TO: CITY COUNCIL  
ATTN: FINANCE COMMITTEE  
FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES  
DATE: FEBRUARY 5, 2008 CMR: 140:08  
SUBJECT: RESPONSE TO FINANCE COMMITTEE QUESTIONS AND DIRECTION ON FINANCING OPTIONS FOR PUBLIC SAFETY BUILDING

RECOMMENDATION
Staff recommends that the Finance Committee review the responses to the questions and direction received during the January 15, 2008 FC meeting on financing options for the Public Safety Building and recommend a financing strategy to the City Council.

BACKGROUND
On November 19, the City Council directed staff to investigate the use of Certificates of Participation (COPs) to finance the purchase of a 1.27 acre parcel and construction of a Public Safety Building (PSB). This required staff to identify internal and new revenue resources, “self-financing” the PSB without relying on general obligation bonds.

On January 15, 2008, the Committee reviewed staff’s report on financing options for the Public Safety Building (CMR:114:08) “Financing Options for Public Safety Building” and Attachment A). In general, the Committee raised questions about funding the Public Safety Building using COPs exclusively. A goal of issuing a combination of general obligation bonds and COPs for both the PSB and Library facilities was expressed. This goal was cited, in part, because of concerns about the financial pressures that would be brought to bear on the General Fund by issuing COPs. In using COPs, the estimated annual debt service cost of $5.2 million was cited in the staff report. Some of the concerns centered on the possibility that if expected revenue sources did not materialize as anticipated, additional operating expense reductions would be necessary to meet debt service obligations. In addition, the Committee indicated that relying on new development revenues, such as those from the expansion of the Stanford Shopping Center, in meeting annual debt service obligations was inappropriate since the expansion has not been formally approved by Council.

Council Member Yeh indicated that General Obligation Bonds would not only provide a guaranteed tax stream to pay debt service, but would also result in lower debt service costs. He asked about the cost tradeoff between maintaining a debt service reserve (as proposed in the COPs financing) or purchasing bond insurance to assure investors of their bond payments.
Council Member Burt requested more refined information on the revenue generated by the recent 2 percent increase in the transient occupancy tax and on potential rent from leasing the Civic Center’s police wing. A question about creating a 911 response service fee to raise additional resources to pay COPs debt service was also raised.

Finally, several Council Members raised the policy and funding issue that there are numerous City priorities competing for limited resources. They recommend that any available resources identified by staff to pay for COPs be used as “matching funds” to supplement GO bonds approved by the voters for the PSB and library facility projects, and perhaps for other needs. The issue of General Fund priorities and resource challenges has been discussed in recent reports to the Council on a sustainable budget (CMR:387:07) and in the 2008-2018 Long Range Financial Forecast (CMR:462:07).

**DISCUSSION**

The question of whether to mix and match COPs and GO bonds to finance the PSB and Library improvements is strictly a strategy decision. To address the technical information request about using a combination of GO bonds and COPs, staff researched a 50 percent funding mix for the PSB. As previously stated, by the time of building construction, it is expected this project will cost $69 million. The following table compares all-COPs financing to the equal combination of COPs and GO bonds.

<table>
<thead>
<tr>
<th>Terms</th>
<th>COPs Exclusively</th>
<th>50 Percent COPs</th>
<th>50 Percent GO</th>
<th>Total of GO and COPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Cost</td>
<td>$69 million *</td>
<td>$34.5 million</td>
<td>$34.5 million</td>
<td>$69 million</td>
</tr>
<tr>
<td>Principal of Issue</td>
<td>$81.2 m.</td>
<td>$40.8 m.</td>
<td>$34.5 m.</td>
<td>$75.3 m.</td>
</tr>
<tr>
<td>Borrowing Term (years)</td>
<td>30 years</td>
<td>30 years</td>
<td>30 years</td>
<td>30 years</td>
</tr>
<tr>
<td>Fixed Interest Rate</td>
<td>4.94%</td>
<td>4.94%</td>
<td>4.84%</td>
<td></td>
</tr>
<tr>
<td>Average Annual Debt Service</td>
<td>$5.2 million</td>
<td>$2.6 million</td>
<td>$2.2 million</td>
<td>$4.8 million</td>
</tr>
</tbody>
</table>

* This figure includes property acquisition costs, building construction (adjusted for inflation), project development costs, and contingencies typically used in cost estimating of this magnitude. Note that this figure also included fixtures, furniture and equipment (FF&E). FF&E can be financed through COPS, but not through GO bond proceeds.

