



Staff Report

City of Manhattan Beach

TO: Honorable Mayor Tell and Members of the City Council

THROUGH: David N. Carmany, City Manager

FROM: Bruce Moe, Finance Director
Henry Mitzner, Controller
Eden Serina, Budget Analyst

DATE: October 18, 2011

SUBJECT: Consideration of a Resolution for the Early Redemption of \$3,240,000 of Outstanding Water and Wastewater Certificates of Participation, to Be Financed By an Inter-fund Loan from the General Fund (Reserve for Economic Uncertainty) to the Water and Wastewater Funds and Existing Bond Reserve Balance

RECOMMENDATION:

The Finance Subcommittee and City staff recommend that the City Council adopt Resolution No. 6330 which will: a) approve the early redemption of the remaining Water and Wastewater bonds issued in 1996; and b) approve inter-fund loans from the General Fund (utilizing Economic Uncertainty designated funds) to the Water Fund (\$1,944,678) and the Wastewater Fund (\$956,751). Staff further recommends that the City Council appropriate \$2,171,605 from the Water Fund and \$1,068,395 from the Wastewater Fund in order to redeem the bonds.

FISCAL IMPLICATION:

The redemption of the \$3,240,000 in outstanding Water and Wastewater bonds may be accommodated through the utilization of \$2,901,429 of the General Fund's Economic Uncertainty Reserve (currently at \$4 million). The total amount of the redemption plus interest will be paid back to the General Fund by the Water and Wastewater Funds according to the attached schedule.

BACKGROUND:

In September 1996, the Manhattan Beach Capital Improvements Corporation issued \$4,615,000 of debt in the form of Certificates of Participation to finance 1996 and 1997 enterprise fund projects related specifically to the water and wastewater systems. The certificates bear annual coupon interest between 5.3% and 5.8%, and mature in stages through 2026. The remaining principal and interest payments of the outstanding Certificates equal \$4,947,393 (\$3,240,000 in principal and \$1,707,393 in interest). Annual debt service through September 2026 for the remaining certificates range from \$321,000 to \$338,000. There is a legally required debt service reserve fund held by the bond trustee in the amount of \$338,571.

DISCUSSION:

As of August 31, 2011, the City's investment portfolio yielded 1.21%. The current investment environment offers historically low yields and is not showing significant signs of improvement in the near future. An alternative to investing in low-yielding securities is to utilize funds to pay off the high interest rate debt of the Water and Wastewater Funds, saving approximately \$1,076,526 in interest payments according to the attached accelerated payoff schedule.

The proposed accelerated payoff schedule assumes a gradual increase in the City's portfolio yield (maxing out at 5% annually), but the yield is expected to remain below the interest rates of the outstanding bonds (5.3% to 5.8% coupon rate). These lower interest rates (which are in line with our current portfolio yield and used for other existing inter-fund loans) will be used to calculate the interest on the loan from the General Fund to the Water and Wastewater funds. **The accelerated payoff schedule maintains a similar annual level of debt service to that of the original bond issue but allows a greater portion of the loan principal to be paid off due to the lower interest payment.** The significant savings ultimately result in the entire principal being repaid three years ahead of schedule (see Attachment "A").

Alternatives

Other alternatives to the inter-fund loans were considered as well. Performing a refunding of the bonds (e.g., issue new bonds to pay off the old bonds) would result in reduced interest expense, however, the costs of issuance (legal, financial advisory, underwriter, etc.) would reduce the overall savings, and would be more expensive than the inter-fund loan plan.

Staff also discussed a private placement arrangement where a bank or other firm would loan the City the funds to payoff the existing bonds. This arrangement was also not as cost effective as the proposed inter-fund loan because the rates would be higher than our portfolio rate and some legal expenses would be incurred. Further, the maximum term is limited to ten years (albeit at a fixed rate) which would result in refinancing in ten years, or requiring a higher payment now to amortize the loan within that timeframe. Current water and wastewater user rates are set based on the existing debt service, and could not accommodate such an increase without a corresponding rate increase.

Staff has concluded that the most cost effective method to redeem these bonds is through the proposed inter-fund loans.

Mechanics of the Inter-fund Loan

The recommended loan utilizes a portion of the General Fund's \$4 million Economic Uncertainty Reserve to pay off the bonds. Total payment to the bond trustee will be \$3,240,000, consisting of the existing reserve fund of \$338,571 plus a transfer of \$2,901,429. Payment will be \$2,171,605 to the Water Fund and \$1,068,395 to the Wastewater Fund.

While liquidity in the General Fund will be reduced, total assets will not be compromised due to the simple exchange of current assets (reserved cash) for long-term assets (loan receivable). The inter-fund loan will be considered a long-term investment for the General Fund as the interest rate of the loan will be commensurate with the City's investment portfolio yield (similar to the structure of the existing inter-fund loan between the CIP Fund and the Parking Fund). The City's investment

portfolio yield is higher than any other investment option currently available on the market making the loan an attractive investment.

