MEMORANDUM 08-22

DISCUSSION PAPER

TO: Mayor Hornaday, Homer City Council

FROM: Walt Wrede

DATE: February 11, 2008

SUBJECT: Financing / City Hall Town Square Project

<u>Introduction</u>

The Homer City Council is currently is the process of evaluating and planning for construction of the proposed new City Hall and Town Square. The City and the project design team have been attempting to engage the public and disseminate as much information about the project to the community as possible. As part of this process, the City is attempting to provide answers to the important, substantive questions it receives from the community.

Where is the money coming from? This is one of the most critical and prominent questions the City has heard from the public to date. This question is very important in its own right. But it has assumed added importance because the City Council has stated that it intends to complete this project without raising taxes or negatively impacting existing services.

This discussion paper is intended to generate debate and shed some light on the City's fiscal condition with respect to its ability to handle this project without new revenues or budgets cuts.

<u>Project Costs</u>

The City asked the design team to produce a more refined budget and precise project cost estimates based upon what it knows at this time. Normally, we would wait until the 35% plans were delivered to the Council (scheduled for March 10) but in this case, we asked for refined numbers now due to the upcoming special election on March 25 and because a decision must be made on the debt authorization ordinance. Following is a summary of projected project costs:

Projected Project Cost: $11,800,000

Comment: This number represents the latest cost estimate produced by the design team. There is a significant risk in producing a cost estimate at this time because we have not yet attained 35% plans and there are many variables. However, the team is pretty confident in this number. Please refer to Memorandum 08-20 from the Public Works Director for a description of what this number includes. The reader should note that this number is for all costs associated with the building and the square. It does not address land acquisition or infrastructure. This amount could be adjusted by the Council when it considers approval of a preliminary project budget (Resolution 08-20).

Funding Secured to Date: $3,715,000

Comment: The funding secured so far includes a $2,000,000 legislative grant received in FY 06, $1,300,000 anticipated from the sale of the old City Hall building to the University, and a $415,000 transfer from a City Hall depreciation account to a City Hall Construction account (Ordinance 07-29).

Budget Shortfall: $8,085,000

Comment: The City Council is considering selling general obligation bonds in the amount of $8 Million. A special election is scheduled for March 25th to determine if the voters are in favor of authorizing the City to incur debt and borrow that amount. If the voters vote yes, that simply means they have authorized the Council to borrow up to, but not exceed that amount. The Council would decide later if it wants to sell bonds and in what amount. It is hoped that the Council would not need to borrow the full amount and that some of the shortfall can be made up with grants and other fund raising efforts.

Land and Infrastructure Costs:

There are other project costs not described above. The proposed location of the new town square is on land currently owned by Cook Inlet Region Inc. The City will need to acquire that property. In addition, at least some road and water and sewer infrastructure will need to be built in order for this project to move forward. These costs will be determined through a separate agreement between the City and CIRI. Negotiations on these items are currently underway and the City intends to make public a basic framework for such a deal (including cost) prior to the special election.

CIRI has endorsed the town center plan and recognizes that this project, and the construction of infrastructure in the Town Center, is mutually beneficial to both parties. The City expects to pay its proportionate share of infrastructure costs. A limited amount of infrastructure is likely to be built in this phase of Town Center development. City contributions to these costs are most likely to include either land trades and/or funding for infrastructure.

Money for infrastructure would come from the dedicated Homer Accelerated Roads and Trails Program (HART) and the Homer Accelerated Water and Sewer Program (HAWSP). These are dedicated funds with revenues derived from sales taxes. The HART fund receives $1.4 Million in revenue every year and is projected to have a fund balance at the end of this fiscal year of $3,592,934. The HAWSP fund also has revenues of $1.4 Million a year and its projected fund balance at the end of this fiscal year is $1,811.527.

Money could also be borrowed for infrastructure and repaid with dedicated revenues from these funds in order to reduce impacts on fund balances.

