance plan to capitalize a liquidity reserve.

<u>Debt Assumptions</u>. The basic assumptions and parameters of a long-term ESC debt issue are as follows:

Debt Assumptions	
Term	36 years
Interest Rate Assumption	6.70%
Annual Debt Service	$21.90 million
Project Funding	212,500,000
Debt Service Reserve	22,600,000
Capitalized Interest (3 years)	59,100,000
Cost of Issue	4,200,000
Total Issue	$298,400,000

The long-term debt would have a fixed interest rate, and the debt service would be level over time. The interest rate used for the assumptions and modeling is 6.7 percent and is based on current market rates for taxable lease-revenue California debt rated at A/A-, plus a one-half percent contingency. The Debt Service Reserve is a standard investor and market requirement and is used to make the final debt-service payment. Annual interest earnings on the reserve partially offset annual debt-service payments. Capitalized interest is also a standard and required feature of all lease-revenue bonds. The capitalized interest covers the interest cost during construction.

The debt will be 100% taxable for federal income-tax purposes. Tax-exempt debt is not feasible because of the private use of the arena, the City's right to use the arena, and the City's receipt of lease payments from SBH.

Debt-Service Sources and Reserve. The illustrative cash flow presented below assumes the debt would be issued in 2014 according to the assumptions in the section above. The table illustrates the first 12 years of the finance plan, when the cash flows are most constrained. After this point, both lease payments and available parking revenues grow significantly over time while the debt service remains constant. Additional detail will be presented to the City Council in the May 13, 2014 report.

Revenue Sources, Debt Service and Reserve	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	12 year Total
Net Parking Revenue	0	0.10	3.00	4.80	9.30	10.40	12.50	15.40	16.20	12.70	16.30	26.20	126.90
ESC Lease Fee	0	0	4.70	6.50	6.50	6.50	6.50	7.53	7.76	7.99	8.23	8.48	70.68
Hotel Tax	2.00	3.00	3.00	0	0	0	0	0	0	0	0	0	8.00
Other ESC Revenue	0	0	1.00	2.50	2.55	2.60	2.65	2.71	2.76	2.82	2.87	2.93	25.39
Total Revenue	2.00	3.10	11.70	13.80	18.35	19.50	21.65	25.64	26.72	23.50	27.40	37.60	230.96
Lease-Revenue Debt Service	0	0	0	-12.6	-21.9	-21.9	-21.9	-21.9	-21.9	-21.9	-21.9	-21.9	-187.80
Liquidity Reserve Balance	2.00	5.10	16.80	18.00	14.45	12.05	11.80	15.54	20.36	21.96	27.46	43.16	43.16

In $millions

Primary Revenue Sources for Debt Services. There are four primary revenue sources for the lease-revenue bond debt-service payments:

1. *Net Parking Revenue*. This revenue is from existing parking operations as well as new revenue resulting from modernization and growth of the parking system.

Furthermore, within six years after the start of ESC debt service, existing parking bonds will be retired, thus providing additional capacity to support the debt. The periodic dips in the net parking revenue assumptions accounts for future capital expenses in the overall parking system. The modernization plan and net parking revenue is based on a comprehensive review of the City parking system by a third-party parking consultant.

2. *ESC Lease Fee*. SBH will pay annual fees for the use of the facility. The minimum annual fee is $6.5 million, with proration in the first year. The fee will increase annually by the greater of 3% or the annual increase in thea CPI. The annual fee will remain flat for the first five years. A compounded catchup adjustment will be effective in year six. The resulting minimum payment of $7.53 million in the sixth year will escalate each year thereafter to a minimum of approximately $18 million. As the annual fee increases over time, it will offset the portion of the debt service paid from Net Parking Revenue.

3. *Hotel Tax*. The City's existing hotel tax (transit-occupancy tax) will be used to seed a Liquidity Reserve Fund. Recently retired bonds secured by the hotel tax provide a revenue source to fund the Liquidity Reserve Fund for three years.

4. *Other ESC Revenue*. Several new revenue sources generated by the ESC will be committed to pay debt service. They include new City parking revenues from ESC events (not included in the Net Parking Revenue line item), ESC Possessory Interest Taxes paid to the City, ESC sales and utility taxes, and City property taxes paid by SBH on properties transferred to SBH as a part of the ESC package.

<u>Liquidity Reserve</u>. There are no debt-service payments during ESC construction. The net financing plan generates a surplus through the hotel tax, parking revenues, and SBH's payment of the annual fee. Those revenues are devoted to building the Liquidity Reserve. In fiscal years 2018, 2019, and 2020, the plan revenues are below the threshold to meet all the financing-plan requirements, so draws from the Liquidity Reserve will be necessary. The financing plan projects a return to a positive level in fiscal year 2021.

The Liquidity Reserve will require active management to be maintained at adequate and reasonable levels. Releases from the reserve will be determined through active monitoring of the actual performance of revenues. Actual performance will also determine the need to make continuing contributions to the reserve from the finance plan sources or to release those sources when the reserve is adequately sized.

Treasurer’s Conclusion

The debt-financing plan represents a secure and flexible approach to generating the $212.5 million of the City’s cash contribution for the ESC project and its schedule challenges.