SESSION FOUR
Long-term Financing Options

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The Right Long-Term Financing Solution Fits the Context

- Debt is not a resource; it is a tool for managing future resources
  - Accelerates delivery of a capital project vs. having to accumulate cash
    - Earlier service delivery
    - Savings when cost of borrowing is lower than construction inflation
  - Spreads cost of capital project over more of useful life of the asset
    - Generational equity
- Any debt issuance should be <u>preceded by</u> a longer-term financial plan that considers:
  - The project
  - Overall capital needs
  - The appropriate revenue sources to fund and/or finance the project
  - The "right" combination of existing resources (i.e., pay-as-you-go) and future resources (debt)
- And after that, you can start talking about the specific tools of finance: bonds, loans, and all that jazz…

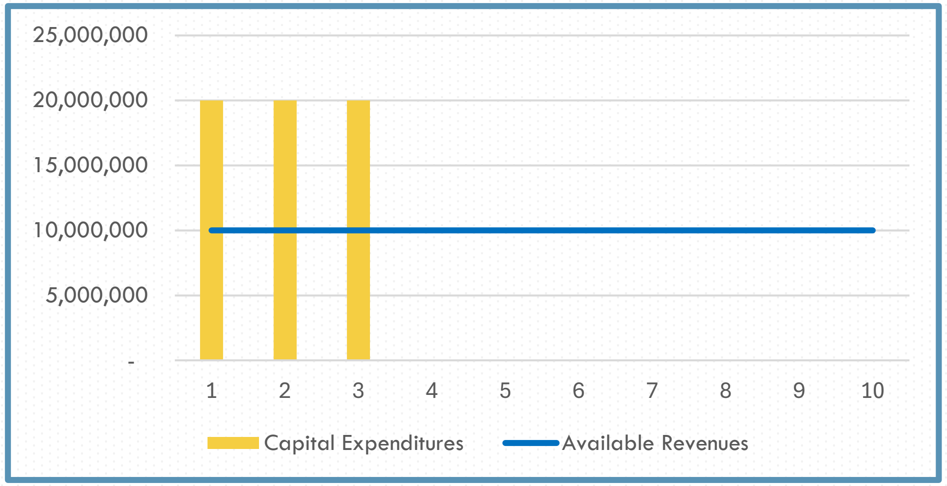
Projects are Often Funded with Multiple Resources

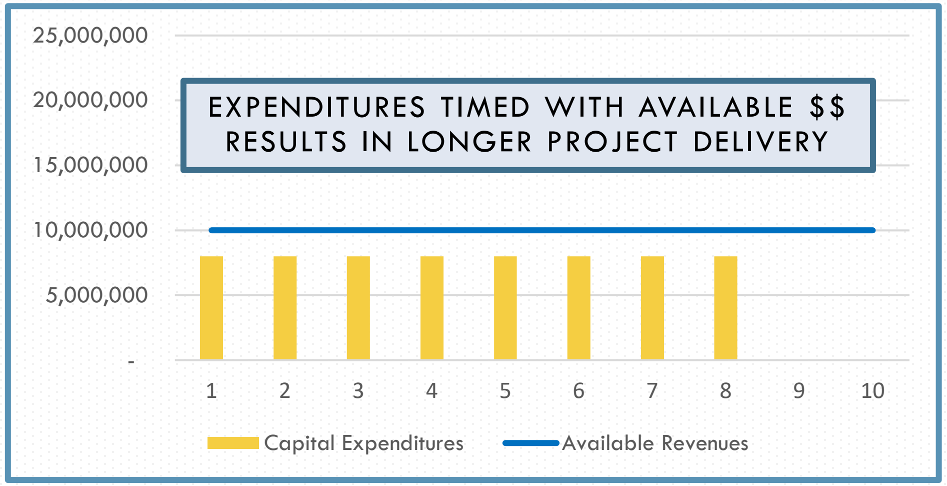
AVAILABLE REVENUES/ CASH BALANCES	FEDERAL/STATE GRANTS OR LOANS	BORROW BONDS, LOANS, NOTES
• "Pay-As-You-Go" • Small and recurring capital projects • Projects built slowly over time • Easiest source of money • Opportunity cost of funds (i.e. interest earnings)	• "Free" money with strings attached • May require oversight or thorough review • Application process can be drawn-out and competitive • Timing of funds can be uncertain	• Large capital expenditures • Acquisition projects • Future revenues from project available for debt service • Interest and financing costs • Staff resources required for financing process

Optimal financing plans tend to involve a mix of pay-go, grant funding, and financing