Bond Payments

The Alaska Municipal Bond Bank reports that interest rates on tax free municipal bonds are very favorable at this point in time. The Director said that if the sale were to take place today, interest rates would likely be around 4.5% or lower. He did not anticipate that interest rates would go up much in the next few months and felt that even with the current problems in the bond insurance industry, the City would likely secure an interest rate around 4.5% assuming it sold the bonds in late April or May. He stated that a City of Homer bond sale in May would likely be packaged with bond sales being proposed by Seward, Skagway, Sitka, and Juneau. This timing would work well with the City's proposed construction schedule and projected project cash flow needs.

Several Dept Service Schedules are attached for review and comparison purposes. The standard term for municipal bonds is 20 years but the term can be extended under certain circumstances provided that it does not exceed the life expectancy of the building. If the City sells bonds in May, it will only have to make an interest payment in November of this fiscal year. Full principal and interest payments would begin in Fiscal year 2009.

An $ 8 Million dollar bond sale, with a 25 year term, at 4.5% interest would result in net principal and interest payments of $540,000 per year. Annual debt payments could be reduced by increasing the term or by reducing the amount borrowed. The Council could also reduce the project budget or self finance a portion of the cost if it finds that to be in the City's interest.

Present City Indebtedness

An important factor to be considered in any decision to borrow money is how much debt the City is already carrying. The City of Homer has a relatively low level of debt at this point in time. The total City debt at the end of this fiscal year is projected to be $7,828,568. Of the total debt, only $1,945,232 or about 25% is attributable to the General Fund. This is important because it is the General Fund that would shoulder the new debt associated with the City Hall / Town Center Project. Almost all of the General Fund debt is the low interest (4.13%) loan for the New Library. The Council intends to pay a large portion of that debt off with the sale of the old library. General Fund debt service payments in this fiscal year are $170,164.

The remainder of the City's current debt load is being paid off with dedicated revenue sources such as taxes, user fees, and assessments. The enterprise funds and dedicated revenue funds are generally in very good shape with respect to debt. The HART Fund has no current debt. Its last bond payment was retired in 2007. The Water and Sewer Enterprise Fund has debt for equipment that will be retired in 2009. Debt service this year is $66,000. The Port and Harbor Enterprise Fund has port bonds and equipment debt that will be retired in 2009. Debt service in FY 2008 is $ 215,640. By far, the fund with the heaviest debt load is HAWSP which has a current obligation of $5,604,000. All of this is low interest loans (1.5 to 2.5%) which are repaid with taxes and assessments.

The City currently has a relatively low debt burden for a municipality of its size and resources. $7,828,568 is not a large burden when you have an overall operating budget of $23,162,340, total net assets of approximately $120 Million, and cash and investments (some of its restricted) in excess of $10 Million (2007 Audit). The debt burden is further reduced by the fact that 75% of it will be paid off with dedicated revenue sources.

The main focus in this analysis should be the General Fund since it will be responsible for the debt load associated with new General Obligation Bonds. The General Fund Budget in FY 2008 is $12,004,967. Debt payments in 2008 are $170,164. A discussion of General Fund reserves and budget projections appears below.

A word of caution: It must be noted that the analysis above describes the current debt load at this time. The City Council recently authorized the administration to apply for $8 Million in new low interest loans for the new water treatment plant. Again, these loans are relatively inexpensive and they will be repaid with an identified and dedicated revenue source. If the Council decides to sell General Obligation Bonds in the amount of $8 Million for the Town Square / City Hall Project, the City will have increased its overall debt load by 16 Million this year. This is still well within the debt level that is reasonable however, it is a significant new obligation that should not be taken lightly.

<u>Where Will the Money Come From / A Review of the General Fund</u>

The General Fund is in very good shape overall thanks in large part to conservative fiscal policies implemented by the Council, conservative revenue projections provided by the Finance Department, and good fiscal management by the City Department Heads. In the last few years, the City has adopted balanced budgets, increased contributions to depreciation and fleet reserves, and expanded the General Fund Reserves. It has been able to do all of this while absorbing inflationary costs, adding needed new staff, and assuming new programs like Community Schools.

