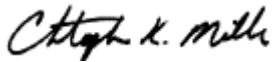


REQUEST FOR COUNCIL ACTION

Date: 11/14/11
Item No.: 13 . a

Department Approval



City Manager Approval



Item Description: Discussion on Fire Station and Park Improvement Bond Allocation

BACKGROUND

At the October 24, 2011 City Council meeting, the Council authorized the issuance of \$10 million in general obligation bonds to finance the construction of a new fire station and various park improvements. The bonds are part of a larger \$27 million funding package that is scheduled to be fully implemented by 2013.

City Staff had recommended that \$8 million be allocated for the fire station, and \$2 million for the park improvements. This recommendation was based on IRS Regulations that pertain to City-issued tax exempt bonds and is consistent with the City's cash flow needs. City Staff further recommended that a subsequent bond be issued in 2012 and again in 2013 to complete the funding package.

While the Council has discretion to determine the eventual bond allocation package, Staff felt it was important for the Council to understand the various factors that led to Staff's recommendation. These guiding factors are addressed in greater detail below.

Overview of Applicable IRS Regulations

The United States Internal Revenue Code establishes regulations to govern the issuance of tax exempt bonds by governmental agencies including municipalities. The tax exemption is essentially a federal subsidy and over time was increasingly abused. To counter this, regulations were put in place in 1986 to discourage issuers from:

- 1) Issuing more bonds than were needed
- 2) Issuing bonds before they were needed
- 3) Leaving bonds outstanding longer than needed

These regulations became known as 'Arbitrage and Rebate Regulations'. In essence, municipalities face financial penalties and added regulatory costs if they fail compliance. With regard to the proposed bond financing for a new fire station and park improvements, only the second bullet point will come into play.

Specifically, the City must spend down a certain percentage of the bond proceeds at various intervals over a 2-year period. Failure to meet these spend-down requirements will trigger potential penalties and added regulatory costs.

To avoid this, the City should consider structuring the bonds and set the timing of when those bonds are issued to be consistent with projected cash-flow needs.

A second IRS concern is with respect to the bond's tax exempt status. Generally speaking, tax exempt bond proceeds must be spent within 3 years to retain tax exempt status. If the proceeds are not spent within 3 years, the bonds become taxable for income purposes. Any investor holding the bonds would now have to pay income taxes on the earnings which would immediately lower the value of the investment itself. This could have a detrimental impact on investor relations on future bond issues, potentially shrinking the number of interested bidders.

Projected Construction Cash Flow Needs

As noted above, the cash flow needs of the fire station and park improvements construction should be a consideration in when and how much bonds are issued.

With regard to the new Fire Station, the City Council has already authorized the hiring of a construction manager, architect, and demolition contractor. The City can expect to incur several hundred thousand dollars in costs over the next few months. Beginning in the spring of 2012, it is expected that the City will have entered into all construction contracts and will incur approximately \$435,000 per month in construction costs. The \$8 million is expected to be fully spent by October, 2013.

In contrast, the implementation schedule for the park improvements is scheduled to take place over 5 years. The improvements have not been prioritized, nor has the City taken any steps to hire a construction manager or architect/consultant to begin designing the improvements and assessing the optimal phasing strategy. It is further anticipated that neighborhood meetings will take place on the proposed improvements once preliminary designs are complete.

Based on these timeline-related factors, \$2 million should be more than sufficient to offset any park acquisition or design that may occur through June, 2012 or later. Depending on the level of citizen involvement in the proposed improvements, it is conceivable that actual park improvements will not begin until the fall of 2012. If this timeline proves accurate, the vast majority of the \$19 million in proposed park improvements would not occur until 2013 or beyond.

In short, the construction timeline for the park improvements would easily be met by the planned issuance of \$2 million in 2011, \$10 million in 2012, and \$7 million in 2013.

Final Comments

The Staff Recommendation noted above was designed to avoid any IRS penalties while meeting our cash flow needs. Certainly the City Council has discretion to select a different timeline and bond allocation plan. While it's difficult to estimate what the financial penalties and added regulatory costs will be if we fail to comply with IRS regulations, it could easily exceed \$200,000 if the City fails to comply with the entire \$27 million package.

A more significant penalty would arise if the City loses tax-exempt status on its bonds because it issued bonds too early and subsequently failed to spend the proceeds within the allotted timeframe.

POLICY OBJECTIVE

See discussion on applicable IRS Regulations described above.

81 **FINANCIAL IMPACTS**

82 Not applicable.

83 **STAFF RECOMMENDATION**

84 By previous correspondence, Staff recommended that \$8 million be allocated for the fire station, and \$2
85 million for the park improvements, for this initial funding package. But it is acknowledged that there may
86 be other considerations not addressed above.

87 **REQUESTED COUNCIL ACTION**

88 The Council is asked to pass a motion to formally allocate the 2011 Bond proceeds for the construction of a
89 new fire station and park improvements.

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Prepared by: Chris Miller, Finance Director

Attachments: A: Not applicable.