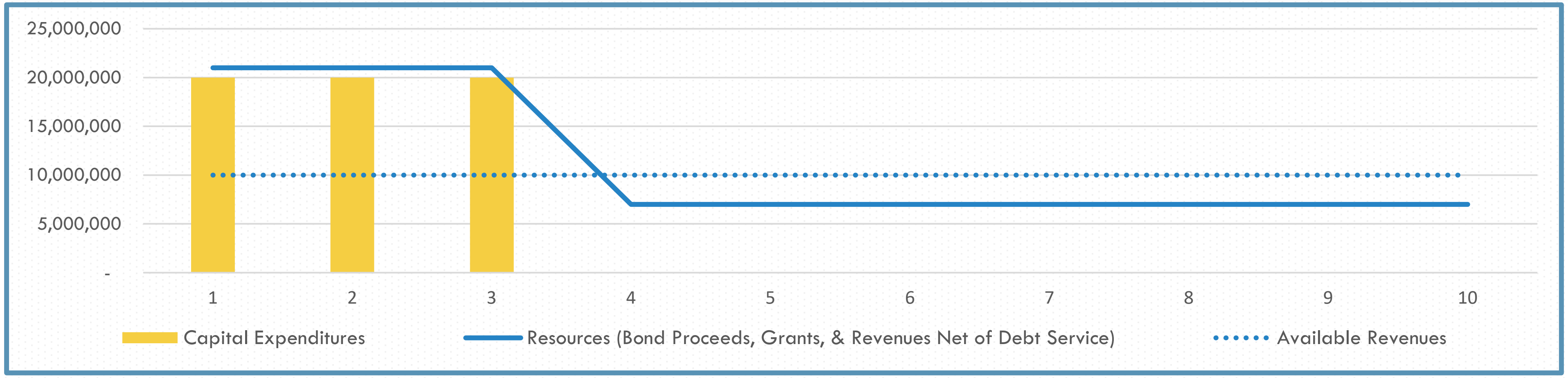
Why is Debt Utilized to Fund Projects?

CAPITAL EXPENDITURES ARE GREATER THAN AVAILABLE REVENUES





BONDING ACCELERATES FUTURE REVENUES TO DELIVER PROJECTS



A Plan of Finance Determines the Timing & Amount of Debt

Identify Project Needs and Funding Resources

- Assess project readiness and environmental approvals
- Prioritize project(s) from CIP – i.e., high, medium, and low
- Determine project cost expectations
- Identify available cash, revenues, or outside funding sources

Develop Financial/Cash Flow Model

- Estimate amount and timing of annual capital expenditures
- Establish PAYGO and cash balance targets
- Identify amount and timing of “unfunded” or bonding need
- Group potential bond financings to satisfy IRS expenditure test requirements to access lower tax-exempt rates

Project Repayment Sources for Annual Debt Service

- Prepare pro forma debt service numbers and evaluate debt affordability
- Evaluate legally available and/or pledged revenues for debt repayment
- Coverage requirements

Available Revenue Sources Determine the Type of Debt

COMMON GOVERNMENTAL REVENUE SOURCES

- General Fund revenues
- Enterprise revenues
- New voter-approved taxes
- User fees and charges
- Other?

THE SOURCE OF REPAYMENT WILL NARROW THE TYPE OF "DEBT" YOUR AGENCY CAN INCUR

- General Obligation Bonds
- Special Tax Bonds

- Lease Revenue Bonds
- Certificates of Participation
- Revenue Bonds

Debt Comes in All Shapes and Sizes…

- Tax-Exempt
- Taxable

- Public Offering
- Private Placement

- State & Federal Loans

- Fixed Rate
- Variable Rate

- Bonds, Notes, Certificates of Participation

So…What is "Debt?"

- US Constitution delegates municipal affairs to the states
- State law governs a local agency's ability to raise revenue and commit it to long term obligations
- California Constitutional Debt Limitation restricts true "indebtedness"

ARTICLE 16 PUBLIC FINANCE SEC. 18. No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the qualified electors thereof, voting at an election to be held for that purpose…; nor unless before or at the time of incurring such indebtedness provision shall be made for the collection of an annual tax sufficient to pay the interest on such indebtedness as it falls due, and also provision to constitute a sinking fund for the payment of the principal thereof…

What is Debt…In California?

