

CITY OF DANA POINT
AGENDA REPORT

Reviewed By:	
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DATE: JANUARY 11, 2006

TO: CITY MANAGER/CITY COUNCIL

FROM: INVESTMENT REVIEW COMMITTEE

SUBJECT: EARLY RETIREMENT OF CAPITAL LEASE DEBT OBLIGATION

RECOMMENDED ACTION:

That the City Council authorize the early retirement of the City's outstanding capital lease obligation debt of \$2,925,000 on August 1, 2006, using funds from the City's undesignated General Fund reserve, and modify the fiscal year 2007 General Fund operating budget accordingly.

ISSUE:

Shall the existing debt, which carries an interest rate of 6.35%, be retired prior to its current maturity date of August 1, 2012?

BACKGROUND:

On August 1, 1992 the Capistrano Bay Park & Recreation District ("CBP&RD") entered into an agreement with the CSDA Finance Corporation that resulted in the issuance of a \$6,040,000 20-year debt obligation, structured in the form of a capital lease. A portion of the proceeds of the debt were used by the CBP&RD to purchase vacant land parcels known as the Via Cañon property and the Stonehill/Alipaz property. The Stonehill/Alipaz property was subsequently developed by the City into Creekside Park. The Via Cañon property remains undeveloped.

On December 22, 1993, pursuant to a resolution of the Orange County Local Agency Formation Commission, the CBP&RD was merged with the City, and the City assumed the aforementioned debt obligation. In 1995 and 1996 the City used all of the remaining unspent debt issuance proceeds to make improvements to sports fields at Dana Hills High School in exchange for the right to periodically use the fields for City-sponsored recreation activities.

Since the merger the City has reduced the outstanding principal balance on the capital lease obligation by \$3,115,000, leaving a current outstanding principal

balance of \$2,925,000. This debt carries an interest rate of 6.35% from now until the final principal payment is made on August 1, 2012.

DISCUSSION:

When it was originally issued the debt carried an initial effective interest rate of 3.25%, which gradually grew to the current rate of 6.35%. Due to the decrease in prevailing market interest rates in the intervening years between the original debt issuance and now, the Investment Review Committee ("IRC") evaluated the potential fiscal benefits of retiring the remaining debt prior to its scheduled maturity in 2012. To that end the following three potential courses of action were considered and evaluated by the IRC at its regular meeting on December 6, 2005:

1. Retire the debt early by issuing new debt at a lower rate of interest
2. Retire the debt early utilizing existing City fiscal resources
3. Do not retire the debt early

The following is an analysis of the fiscal impact of each of these options:

Option 1: Retire the debt early by issuing new debt at a lower interest rate

This action, which is called "refunding", would involve the issuance of new debt at lower current market interest rates in an amount sufficient to retire the existing current debt. The financial advisory firm Fieldman, Rolapp & Associates ("FR&A") has generously provided us with an estimate of the potential savings associated with this course of action. It should be noted that their analysis was performed based on prevailing market conditions at the time the analysis was prepared, and that these conditions are subject to change as interest rates change.

FR&A ran projections of cost savings under two scenarios - one with an assumed borrowing rate of 4.6%, and another with an assumed borrowing rate of 4.1%. These projections are included as attachments 1 and 2 to this report. In both cases they factored into the new borrowing the estimated new debt issuance costs of \$100,000 in calculating the net savings through the refunding. FR&A has estimated the savings as follows:

Assumed borrowing rate of 4.1% = **\$164,099 total savings**

Assumed borrowing rate of 4.6% = **\$123,359 total savings**

It should be noted that while these scenarios do factor in third-party issuance costs, they do not include the costs of Staff time which would be involved in the issuance process, nor do they include any City Attorney costs (for which the City contracts to the private sector). As the City has not previously been involved in a debt issuance we do not have any means of accurately assessing the extent of

Staff and City Attorney time which would be involved in the process. However, any such costs would reduce the savings amounts indicated above.

Option 2: Retire the debt early using existing City fiscal resources

Under this scenario the City would utilize existing undesignated General Fund balances to retire the debt. The funding for this would be obtained through the use of funds currently invested by the City in the Local Agency Investment Fund ("LAIF") and/or in U.S. Treasury Notes.

