CITY COUNCIL COMMUNICATION:

00-299

AGENDA:

JULY 10, 2000

SUBJECT:

ISSUANCE OF NOT TO EXCEED $10,000,000 GENERAL OBLIGATION CAPITAL LOAN NOTES FOR ALLIED GATEWAY CAMPUS PROJECT

TYPE:

<u>RESOLUTION</u>
ORDINANCE
RECEIVE/FILE

SUBMITTED BY:

KEVIN RIPER
FINANCE DIRECTOR

ITEM ____

OFFICE OF THE CITY MANAGER
CITY OF DES MOINES, IOWA

SYNOPSIS -

The primary funding source for the City's out-of-pocket contributions to the Allied Gateway Campus Project is tax increment, as outlined in Roll Call No. 00-266 and Council Communication Number 00-037, approved on February 1, 2000. Tax increment, of course, is a long-term recurring annual funding source, but the City needs cash now in order to acquire and prepare the site to be occupied by the Allied Gateway Campus Project. Therefore, staff has negotiated with a local financial institution (Wells Fargo, formerly Norwest) the terms of a new financial instrument that will enhance the City's flexibility in long-term debt management: a 10-year, $10 million loan agreement, to be repaid by Tax Increment Financing (TIF) or any other source the City later designates, with a year-to-year appropriation clause that prevents the loan from being counted against the City's constitutional debt limit.

FISCAL IMPACT -

Since the loan is for a private purpose, interest on the loan will be taxable to investors, just as portions of the City's recent Public Parking System Revenue Bonds (Series 2000B) and General Obligation Bonds (Series 2000E) were. Such loans carry a higher interest rate than traditional tax-exempt municipal debt. Combined with the unsecured nature of this loan, the taxability drives the fixed, 10-year interest rate into the "prime rate" range of 9.69 percent. Even so, staff and the City's financial advisor, Public Financial Management, Inc., feel that both the interest rate and terms of the loan agreement are fair and in the best interest of the City. At the $10 million loan amount, annual debt service would be $1.69 million, as shown in the attached downtown TIF district projections over the next seven years. For comparison, a taxable 10-year "full faith and credit" general obligation bond, of the type the City sells each spring, would require annual debt service of $1.56 million. The loan contains a seven-year call provision, and the City's intent is to set aside TIF funds to call the note at that time.

RECOMMENDATION -

Approve and authorize a form of loan agreement and the issuance of not-to-exceed $10,000,000 General Obligation Capital Loan Notes to Wells Fargo Brokerage Services, LLC (Michael Olauson, Senior Vice President, Minneapolis, MN), for the acquisition, demolition and clearance, relocation, and site preparation costs associated with the Allied Gateway Campus Project and other private redevelopment initiatives.

BACKGROUND -

There are two policy reasons to consider this new type of debt instrument as an alternative to traditional general obligation bonds: flexibility in debt management and enhancing the City's reputation in the capital markets as an innovative and reliable borrower.

1. Flexibility in debt management. The economic activity and development in the City are already attracting, and are likely to attract more, demand for City capital contributions in amounts that only borrowing can provide. These needs are likely to soak up all of a possible $35 million in additional general obligation debt capacity that would arise from, say, a 10 percent increase (from 70 percent to 80 percent) in the self-imposed debt limit. Many, perhaps all, of these requirements will need to be met with traditional general obligation bonds. In contrast, the Allied Gateway Campus Project is attractive to Wells Fargo and its sophisticated investors because of the strong financial position of both Allied/Nationwide Insurance and the City itself, and the project's key placement in the midst of downtown. The financing opportunity such as the one recommended here is not likely to recur. Indeed, Wells Fargo reports that "There are only half a dozen cities in our service area - all states west of the Mississippi - that Wells Fargo would even consider talking to about this kind of financing, and Des Moines is one of them." Thus, maximum flexibility for long-term development would result from issuing the recommended capital loan notes to Wells Fargo for the Allied Gateway Campus Project, and reserving the traditional general obligation bond capacity for other projects as they arise.

2. The City's reputation as an innovative and reliable borrower. As noted by Wells Fargo in paragraph #12 above, the City's strong reputation in the capital markets provides the City with an opportunity to avail itself of a financing instrument that does not

require a pledge of the full faith and credit of the City. Expanding its portfolio of borrowing techniques, and paying the debt service in a timely manner (see discussion below) will cement the City's reputation as a progressive and faithful borrower. Thus, the City will be better positioned to consider taking advantage of future innovations in public finance. Finally, both municipal bond rating agencies (Moody's and Standard & Poor's) have indicated that the recommended Allied Gateway Campus Project financing would not harm the outlook for the City's general obligation bond rating.

In addition, there is always the possibility that a new law or judicial ruling could narrow the definition of "assessed valuation" of the City's taxable property, which would cause an automatic decrease in the City's debt margin. The recommended financing would provide a debt margin cushion against such an event.

Balanced against these policy reasons in favor of the recommended financing is the additional cost: an estimated $130,000 in higher annual debt service at the 9.69 percent rate that Wells Fargo will charge, compared with traditional general obligation debt. A disadvantage, however, of falling back on general obligation bonds for the Allied Gateway Campus Project (in addition to the debt limit implications described above) is that the process will take two or three months, during which time the City will be exposed to interest rate risk, i.e., rates could rise closer to, or even higher than, Wells Fargo's 9.69 percent (rates could fall, too). The latter interest rate has been "locked" for the City ever since Council set the date of public hearing three weeks ago, and will hold through Friday, July 14, 2000.

On balance, staff and the City's financial advisor feel the benefits of the recommended financing for the Allied Gateway Campus Project outweigh the additional cost, and strongly urge its approval.

The City's general obligation debt subject to the constitutional debt limit is backed by the "full faith and credit" of the City, and the uncapped debt service levy, often supplanted by TIF. In contrast, the loan proposed here would be backed solely by the City Council's annual appropriation of TIF or other available funds, subject to just two major covenants (minimum $3 million available general fund balance, and a pledge to maintain enough uncommitted TIF to pay the annual debt service). The loan would be callable in seven years.

Although in a legal sense, the repayment of this loan is subject to annual "risk of non-appropriation" by future City Councils, in a practical sense, the capital markets and the municipal bond rating agencies will expect the City to pay debt service timely. If the City ever were to determine not to appropriate funds for payment of debt service on this loan, then retribution in the capital markets would be swift and punishing. In the worst case, access to the capital markets would be denied to the City, perhaps for a long time. At the very least, the City would be charged substantially higher interest rates on any subsequent financings, and the rating agencies would almost certainly downgrade the City's bond rating - perhaps on more than just general obligation bonds.

Therefore, the City's ability to repay this loan from future TIF, or other available sources, is critical. The TIF projection attached is based on the longstanding assumption that taxable valuations in the City's TIF districts will increase three percent annually. If this projection proves too optimistic, then the City will have less flexibility in the future to fund other TIF-supported projects.

The next step in financing the Allied Gateway Campus Project is a separate $10 million "assignment and loan agreement" (also being negotiated with Wells Fargo) - for a much shorter term - that will serve as "bridge financing" for the project until Allied pays the City up to $10 million to reimburse the City for the City's cost of acquiring certain parcels on the project site.

Attachments