The Council has stated that it wants to borrow money for the new City Hall / Town Square project without raising taxes or impacting existing services. It is difficult to show that the Council would be able to do that if we only look at the budget projections for future years that are contained in the FY 08 Operating Budget. For example, in FY 09, excess or surplus from operations is projected to be $42,803. If we assume debt service payments of $540,000 per year (8 million, 4.5%, 25 years) it would be really hard to see using existing budget projections, how those payments could be made without affecting existing services unless reductions were made in contributions to depreciation and fleet reserves (not recommended).

However, upon closer review, I believe it is possible to show that the General Fund has the capacity and resources to make these payments if we take a number of other factors into consideration. First, if we assume that revenue projections for future years are conservative, that the economy will continue to grow, and that the Council and City staff will continue to exercise fiscal prudence and constraint, there is sufficient reason to believe that the recent trend of year-end surpluses will continue to some degree. For example, in 2005 the year- end surplus was $872,428; in 2006 it was $1,038,694 and in 2007 it is projected to be approximately $1,100,000. There is no reason why a portion of this money could not be transferred to a debt service fund and still grow the General Fund Reserves. The Council did something similar to that at the end of FY 2006.

The General Fund also has significant reserves. The General Fund Reserve Account is projected to contain $4,012,100 at the close of this fiscal year. The General Fund also has $682,634 in a Special Projects Account and $931,249 in depreciation and fleet reserve accounts. So, while we would not recommend using depreciation or fleet reserve accounts or reducing the contributions to them, we think the General Fund has more than sufficient reserves to show that bond payments can be made without raising taxes or reducing services.

If the Council conducts an $8 Million dollar bond sale this spring, it will need to appropriate about $180,000 in this fiscal year (2008) for an interest payment in November. The first full interest and principal payments will be due in May 2009. So, in other words, we would need to find $540,000 when we prepare the FY 2009 Operating Budget, beginning this fall. At that time, we will have a much better picture of revenues, expenditures, fund balances, etc. The first objective when preparing the budget would be to fit those payments within the existing revenues and not tap reserves.

General Comments

The General Fund has the capacity and resources to absorb bond payments without raising taxes or impacting existing services. However, we must be clear that this conclusion is based upon assumptions. As always, there is an element of risk and our job is to evaluate and manage that risk. The assumptions are that the economy and revenues from taxes will continue to grow (or at least not decrease), and that the City will refrain from assuming responsibility for major or expensive new programs or services; at least in the next few years. The City must exercise fiscal discipline and recognize that General Obligation Bond payments must be a first priority when it comes to budgetary policy.

In the end though, there will probably never be a cheaper time to do this project. The City already has about 3.7 Million dollars (not including HART and HAWSP funds) identified for the project. This will help us leverage other funding. The costs of materials and labor will only go up if there is a delay. Interest rates are presently very low and may go lower in the next few months. Finally, bond payments get increasingly easier to make in future budgets due to inflation and because the payment as a percentage of the overall budget will decrease. In short, if the community really wants to do this project, now is the time.

Recommendations:

If the City Council decides to sell bonds this Spring, the Administration's first priority will be to incorporate bond payments into the regular FY 09 budgeting process without relying on transfers or dipping into reserve funds. It is impossible to predict exactly how difficult that might be at this time because there are so many variables and unknowns.

The Council may want to consider establishing a "safety net" to assure the public that bond payments can and will be made without increasing taxes or reducing existing services. Council could do that by transferring money into a special city hall / town square bond servicing reserve account that would only be used if absolutely necessary. Appropriations from this account could only occur by ordinance. Council could for example, dedicate or appropriate all or portions of the Special Projects Fund, the surplus from operations in 2007 and 2008, the GF reserve balance, a portion of future Revenue Sharing Funds, earnings of the Permanent Fund etc.

None of this must be done immediately because the first partial payment would not be due until November of this year (assuming a bond sale this spring). The important thing at this point is for the Council and the public to feel confident that the City can make bond payments without raising taxes or impacting existing services; provided that prudent and fiscally responsible policies are adhered to.