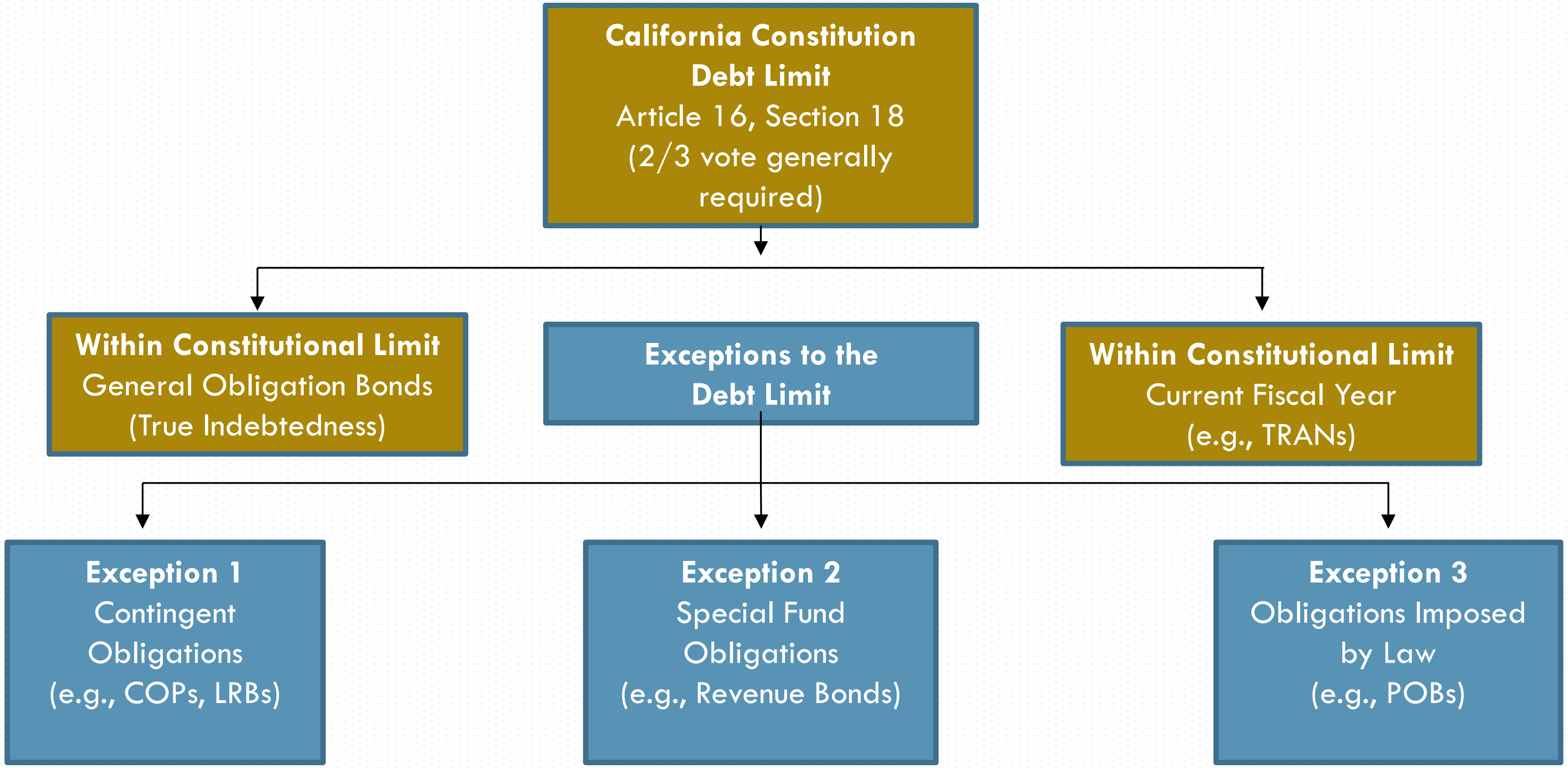
- California courts have identified a number of “exceptions” allowing issuance of debt-like securities if they meet the requirements set forth in their judicial opinions

ALEXIS DE TOCQUEVILLE

Democracy in America

“I have never been more struck by the good sense and the practical judgment of the Americans than in the manner in which they elude the numberless difficulties resulting from their… Constitution.”

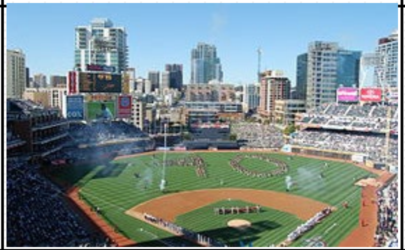
What is Debt…In California?
Exceptions to the Voter-Approval Requirement



Available Revenue Sources Determine the Type of Debt an Agency Can Issue

TYPES OF BONDS					
	GENERAL OBLIGATION	LEASE REVENUE	ENTERPRISE REVENUE	SPECIAL TAX	SPECIAL ASSESSMENT
REVENUE PLEDGE	"Full faith and credit" of issuer Secured by property taxes	Lease payments for use of govern-ment asset; paid from general fund	Net revenue of a specified enterprise, such as water, sewer, solid waste, or parking	Lien on property; bonds paid from tax levied in addition to normal 1% ad valorem tax	Lien on property; bonds paid from annual assessment on property that benefits
VOTE?	2/3rds vote threshold; Schools may be 55%	No public vote required	No public vote required	2/3rds vote of property owners by acreage or by vote of registered voters	50% + 1 vote of assessees, weighted by amount of assessment

City of San Diego: Long-Term Borrowing Programs

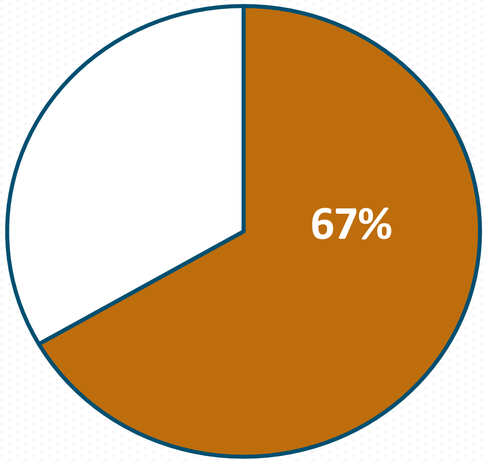
TYPES OF BORROWING PROGRAMS					
	GENERAL OBLIGATION	LEASE REVENUE	ENTERPRISE REVENUE	SPECIAL TAX	OTHER
TYPES		• General CIP • Stormwater	• Water System • Sewer System	• Community Facilities Districts (CFD) • Special Assessment Districts (AD)	• Successor Agency Bonds
LONG-TERM BORROWING VEHICLES		• Lease Revenue Bonds • WIFIA Loans • Capital Leases	• Revenue Bonds • SRF Loans • WIFIA Loans	• Special Tax Bonds	• Tax Allocation Bonds
EXAMPLES					