The cost to the General Fund, based on 50 percent COPs, would equal $2.6 million annually compared to the $5.2 million in an all-COP alternative. This combination would save the GF $2.6 million. Residential and commercial properties would pay taxes for the remaining $2.2 million in GO bond debt service should voters approve the appropriate measure. It should be noted that furniture, fixtures, and equipment (FF&E) cannot be funded via GO bonds, so these costs would be folded into the COP issue. By issuing a 50 percent mix of COP and GO bond debt, the annual debt service the City would have to cover is $4.8 million versus the $5.2 million
for COPs alone, a difference of $400,000 annually. This difference is primarily due to the high issuance costs associated with a COP. Whereas COPs require capitalized interest and a debt service reserve, which in the analysis presented total nearly $11 million, a GO bond issue does not require them. The COPs debt service reserve, however, will earn interest to offset debt service and will be used for the final debt service payment.

Two attachments are provided to inform the Finance Committee about the potential resources and the timing of those resources with respect to covering anticipated COPs debt service. Each of these attachments can be used to determine resources available to cover an all COPs scenario and a 50 percent COPs/GO bond scenario. Attachment B depicts possible resources, with Option 1 showing staff’s original recommendation and Option 2 excluding development resources (e.g., Stanford Shopping Center expansion sales taxes). Option 2 shows total resources of $6.3 million, which would be sufficient to cover annual debt service at some point in time. This option, however, has several items that need additional research and are subject to negotiation. This includes, for example, the rental of the police wing and the leasing of the City’s Cubberley site to Foothill College.

Attachment C shows the expected timing of receipt of the resources identified in Option 2. Several do not coincide with the onset of PSB debt service payments in 2010-11. In the year 2010-11, resources are shown which come close to covering the expected $3.2 million in principal that must be paid under an all-COPs scenario. In the year 2011-12, when full principal and interest of $5.2 million is due, there appear to be sufficient resources based on current projections. Should resources fall short of annual debt service in a COPs scenario, either a new revenue source or expense reductions would be required to meet the City’s commitment. Staff has identified some options that could provide a steady stream of resources over time: retired Civic Center debt savings of $0.4 million; a target of $1.0 million in expense reductions; and $0.5 million by pre-paying retirement and retiree medical payments to PERS. A new General Fund revenue source, such as a business license tax, of $400,000 to $2,500,000 would be useful in meeting the City’s financial needs. A target of $1.5 million is cited in the attachments.

During the meeting, additional information and clarification on a number of items was requested. The following responds to those requests.

Except for GO bonds, which require no debt service reserve, a debt issue requires a net present value analysis to determine whether a debt service reserve or insurance is the optimal means for guaranteeing continuing bond payments. The decision to use a reserve or insurance is strictly based on which is less costly in current dollar terms. In the current market and with concerns about the financial condition of insurers such as AMBAC and MBIA, obtaining insurance is problematic and extremely expensive at best. Bond investors will expect a debt reserve fund or insurance policy regardless of the credit rating of the issuer.

Staff has refined numbers and gathered additional information on several potential revenue sources to pay for COPs debt. Space available for a lease of the current Police wing equals about 19,081 square feet. Based on a recent tour of the wing by two local developers, it is estimated that a lease rate of between $3.50 and $4.00 could be expected. Using the midpoint, this could yield $860,000 annually. Further research into how much net space can be made available, current market rate, potential tenant uses, as well as the cost of improvements necessary to occupy that space may well result in changes to the preliminary lease revenue estimate. If the
Development Center (DC) were moved to the Police wing, the General Fund is limited to recovering the costs associated with occupation of the wing. This includes utility, phone service, maintenance, and an annual depreciation cost. Should capital improvements be made to the wing, then these costs will be amortized and charged to the DC as well. Additional analysis would have to be conducted to determine total cost for occupancy. A comparison of a commercial or market rate rental to occupancy with a cost recovery approach could then be made.

At this time, staff does not believe that there would be material savings from currently used City or rental space used for storage that could be transferred to the Police wing. Moreover, occupancy of the wing by a tenant may raise accessibility issues. Staff will continue, however, to investigate this option.

Council Member Burt requested that staff revisit the revenue estimate provided for the recent 2 percent TOT increase. Based on 2006-07 actual revenues of $6.7 million, and holding all other factors constant, an additional $1.3 million could be raised by the rate change. To be somewhat conservative in light of a softening economy, staff believes at least $1.2 million can be expected. It is important to note, however, that staff’s earlier recommendation was to use this revenue growth to cover rising health care, infrastructure, and other General Fund expenses. This revenue was incorporated into the City’s Long Range Financial Forecast. In addition, since the TOT is a general tax (rather than a special tax) it cannot be dedicated to any particular use.

It was requested that staff to investigate implementing a 911 service fee to help pay for the PSB. Santa Clara County’s Board of Supervisor’s has recently passed such a fee while San Jose and San Francisco have one in place. Due to Proposition 218 requirements, this service fee must be approved by a majority of voters as a general tax. Potential revenue estimates for this tax are in the process of being developed.