For purposes of this calculation, Staff assumed a future rate of return on City investments of 4.3%, which was the current rate on 5-year Treasury Notes at the time this analysis was prepared. The savings under this alternative would be the difference between the estimated 4.3% the City would earn on its investments if the funds were not used to retire the debt early, and the 6.35% the City would continue to pay on the debt. As shown in attachment 3 to this report, the estimated net interest savings under this scenario amount to \$166,392. Additionally, under the terms of the lease agreement the City pays the trustee, Bank of New York, an annual administration fee of \$3,200 which will be avoided if the debt is retired early. **This increases the estimated total savings under this scenario to \$185,592.**

Option 3: Do not retire the debt early

This is the most costly of the three options. As discussed earlier, at 6.35% the existing debt carries an interest rate that exceeds both that of new debt which could be issued and also the rate of return current being generated by City investments.

Summary and Conclusion

Both options one and two offer significant fiscal advantages to the City, which are summarized as follows:

	Total Savings	Present Value of Savings
Option 1 – refunding (4.1% borrowing rate)	\$164,099	\$144,711
Option 1 – refunding (4.6% borrowing rate)	\$123,359	\$108,196
Option 2 – early payoff using City funds	\$185,592	\$166,440
Option 3 – take no action	None	None

The greatest benefit lies in option two (retiring the debt early using existing financial resources), principally because it avoids the \$100,000 of costs associated with a new debt issuance. However, option two presupposes that the City has sufficient undesignated resources available to actually fund an early retirement.

Due to favorable economic conditions combined with continued effective management control over expenditures, in fiscal 2005 the City generated a General Fund operating surplus (revenues over expenditures) of \$2,584,425, which is the recommended source for the payoff funds. (In total, at June 30, 2005 the City had \$8,035,519 of unreserved and undesignated fund balances).

After consideration and discussion of the three options outlined in this report, the IRC directed Staff to prepare this agenda report and forward their unanimous recommendation that the City Council approve option two, early retirement of the debt using existing financial resources, and modify the City’s operating budget accordingly.

NOTIFICATION/FOLLOWUP:

If the City Council approves the recommended action the trustee, The Bank of New York, will be provided with the required 60-day advanced notice of the early debt retirement.

FISCAL IMPACT:

There is no impact on the adopted budget for FY2006. For FY2007 the expenditure budget would be increased by \$2,494,585 to fund the payoff. This equals the \$3,017,869 payoff amount (\$2,925,000 principal plus \$92,869 of accrued interest through 8/01/06), less the elimination of currently budgeted FY2007 debt service principal and interest payments of \$519,784 and trustee administrative fees of \$3,500. In addition, the investment interest revenue budget for FY2007 will be reduced by \$110,000 to account for City investments that would be liquidated to generate cash to retire the debt.

ATTACHMENTS:

1.	Refunding analysis – assumed borrowing rate of 4.6%	5
2.	Refunding analysis – assumed borrowing rate of 4.1%	6
3.	Early retirement analysis.....	7

ATTACHMENT 1

City of Dana Point 2005 Refunding of 1992 Series Q COPs

Assumed Borrowing Rate = 4.6%

(Private Placement)

Date	Principal	Coupon	Interest	Debt Service	Annual Debt Service	1992 COPs Net D/S	Savings	PV Savings
3/1/2006								
9/1/2006	365,000	4.60%	57,270	422,270	479,540	429,175	6,905	6,598
3/1/2007			48,875	48,875		73,221	24,346	22,741
9/1/2007	385,000	4.60%	48,875	433,875	482,750	438,221	4,346	3,968
3/1/2008			40,020	40,020		61,632	21,612	19,290
9/1/2008	405,000	4.60%	40,020	445,020	485,040	451,632	6,612	5,769
3/1/2009			30,705	30,705		49,250	18,545	15,816
9/1/2009	425,000	4.60%	30,705	455,705	486,410	464,250	8,545	7,123
3/1/2010			20,930	20,930		36,073	15,143	12,341
9/1/2010	445,000	4.60%	20,930	465,930	486,860	476,073	10,143	8,080
3/1/2011			10,695	10,695		22,103	11,408	8,884
9/1/2011	465,000	4.60%	10,695	475,695	486,390	492,103	16,408	12,490
3/1/2012						7,181	7,181	5,343
9/1/2012						(27,836)	(27,836)	(20,246)
	\$ 2,490,000		\$ 359,720	\$ 2,849,720	\$ 2,906,990	\$ 2,973,079	\$ 123,359	\$ 108,196