Voter Approval Required: General Obligation Bonds

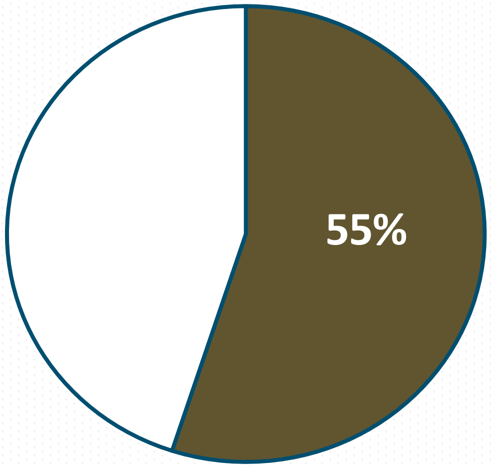
- True "indebtedness" under Constitutional debt limit
- Secured by special levy of ad valorem taxes
  - Generates additional revenue to pay debt service on bonds issued for capital improvements
- Approved by 2/3 majority vote
  - Proposition 39 school bonds approved by 55% majority

VOTER APPROVAL THRESHOLDS

CITIES AND SPECIAL DISTRICTS



SCHOOL DISTRICTS



Proposition 5: Statewide constitutional amendment would make it easier to pass local and regional GO bonds by lowering the voter-approval threshold from two-thirds to 55%

Exception 1: Lease Obligations

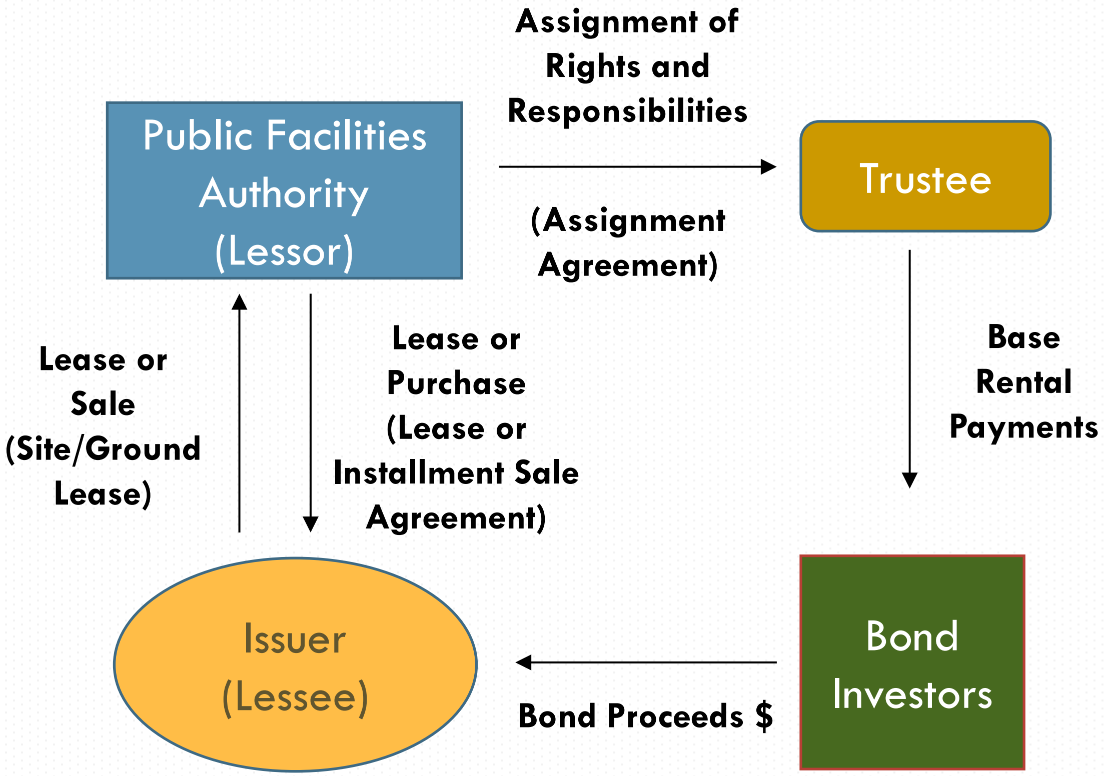
- Lease rules in California commonly referred to as “Offner-Dean,” after the two key California Supreme Court cases
  - Payment for “beneficial use and occupancy” of leased facilities in that year
  - Payment **abated** with loss of use and occupancy
  - No acceleration of future rent in the case of a payment failure
  - Rent cannot exceed “fair rental value” of leased assets

- Payable from “legally available funds”
  - In practice, this means general fund revenues

- Overcoming Abatement Risk
  - Capitalizing interest payments until project is complete
  - Asset transfer—lease leaseback of existing asset
  - Insurance
  - Reserve Fund

Exception 1: Lease Obligations

- Issuer leases an essential asset to a nonprofit corporation or JPA as leasing partner
- Issuer then subleases asset back, and agrees to make lease payments for use of property
- Lease payments serve as debt service on Lease Revenue Bonds or COPs
- Trustee can sue for rent if issuer does not make payments when asset available for use



