CITY OF RIVERSIDE

City of Arts & Innovation

City Council Memorandum

TO: **HONORABLE MAYOR AND CITY COUNCIL** **DATE: FEBRUARY 5, 2019**

FROM: **FINANCE DEPARTMENT** **WARDS: ALL**

SUBJECT: **NEW MAIN LIBRARY FINANCING OPTIONS**

ISSUE:

Review financing options, presented herein, for construction costs related to the Main Library Project upon approval of bid award scheduled for the February 5, 2019 City Council meeting. Confirm that traditional bond financing, as recommended by City staff, is the preferred method of financing the Main Library project.

RECOMMENDATIONS:

That the City Council:

1. Receive and provide input on the financing options, presented herein, for construction costs related to the Main Library project; and

2. Direct staff to move forward with the traditional bond financing option with collateral as recommended by the Chief Financial Officer.

BACKGROUND:

On October 2006, the City Council included the Main Library as an expansion project in the Riverside Renaissance Plan. On April 2007, the City hired Pfeiffer Architects from Los Angeles to design a 45,000 square foot shared expansion for the Main Library, including a museum exhibit hall. Between 2008 and 2012, the City pursued various avenues to renovate and expand the existing library, relying on the expertise of design consultants and participation from the local community.

On July 20, 2016, City staff issued a Request for Qualifications (RFQ) for the development of a new Main Library design. Twenty-one firms responded to the RFQ. After scoring the proposals, an Architect Selection Committee (Committee) comprised of City staff, a Library Trustee and a local business member selected the top eight (8) firms to submit responses to a Request for Proposals (RFP).

On November 10, 2016, City staff issued the RFP to the top eight (8) firms with seven (7) companies responding. The Committee reviewed and scored the proposals and agreed to invite the top four (4) firms to participate in the interview phase of the selection process. The Committee held Interviews on March 2, 2017 and subsequently determined that Johnson-Favaro Architects

(Johnson-Favaro) was the most qualified firm to perform the design services pursuant to the conditions of the RFP.

On May 9, 2017, the City Council approved a Professional Consultant Services Agreement (PSA) with Johnson-Favaro for $1,725,000 for architectural and engineering design services for the new Main Library project.

On October 3, 2017, the City Council amended the Measure Z five-year spending plan by allocating an additional $9,692,600 to the new Main Library project, and approved a revised Main Library design to deliver a three-story library, instead of a two-story design as originally planned. At that time, the City Council approved an overall project budget of $39,692,600.

On December 19, 2017, the City Council amended the Measure Z five-year spending plan for a second time (See attachment #4), authorizing an additional allocation of $3.3 Million to construct a City Archive within the new Main Library. At that time, the approved overall project budget inclusive of the City Archive was $43.3 Million for the new Main Library.

On February 20, 2018, the City Council approved a financing team to secure new traditional bond financing for the Main Library project with fees related to the financing to be paid from the proceeds of the financing.

On February 27, 2018, the City Council approved a First Amendment to the PSA with Johnson-Favaro for $342,000 in additional design services, for a revised contract amount of $2,067,000, including $129,630 contingency, for a total not to exceed contract of $2,197,230. The additional design services included changing the library design from a two-story Library, as originally planned, to a three-story library and adding the City Archive to the new facility.

DISCUSSION:

Before City staff submitted a request for bids for the construction of the Main Library, Johnson-Favaro's construction cost estimator provided a revised Engineer's cost estimate of $35,760,000 to build the new Main Library project. This cost estimate includes $3.3 million to construct a City Archive in the new Main Library as approved by the City Council, and a construction escalation cost of $160,000. The $3.3 million City Archive component of the Main Library is included in the Measure Z five year spending and will not be included in debt financing. There is available budget to pay this amount as the construction costs are incurred.

On October 5, 2018, the City Finance/Purchasing Division posted Bid No. 7624 seeking bids from potential bidders for constructing the new Main Library, with a bid due date of December 4, 2018.