Par Value Refunded \$2,925,000

PV Savings as % of Par Refunded 3.70%

PV Savings as % of Refunding Par 4.35%

Assumptions

6-Year MMD (A-Rated) = 3.85% as of October 27, 2005	3.85%
+ 50 bps Private Placement + 25 bps interest rate cushion =	0.75%
Assumed Borrowing Rate	4.60%

1992 COPs Par Value Outstanding	\$ 2,925,000
Less: 1992 COP DSR used to reduce amount of refunding bonds	(535,017)
Plus: Cost of Issuance	100,000
Par value of Refunding Bonds	\$ 2,490,000

ATTACHMENT 2

City of Dana Point 2005 Refunding of 1992 Series Q COPs
Assumed Borrowing Rate = 4.1%
(Private Placement)

Date	Principal	Coupon	Interest	Debt Service	Annual Debt Service	1992 COPs Net D/S	Savings	PV Savings
3/1/2006								
9/1/2006	370,000	4.10%	51,045	421,045	472,090	429,175	8,130	7,806
3/1/2007			43,460	43,460		73,221	29,761	28,003
9/1/2007	390,000	4.10%	43,460	433,460	476,920	438,221	4,761	4,390
3/1/2008			35,465	35,465		61,632	26,167	23,642
9/1/2008	405,000	4.10%	35,465	440,465	475,930	451,632	11,167	9,887
3/1/2009			27,163	27,163		49,250	22,087	19,162
9/1/2009	425,000	4.10%	27,163	452,163	479,325	464,250	12,087	10,276
3/1/2010			18,450	18,450		36,073	17,623	14,682
9/1/2010	440,000	4.10%	18,450	458,450	476,900	476,073	17,623	14,387
3/1/2011			9,430	9,430		22,103	12,673	10,138
9/1/2011	460,000	4.10%	9,430	469,430	478,860	492,103	22,673	17,773
3/1/2012						7,181	7,181	5,516
9/1/2012						(27,836)	(27,836)	(20,952)
	\$ 2,490,000		\$ 318,980	\$ 2,808,980	\$ 2,860,025	\$ 2,973,079	\$ 164,099	\$ 144,711

Par Value Refunded **\$2,925,000**

PV Savings as % of Par Refunded **4.95%**

PV Savings as % of Refunding Par **5.81%**

Assumptions

6-Year MMD (A-Rated) = 3.85% as of October 27, 2005 3.85%
+ 25 bps Private Placement + 0 bps interest rate cushion = 0.25%
Assumed Borrowing Rate **4.10%**

1992 COPs Par Value Outstanding \$ 2,925,000
Less: 1992 COP DSR used to reduce amount of refunding bonds (535,017)
Plus: Cost of Issuance 100,000
Par value of Refunding Bonds **\$ 2,490,000**

ATTACHMENT 3

City of Dana Point, 1992 COPs, Series Q

Date	Outstanding Balance	1992 COPs	City Reserve	Savings	Trustee Fees	Total Savings	PV Savings
1/1/2006		6.35%	4.30%				4.30%
9/1/2006	2,425,000	102,658	69,517	33,142	3,200	36,342	35,336
9/1/2007	2,080,000	132,080	89,440	42,640	3,200	45,840	42,734
9/1/2008	1,715,000	108,903	73,745	35,158	3,200	38,358	34,284
9/1/2009	1,325,000	84,138	56,975	27,163	3,200	30,363	26,019
9/1/2010	910,000	57,785	39,130	18,655	3,200	21,855	17,957
9/1/2011	470,000	29,845	20,210	9,635	3,200	12,835	10,111
9/1/2012	<i>Assumes DSR is used to pay D/S in final year</i>						
			\$ 349,017	\$166,392	\$19,200	\$185,592	\$166,440