San Diego Lease Obligations

Master Lease includes
Fire Stations, Libraries, Police Stations, Community Parks, Ground Leases

Public Facilities Financing Authority of the City of San Diego (Lessor)

Rights, Duties and Responsibilities, Administration of Funds →

(Indenture)

Computershare (Trustee)

Lease or Sale (Site/Ground Lease)

Lease or Purchase (Lease or Installment Sale Agreement)

Base Rental Payments

City of San Diego (Lessee)

← **Bond Proceeds $**

Bond Investors

Bond proceeds used for various facility Improvements to parks, libraries, fire stations, sidewalk repairs, street reconstructions, etc.

EXHIBIT B

BASE RENTAL PAYMENT SCHEDULE

Payment Date	*Amount*	*Payment Date*	*Amount*
10/10/2023	$28,101,507.48	10/10/2038	$29,684,577.60
04/10/2024	12,437,840.61	04/10/2039	4,663,602.65
10/10/2024	28,644,665.61	10/10/2039	23,448,602.65
04/10/2025	11,153,090.13	04/10/2040	4,225,643.95
10/10/2025	29,007,890.11	10/10/2040	23,910,643.95
04/10/2026	10,803,711.11	04/10/2041	3,766,282.05
10/10/2026	29,358,111.11	10/10/2041	24,391,282.05
04/10/2027	10,442,841.56	04/10/2042	3,284,562.50
10/10/2027	25,631,741.56	10/10/2042	20,649,562.50
04/10/2028	10,127,221.66	04/10/2043	2,852,237.50
10/10/2028	25,950,721.66	10/10/2043	18,897,237.50
04/10/2029	9,801,763.16	04/10/2044	2,451,112.50
10/10/2029	26,309,388.16	10/10/2044	19,296,112.50
04/10/2030	9,460,496.93	04/10/2045	2,054,462.50
10/10/2030	26,667,503.18	10/10/2045	12,639,462.50
04/10/2031	9,093,215.13	04/10/2046	1,815,312.50
10/10/2031	27,059,296.38	10/10/2046	12,890,312.50
04/10/2032	8,711,651.23	04/10/2047	1,564,962.50
10/10/2032	26,747,094.98	10/10/2047	14,784,962.50
04/10/2033	7,606,853.48	04/10/2048	1,300,562.50
10/10/2033	27,166,853.48	10/10/2048	15,060,562.50
04/10/2034	7,181,230.65	04/10/2049	1,025,362.50
10/10/2034	27,621,230.65	10/10/2049	15,385,362.50
04/10/2035	6,729,905.05	04/10/2050	700,537.50
10/10/2035	28,094,905.05	10/10/2050	15,725,537.50
04/10/2036	6,256,635.35	04/10/2051	360,412.50
10/10/2036	28,606,635.35	10/10/2051	7,045,412.50
04/10/2037	5,750,088.80	04/10/2052	184,931.25
10/10/2037	29,140,088.80	10/10/2052	7,229,931.25
04/10/2038	5,219,577.60		

Base Rental Payments
=
Lease Payments
=
Debt Service Payments

City of San Diego: General Fund Lease Debt

LEASE BORROWING PROGRAM (AS OF 6/30/24)

GENERAL FUND LEASE REVENUE BONDS	
Master Indenture Lease Revenue Bonds:	$497 million
Other Lease Revenue Bonds:	$107 million

OTHER LEASE OBLIGATIONS	
Equipment & Capital Leases:	$74 million
Other Leases with GF Support:	$15 million
Commercial Paper Notes:	$67 million ($21.5 million undrawn)
WIFIA Stormwater Loan:	-- ($359 million undrawn)

Source: Fiscal Year 2025 Adopted Budget Debt Obligations.