The revised overall projected cost for the new Main Library project is $43.3 million as summarized below:

Description	**Costs**
Construction Agreement (Icon West Inc.)	$34,266,308
10% Contingency	$3,426,630
Total Construction Cost	**$37,692,938**
Design Fees	$2,197,230
Project Management, Utility Fees and Permits	$500,000
Furniture, Fixtures & Equipment (FF&E)	$2,609,832
Main Library Overall Projected Costs	**$43,300,000**

A capital project this size has historically been financed by issuing bonds to pay for the construction costs with debt service incorporated into the biennial budget. Debt financing spreads the cost to construct a new facility over a specific time period that is in line with a particular funding stream, or the facility's useful life. Other options include paying for the construction of the facility out of City cash reserves, reimbursing the borrowed funds over a specific time period through an interfund loan or paying for construction via a pay-as-you-go method. Below is a comparison of traditional debt financing with its related costs as well as a potential option of an internal borrowing from the City's cash pool via an interfund loan. The pay-as-you-go method is an option that provides significant costs savings, but requires extensive discussion and input for all stakeholders. A brief description of pay-as-you-go is provided for informational purposes.

<u>Traditional Financing</u>

In a traditional debt financing structure, the City issues bonds in an amount equal to the project costs plus all associated debt issuance costs. To issue a bond is to borrow money. A bond is simply the evidence of the debt, in the same way that a promissory note is evidence of the obligation to repay an ordinary loan. The issuance of bonds in connection with borrowing results in the creation of securities that allow the loan to be bought and sold, i.e. "traded." The buyers of bonds are both individual and institutional investors, who loan money to the public agency issuer (or through the public agency issuer to conduit borrowers) through the purchase of bonds.

A bond typically specifies an obligation to pay a stated amount (the "principal") at a given time (the "maturity") with interest at a stated rate (the "coupon").

Below is a cost estimate using traditional debt financing at a current interest rate over 17 years, which corresponds to the expiration of the Measure Z Transaction & Use tax. While interest rates are volatile and can change rapidly, the current cost of capital in the financing market is still considered to be relatively inexpensive with debt service structured over the useful life of the asset. This structure provides for generational equity which allocates costs over the service life of the asset rather than placing all project costs on current users. Total estimated projects costs are $43.3 million; however, the financed amount is estimated at $40 million as $3.3 million for the City Archive is included in the Measure Z five year spending plan and will be paid out as construction costs are incurred.

	Traditional Financing
Debt Issuance	$40,000,000
Cost of Issuance	$350,000
Underwriter's Discount	$233,870
Premium	($4,608,852)
Term (Years)	17
Projected TIC (Interest)	3.53%
Annual Payment (Average)	$3,187,195
Total Interest Cost	$18,467,908
Total Cost of Debt	$54,442,926

In addition to the financing costs and one-time cost of issuance charges, the City is required to provide essential City assets as collateral for bond financing. To finance the construction of a new facility, collateral is an essential component to entice investors to purchase City bonds. Investors require collateral as a guarantee against the risk of a default.

City Hall is an essential asset that is partially encumbered on another bond transaction. Staff recommends using the remaining portion of City Hall's value as collateral for this transaction. In addition to City Hall, staff would recommend using the Mission Square facility as collateral in this financing deal. While Mission Square was purchased out of ratepayer funds by the Electric Fund, the use of Mission Square as collateral for City financing is legally permissible and would not adversely impact the Electric Fund. Upon completion of the library construction, the financing deal would include language that would substitute the completed library as collateral for the financing, replacing the City Hall and Mission Square assets. This would release those assets from encumbrance and free them up for any future borrowing opportunities. This is the preferred financing structure for construction of the Main Library project.

If the City is unable to provide sufficient collateral from its remaining essential assets for the financing, then the project would be financed via capitalized interest. This is a common financing practice where the primary source of repayment for interest on the debt obligation is built into the financing, essentially paying interest payments out of bond proceeds until such time that the facility is constructed and producing project revenue. Because this process essentially turns construction period interest into a project cost, it is said to be "capitalized." This practice can add an additional $4 - $5 million to the total borrowed amount and is a more expensive option. The City has financed large capital projects in this manner such as the Regional Water Quality Control Plant which was a $200 million project.

Below is the estimated cost of an alternative debt financing structure with a capitalized interest period from May 2019 to November 2020 at the same term and interest rate as the traditional debt financing. This capitalization period assumes a one-year construction phase with an additional six-month timeline cushion, which conforms to S&P Global Ratings credit guidelines for new construction.