Staff is cognizant that there will be additional operating expenses for the PSB, libraries and Mitchell Park community center and wants to call this to the Council’s attention. It is currently estimated that utility, custodial, and maintenance expenses for any new building will cost approximately $8.00 per square foot. Since the facilities are still in the design process, additional operating costs have yet to be determined. For example, landscaping costs have not been calculated to date. Although furniture, fixtures and equipment could be included in a COP issue, there may be additional unidentified needs that would not be eligible for COP or GO bond financing. As the projects are further defined, staff will be able to refine the operating and maintenance cost estimates and identify potential funding sources.

In conclusion, this report addresses the FC’s direction to examine using a combination of COPs and GO bonds for the PSB. Staff requests that the FC direct staff to send the Committee’s recommendations on this report to the Council for consideration at the February 11 meeting.

**RESOURCE IMPACT**

By the time construction begins, and based on current construction index inflation rates, the estimated final cost to build a new public safety building is $69 million (including FF&E). It is critical to note that for each month the PSB project is delayed beyond the scheduled construction date cited below, it is expected that project costs will increase by an estimated $500,000 to 600,000 per month.
The table below shows the PSB costs that could be covered under a GO bond and under a COPs issue. This information is provided to show the components of the project and to facilitate the strategic decision on how to mix and match these financing vehicles.

**TABLE II Comparison of GO Bond & COPs Cost Coverage**

<table>
<thead>
<tr>
<th>Terms</th>
<th>GO</th>
<th>COPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction 2008 dollars</td>
<td>$36 million</td>
<td>$36 million</td>
</tr>
<tr>
<td>Project Development</td>
<td>$5 million</td>
<td>$5 million</td>
</tr>
<tr>
<td>Land</td>
<td>$11 million</td>
<td>$11 million</td>
</tr>
<tr>
<td>Design &amp; Construction Contingencies* (18%)</td>
<td>$6.5 million</td>
<td>$6.5 million</td>
</tr>
<tr>
<td>Inflation* (10%/year)</td>
<td>$7.5 million</td>
<td>$7.5 million</td>
</tr>
<tr>
<td>GO &amp; COPs Subtotal</td>
<td>$66 million</td>
<td>$66 million</td>
</tr>
<tr>
<td>FF&amp;E including moving costs</td>
<td>$0 million</td>
<td>$3 million</td>
</tr>
<tr>
<td>GO &amp; COP’s Total</td>
<td>$66 million</td>
<td>$69 million</td>
</tr>
</tbody>
</table>

Annual debt service costs vary according to the debt instrument selected. As is shown in Table I above, a total COP issue is expected to result in annual payments of $5.2 million. The mix of a 50 percent GO and COP combination is expected to result in annual citywide debt service of $4.8 million, of which the City must find resources to cover $2.6 million in debt. The remainder would be paid through property taxes. Resource options are presented in Attachment A and are subject to further analysis and research.

In order to proceed along the project timeline outlined below, a $4 million appropriation will be required for the public safety building project. This amount will cover $3 million in architectural fees (design work) as well as $1 million in construction management and other expenditures. This additional funding will be requested through a Budget Amendment Ordinance in the coming months. These costs are part of the $69 million project and will be reimbursed through COPs or bond proceeds.

As stated above, there will be operating costs associated with the new PSB. For maintenance, custodial and utility costs, a cost of $8.00 per square foot is estimated at this time. As this project is further defined, staff will have better cost estimates and identify potential funding sources. Operating costs are not included in the COP or GO bond amounts above.

**POLICY IMPLICATIONS**

This recommendation is consistent with Council’s establishment of securing funding for the Library/Community Center and Public Safety projects as a Top 4 priority for 2008.

**TIMELINE**

The following timeline below is based on Council providing direction to proceed with the project by February, 2008 using COP debt financing only.
March to November 2008  Complete design and prepare construction documents for bidding (nine months). This timeline is based on one-time reviews by City Boards and Commissions. Additional reviews will push the entire timeline into the future

December 2008 to February 2009  Bid project including addendums and bid opening (three months)

April 2009  Council awards construction contract

April 2011  PSB construction (2 years) and occupancy of facility

**ENVIRONMENTAL REVIEW**
An Environmental Impact Report was certified by the Council on November 18, 2007 pursuant to the California Environmental Quality Act.

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**ATTACHMENTS**
Attachment A:  CMR: 114:08 “Financing Options for Public Safety Building”
Attachment B:  Table of Financial Resources Available to Pay Certificates of Participation
Attachment C:  Timing of Project, Debt Service Payments (All COP), and Resources Available to Pay Debt Service