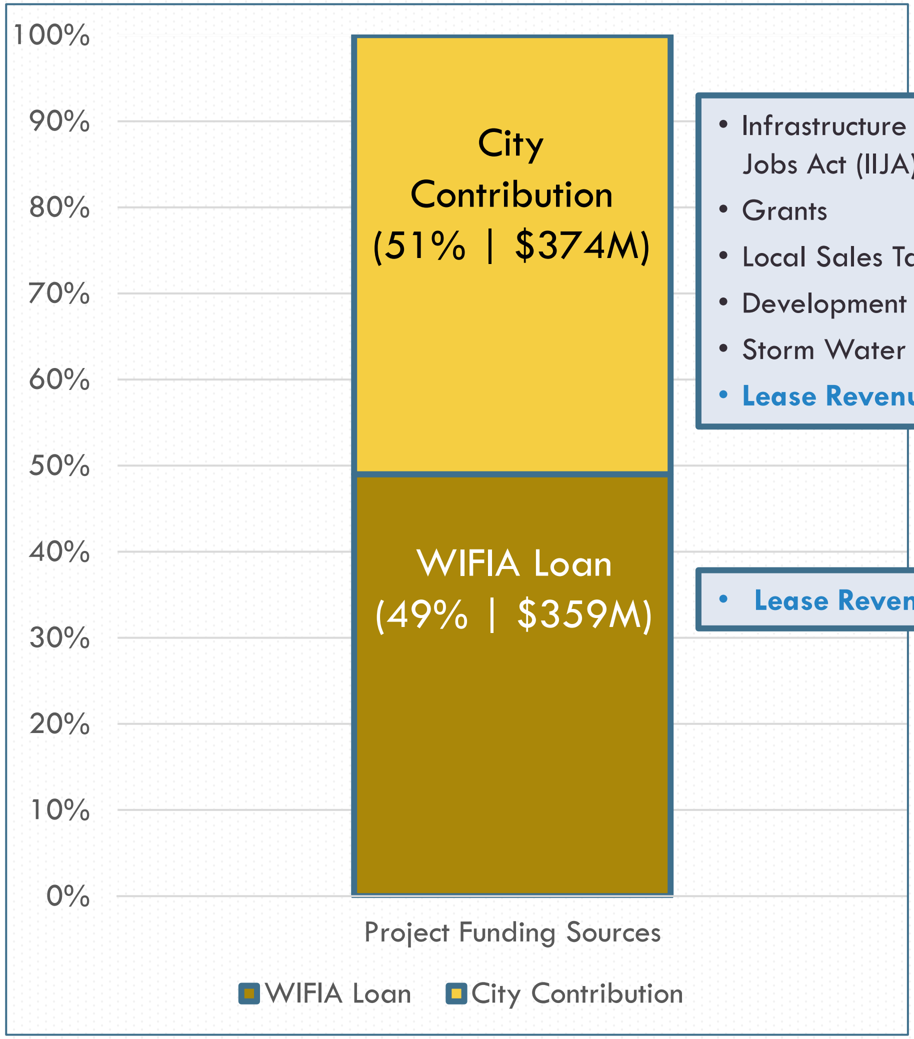
- **FY 2025-2029 Five-Year Capital Infrastructure Planning Outlook[1]**
- Storm Water and transportation (streets, roads, and streetlights) infrastructure are the asset types with largest needs, each comprising $2.2 billion over the CIP Outlook period
- Anticipated funding/financing includes:
  - $534 million in projected long-term lease revenue bond issuances
    - Use of Commercial Paper Program as Interim Financing as needed in FYs 2025 through 2029
  - $733 million of WIFIA Loan and other City-match funds to finance priority Storm Water Program projects
  - ~$300 million of additional lease borrowing via the Equipment and Vehicle Financing Program

1. Fiscal Year 2025-2029 Five-Year Financial Outlook.

City of San Diego: Storm Water Capital Program

- The Storm Water Program is funded primarily from the **General Fund** with minimal support from property-related **storm water fees** and revenue from **parking enforcement** related to street sweeping
- GF pressure and competing priorities
- The City began the development of a storm water funding strategy in 2019 to identify a sustainable long-term funding mechanism for the Storm Water Program
  - analyzed grants, loans and fees;
  - identified cost efficiencies; assessed program innovation;
  - evaluated options for a dedicated, long-term funding mechanism (increased fees)
- Developed a 5-year funding strategy for capital costs
  - $733 million financed through federal Water Infrastructure Finance and Innovation Act (WIFIA) loan and required City-match

STORM WATER WIFIA LOAN BORROWING



- Infrastructure Investment and Jobs Act (IIJA)
- Grants
- Local Sales Taxes (TransNet)
- Development Impact Fees (DIF)
- Storm Water Fees (SRF Loans)
- **Lease Revenue Bonds**

- **Lease Revenue Pledge**

Exception 2: Special Fund Obligations

- Debt limitation interpreted to define restricted "debt" as being paid out of general taxes
  - Does not apply to debt that is paid for out of special revenues and used to finance an asset which is part of a project or system generating such revenues
  - Enterprise fund revenue debt, paid out of service fees and other user charges
- Concept expanded to all special funds
  - Special taxes, fees, assessments or "conduit" finance with private parties
- If special fund revenues are insufficient, there can be no obligation of local agency to pay debt service
  - Lack of a pledge of taxes a key fact distinguishing special fund obligations under California law
  - General Fund revenues usually cannot be transformed into special funds for purpose of securing debt