	Traditional Financing Plus Capitalized Interest
Debt Issuance	$40,000,000
Capitalized Interest Fund	$2,783,103
Cost of Issuance	$350,000
Underwriter's Discount	$249,113
Premium	($5,061,422)
Term (Years)	17
Projected TIC (Interest)	3.53%
Annual Payment (Average)	$3,433,591
Total Interest Cost	$20,332,188
Total Cost of Debt	$58,652,982

The municipal bond market continues to experience historically low rates and the cost of borrowing is relatively inexpensive. As a result, staff recommends financing the library construction via the traditional financing mechanism using collateral for the bond issue as described above. This allows the City to maintain cash on hand to fund every day operating needs while utilizing debt proceeds to pay for the project. Debt service costs for the library financing has already been budgeted in the Measure Z five-year plan.

Interfund Loan

Government Code 53601 (See Attachment #3), City Charter (See attachment #2), and Interfund Loan Policy (See attachment #1), provide for an additional financing option consisting of an internal borrowing structure more commonly referred to as an interfund loan. The City Treasurer actively manages a cash investment pool of approximately $600 million. The investment pool is a combination of cash on hand across multiple City funds such as the General Fund, Measure Z, Electric, and Water Funds. The funds are available to pay operating costs of the respective funds and are frequently replaced with additional operating revenue. A certain component of the funds on hand are also part of the various City maintained required cash fund reserves.

The City has historically used interfund loans as a means of funding certain projects for which external, traditional bond or bank loan financing was either not available or not cost effective. All interfund borrowing must be authorized in advance by the City Council. Interfund loan projects have most often been in the three (3) to five (5) year repayment term, though some have been approved with longer repayment terms for various reasons, consistent with the terms of the Interfund Loan Policy.

In accordance with policy, interfund loans would include a variable interest rate recalculated annually, and equivalent to the City's pooled investment portfolio rate of return during that same fiscal year. As of June 30, 2018 that rate was 1.722%. Any loan made with an interest rate lower than the City's pool rate must be made from the City's General Fund, which has no interest restrictions, unlike the enterprise funds. Any loans with an interest rate other than the City's pool rate should be specifically disclosed when City Council authorization is obtained for the loan.

Below is a listing of several interfund loan options that vary by year and/or interest rate. These options include a potential savings comparison over traditional debt financing. This list is not exhaustive, but is intended to provide sample scenarios if the Council chooses one of these options.

Loan Amount	$ 40,000,000					
Current Cash Pool Rate is ~ 1.9%						
	Scenario 1	**Scenario 2**	**Scenario 3**	**Scenario 4**	**Scenario 5**	**Scenario 6**
Term (Years)	17	17	17	9	9	9
Interest Rate	2.00%	2.50%	3.00%	2.00%	2.50%	3.00%
Annual Payment	$ 2,798,794	$ 2,917,111	$ 3,038,101	$ 4,900,617	$ 5,018,276	$ 5,137,354
Total Interest Cost	$ 7,579,492	$ 9,590,884	$ 11,647,720	$ 4,105,557	$ 5,164,480	$ 6,236,189
Total Cost of Loan	$ 47,579,492	$ 49,590,884	$ 51,647,720	$ 44,105,557	$ 45,164,480	$ 46,236,189
Interest Savings over Traditional Financing Scenario	**$8,716,390**	**$6,704,998**	**$4,648,161**	**$12,190,324**	**$11,131,401**	**$10,059,693**

The interfund loan option is a fiscally prudent option given the estimated savings amount, but is not without its challenges. Reserves are meant to be used, whether for unplanned or unusual circumstances; however, the use of reserves should be limited for emergencies or unique operational costs. If the interfund loan option is selected, the City would be unable to access those funds until the loan is repaid. The City could not issue bond debt to refinance the interfund loan in the event of cash shortage or unplanned event. As the discussion continues on the CalPERS challenge and with the fiscal constraints ahead of us, the ability to utilize available cash on hand to meet long term financial obligations will be critical. In addition, several of the larger City funds that have available cash balances to loan also have cash reserve policies that require the fund maintain a certain level of cash on hand. These reserves were set to maintain the overall health of the fund and are considered a positive credit factor for the credit rating agencies, demonstrating the City's solvency and debt coverage ability.

If the City chooses to use the cash pool for an interfund loan, City Finance will analyze the various funds to ensure that borrowing will not adversely impact any fund. Rather than burden one fund by reducing it by the $40,000,000 needed for the library construction that is net of the $3.3 million City archive component cash contribution, City Finance will allocate the borrowing to several funds, attempting to mitigate any cash flow constraints or cash reserve implications to the extent possible. Interest will be paid to the lending fund (e.g. Electric, Water, Sewer fund) based on the average annual rate of return for the cash pool which is in accordance with the interfund loan policy.

In 2014, interfund loans received public scrutiny from citizens concerned that the practice was illegal. The City Attorney's Office opined that interfund loans were not illegal.

Interfund loans are authorized by Riverside City Charter Section 1110 stating ".... Transfers and loans may be made by the City Council from one fund to another as may be required." Additionally, California Government Code Section 53601 does not exclude them from permissible investments for the City's cash pool.

By way of background, the City has previously used interfund loans for many years as a legal and effective cash management tool and financing method to bridge capital project funding gaps, a practice that is used by many governmental entities throughout the State of California. The amount of funds required is significantly larger than previous interfund loans. Given the project costs and amount needed to fund construction, City staff does not recommend the use of an interfund loan for a project this size; however, consideration of an interfund loan for smaller capital projects should be discussed as a potential financing option.

In addition to these two primary options, City staff considered the pay-as-you-go (PayGo) option. The premise of PayGo is simple: pay for capital projects not with borrowed money or new revenues, but by saving or freeing up money from existing sources. While PayGo is a potentially viable option, staff considered it infeasible for the Main Library as a funding option due to the time-intensive process that would be necessary to revisit and re-adopt the Measure Z priorities (with the public, Budget Engagement Commission and the City Council) contained in the December 2018 City Council amended five-year Measure Z spending plan.

Summary

While there are other financing options available, City staff recommends the use of traditional debt financing and is a relatively cost-effective financing method with an approximate annual interest rate of 3.5% depending on market conditions at the time of debt issuance. The payoff term for a traditional debt financing is tied to Measure Z available funding, and the projected debt service payments are already included in the five-year spending plan. This option provides a longer term to pay back the debt, which reduces annual budgetary impact. Traditional debt financing also keeps cash on hand available for other projects. Conversely, once debt is issued the City is locked into that financing mechanism until it can either refinance it, or pay it off. Bonds are often restricted for a period of years before they can be refinanced or prepaid (called) them. The City can issue bonds that could be refinanced earlier, but generally the shorter the time period before you can refinance (call date) the higher the resulting interest rate. In addition, due to the longer timeframe of the traditional debt financing, the interest cost would be greater, resulting in a significantly higher final project cost.

With the interfund loan option, the cost of capital is tied to the cash pool rate, which is lower than the bond market average interest rate. The total all-in cost of an interfund loan would be several million dollars less than traditional debt financing, depending on the terms of the borrowing. There are no cost of issuance charges with an interfund loan, and subsequent annual disclosures are not required. This saves the City annual consulting fees and staff administrative time to prepare and file annual disclosure statements, legislative reports, and to meet special accounting and auditing requirements. There are no prepayment penalties on an interfund loan. The City can prepay or pay off the interfund loan any time, should Measure Z fund balance rise significantly higher than recommended reserves. Conversely, borrowing from the cash pool reduces the ability to access cash in the event of an emergency, or to meet policy reserve requirements. Overall cash position is also a component that credit rating agencies review on an annual basis. Any reduction in cash on hand could adversely impact the credit rating for that fund, reducing the City's ability to cost-effectively issue new debt through the sale of bonds.

FISCAL IMPACT:

Depending on the financing option, the total costs, including cost of issuance for construction of the Main Library, range from approximately $44 million using the Interfund loan option to approximately $58 million for a traditional financing with capitalized interest. Without capitalized interest, traditional debt financing would be approximately $54 million. Both traditional financing option estimates are dependent on market conditions at the time of debt issuance.

Prepared by: Edward Enriquez, Chief Financial Officer/City Treasurer
Certified as to
availability of funds: Marie Ricci, Assistant Chief Financial Officer
Approved by: Lea Deesing, Assistant City Manager
Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. Interfund Loan Policy
2. City Charter Section 1110-Cash Management
3. California Government Code Section 53601
4. Five Year Spending Plan
5. Presentation