TYPES OF LIMITED OBLIGATION BONDS

I. Enterprise Revenue Bonds/COPs

II. Special Tax Bonds (Mello-Roos)
- Typically 2/3 voter requirement

III. Assessment Bonds
- Paid by properties that receive special benefit
- Not a tax, 50% vote

IV. Other
- Sales Tax Bonds
- Tax Allocation bonds
- Conduit Bonds

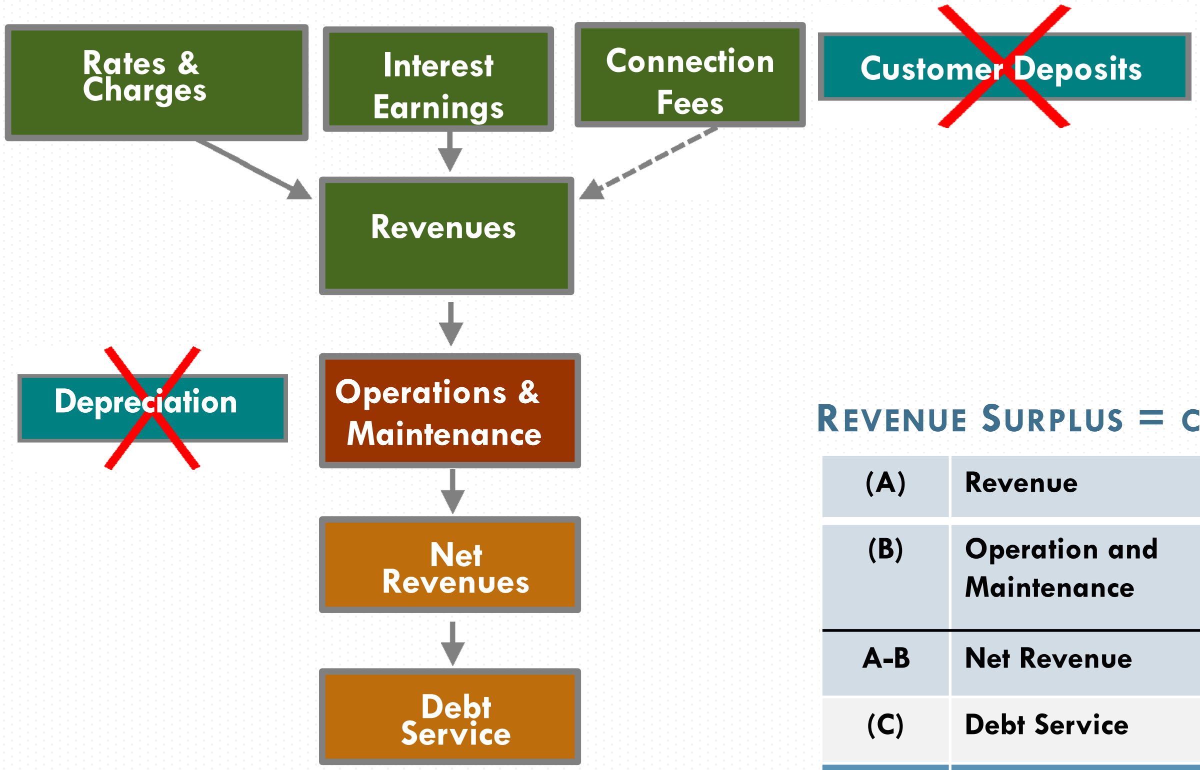
I. Enterprise Revenue Bonds

- Public agencies sell bonds secured by the following enterprises:
  - **Utilities:** Water, wastewater, electric, solid waste
  - **Transportation:** Airports, ports, toll roads, bridges

- Specific revenue stream pledged to bonds
  - Usually for a separate enterprise fund or separate agency supported by user fees
  - Enterprise can consist of an entire revenue-generating system or a single revenue-generating facility

- Revenue bond features
  - Rate covenants to maintain minimum coverage requirement
  - Additional bonds test

I. Enterprise Revenue Bonds



Capital project costs paid after debt service

Revenue Surplus = coverage

(A)	Revenue	$10,000,000
(B)	Operation and Maintenance	7,000,000
A-B	Net Revenue	$3,000,000
(C)	Debt Service	1,500,000
(A-B)/C	Debt Service Coverage (Net)	2.0x

REVENUE BOND SECURITY PLEDGE

- **Net Revenue Pledge:** all fees and charges of enterprise after payment of operations and maintenance (excluding depreciation); no security interest in physical assets of enterprise
- **Rate Covenant:** issuer commits to charge rates sufficient to pay debt service with a coverage cushion; may require rate increases in future with Proposition 218 process
- **Additional Bonds Test:** limits subsequent financings secured by same revenues

City of San Diego: Water Utility Fund Debt

WATER REVENUE DEBT AS OF 06/30/24	
SENIOR/PARITY OBLIGATIONS	
Water Revenue Bonds:	$509 million
State Revolving Fund (SRF) Loans:	$65 million ($56 million undrawn)
SUBORDINATE OBLIGATIONS	
Water Revenue Bonds:	$585 million
SRF Loans:	--
WIFIA Loans	$373 million ($361 million undrawn)
Commercial Paper Program	$123 million ($127 million undrawn)
TOTAL	$1.65 billion outstanding

Source: Fiscal Year 2025 Adopted Budget Debt Obligations.

- **All repayable from Net System Revenues of the Water Utility Fund**
- **Annual Rate Covenants**
  - 1.2x Senior
  - 1.1x Aggregate (Senior + Subordinate)
- **Additional Debt Test for any new loans or bonds**

- Projects include Water Pipelines, Water Transmission Pipelines, Water Storage, Water Treatment Plants, Pump Stations, Pure Water Program Phase 1, and miscellaneous projects
- FY 2025 Annual CIP Budget for Water Fund: $375 million (or 40% of City's overall CIP)

City of San Diego: Pure Water Program Phase I

- $1.6 billion estimated total cost allocated between Water Utility Fund and Sewer Funds

- Water share:
  - 2016 and 2018 Revenue Bonds: $39 million
  - Grants: $19 million
  - WIFIA Loans: up to $733 million (1.29%, 1.82%)
  - State Budget Appropriation: $25 million
  - Cash/Future Bonds

- Sewer share:
  - Grants: $13 million
  - SRF Loans: up to $664 million (0.80%, 1.10%)
  - State Budget Appropriation $25 million
  - Cash/Future Bonds

II. & III. Special Tax & Assessment Bonds

- **Basic premise**
  - Public agency sponsors creation of special district - Property owners agree to put lien on property to fund certain facilities
- **Bond financing**
  - Bonds generate up-front funds for capital projects
  - Repaid with special taxes or assessments levied annually on property tax bill
  - Issuer may foreclose on delinquent parcels
  - In the event of a foreclosure, land value serves as ultimate collateral securing repayment

BENEFITS & CONSIDERATIONS

Benefits

- New revenue stream created for projects
- No payment obligation for public agency

Considerations

- Requires formation of district, which takes time, and voter-approval
- Development projects can be risky in early stages
- Assessment spreads vulnerable to legal challenge

II. & III. Special Tax & Assessment Bonds

	COMMUNITY FACILITIES DISTRICT (CFD)	ASSESSMENT DISTRICT (AD)
Statute	Mello-Roos Act of 1982	1915 Act/1913 Act
Security	Annual special tax on property tax roll	Annual assessment levied on property tax roll
Vote	2/3rds vote of undeveloped property owners or registered voters (Election)	Less than 50% majority protest (Protest Hearing)
Scope	Capital projects with "specific capital projects and maintenance benefits" only	Direct and special benefit improvements, no general public benefit
Spread of Lien	"Reasonable" spread of costs in special tax formula Dynamic payment obligation, can change as development proceeds	Spread must be proportional based on benefit Fixed payment obligation

IV. Other Limited Obligation Bonds

- Sales Tax Revenue Bonds
  - Payable from and secured by revenues from the imposition of a sales and use tax on retail transactions within the issuer's boundaries
- Redevelopment Agency Bonds
  - Secured by dedicated share of property tax (tax increment)
- Conduit Agency Bonds
  - To provide tax-exempt financing for certain “exempt” private activities, secured by a loan to entity

IV. Sales Tax Revenue Bonds

- **Overview**
  - Only public agencies with the statutory authority to impose a sales tax may issue sales tax revenue bonds
  - Sales tax revenues are collected by the California Department of Tax and Fee Administration (CDTFA) and remitted to a Trustee prior to the public agency if sales tax bonds are outstanding
- **When Used?**
  - Although cities and counties may impose sales taxes and issue sales tax revenue bonds, most sales tax revenue bonds are issued by countywide transportation authorities
  - **Direct pledge of sales tax revenues** requires 2/3 voter approval
  - General sales taxes (majority approval) can be used to pay debt service on **general fund lease debt**

BENEFITS & CONSIDERATIONS

Benefits

- Broad-based tax support for public improvements
- Generates new revenue source to repay debt; no support from general fund
- Wide investor acceptance

Considerations

- Time, expense and uncertain outcome of election
- Voter authorization of sales tax required: general tax (majority voter approval) v. special tax (2/3 voter approval)
- Sales tax increase

Exception 3: Obligation Imposed by Law

- Limited case law
  - Key case involved a tax refund in 1921
  - Transactions are "validated" in superior court
  - Debt is a non-contingent obligation of General Fund

- Pension Obligation Bonds most common use of this vehicle
  - Taxable bonds used to extinguish all or a portion of an agency's unfunded pension liability
  - Proceeds are deposited with retirement association, resulting in potential investment gains or losses - Risk arbitrage

- Judgment Obligation Bonds issued occasionally

Bonds or COPs?

- Bonds are a debt
  - Usually have a statutory basis, such as GO, revenue bonds, assessment bonds

- Certificates of Participation (COPs) represent an interest in a payment stream
  - COPs are extra-statutory, created by Wall Street
  - Originally used to avoid statutory restrictions on lease revenue bonds, such as requirement for competitive sale and maximum interest rates
  - Are based on a contract that is legal under one of the "debt limit exceptions"

- While most common for lease obligations, COPs can also be used for special fund obligations
  - Commonly used by general law cities to avoid 1941 Act voter requirements for enterprise revenue bonds

- **Bottom line:** Not much substantive difference between a "Bond" and a "COP"

And What About Tax-Exemption?

- Public agencies benefit from Tax-Exemption
  - Most municipal bonds issued for infrastructure or capital improvements qualify to be issued on a tax-exempt basis
- Bondholders do not pay Federal income tax on interest earnings
  - Investors will purchase tax-exempt bonds at lower yields than taxable bonds
  - Allows a municipal issuer to raise capital at comparatively lower interest rates as compared to taxable/corporate bonds
- Issuers must meet IRS requirements to qualify bonds as tax-exempt
  - For governmental purposes – not for private use
  - Reasonable expectation that proceeds will be expended in 3 years from borrowing
  - Certain invested proceeds may not earn arbitrage (earnings rate > borrowing rate)
  - Certification required to be made by issuer at time of issuance – i.e., tax certificate

However, there are reasons that a public agency may issue taxable debt!

- **Use of proceeds for non-exempt uses**
- **Financing flexibility**
- **Advance refunding of outstanding obligations**

QUESTIONS?

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