CONCLUSION:

The interest rates on the Water and Wastewater bonds (5.3% to 5.8%) will exceed the City's current and projected portfolio yield, which is expected to remain at low levels for the foreseeable future due to the economic climate. Further, with few investment alternatives available to the City that would approximate the yields on the Water and Wastewater bonds, the use of idle cash earning 1.21% is an attractive alternative to reduce costs.

Inter-fund loans from the General Fund to the Water and Wastewater Funds are required to enable the early redemption of the outstanding bonds. Such loans will carry an interest rate that corresponds to the current City portfolio yield and will be variable in nature. The use of the Economic Uncertainty reserve will not create cash flow or working capital deficiencies. Further, other reserves, including the General Fund policy reserve of approximately \$10 million, remains in place in the event we were to encounter sudden and severe financial difficulties.

As a result of this analysis, The Finance Subcommittee and City staff recommend that the City Council adopt Resolution No. 6330 which will: a) approve the early redemption of the remaining Water and Wastewater bonds issued in 1996; and b) approve inter-fund loans from the General Fund (utilizing Economic Uncertainty designated funds) to the Water Fund (\$1,944,678) and the Wastewater Fund (\$956,751). Staff further recommends that the City Council appropriate \$2,171,605 from the Water Fund and \$1,068,395 from the Wastewater Fund in order to redeem the bonds.

- Attachment: a) Loan term Sheet and Repayment Schedule
b) Resolution No. 6330

ATTACHMENT A

LOAN TERM SHEET
\$2,901,429 in Inter-fund Loans from the General Fund to the
Water and Wastewater Funds

Purpose	To facilitate the early redemption of \$3,240,000 in outstanding Water and Wastewater certificates of participation, for the intent of realizing significant interest savings over the long term for the Water and Wastewater Funds
Borrower	Water and Wastewater Funds
Lender	General Fund
Amount	The General Fund will extend a \$1,944,678 loan to the Water Fund and a \$956,751 loan to the Wastewater Fund
Interest	The interest rate will be based on the City’s total portfolio yield, which is calculated on a monthly basis. Interest on the balance of the loan will be calculated by the Finance Director on a monthly basis and paid out semi-annually, on each September 1 st and March 1 st .
Term	The loans will be repaid in full no later than September 1, 2023 (“Maturity Date”). There will be no penalty for early principal repayment. See “Format” below.
Format	The General Fund will utilize its Economic Uncertainty Reserve to extend inter-fund loans to the Water Fund in the amount of \$1,944,678 and to the Wastewater Fund in the amount of \$956,751. The Water and Wastewater Funds will then make a direct payment to the bond trustee (U.S. Bank) in the above said amounts. Existing debt service reserves already in possession of the bond trustee in the amount of \$338,571 will be used to complete the redemption of the outstanding \$3,240,000 in certificates of participation. The inter-fund loans will to be repaid to the General Fund with interest, over a twelve-year period.

While the Maturity Date is September 1, 2023, transfers will be made from the Water Fund and the Wastewater Fund on September 1st of each year, starting September 1, 2012, to prepay a portion of the outstanding principal of the loans. The amount of prepayment for any September 1st will be calculated by the Finance Director, so that the total principal and interest paid during that fiscal year will approximate the amount of debt service on the certificates of

participation, if the certificates had remained outstanding. Estimated total debt service payments are listed in the Loan Repayment Schedule below.

Loan Repayment Schedule (Estimate*):

Payment Date	Original Payoff Schedule			Accelerated Payoff Schedule					
	Principal Payment	Coupon Rate	Interest Payment	Principal Payment	Coupon Rate	Principal Due	Interest Payment	Estimated Savings	Annual Savings
03/01/12		2.8125%	\$93,189		0.747%	\$3,240,000	\$24,203	\$68,986	
09/01/12	\$135,000	2.8125%	93,189	\$275,000	0.747%	3,240,000	24,203	(71,014)	(\$2,028)
03/01/13		2.8125%	89,392		0.747%	2,965,000	22,149	67,243	
09/01/13	145,000	2.8125%	89,392	280,000	0.747%	2,965,000	22,149	(67,757)	(513)
03/02/14		2.8125%	85,314		0.747%	2,685,000	20,057	65,257	
09/01/14	155,000	2.8125%	85,314	285,000	0.747%	2,685,000	20,057	(64,743)	514
03/01/15		2.8125%	80,954		1.500%	2,400,000	36,000	44,954	
09/01/15	165,000	2.8125%	80,954	255,000	1.500%	2,400,000	36,000	(45,046)	(91)
03/01/16		2.8750%	76,314		1.500%	2,145,000	32,175	44,139	
09/01/16	175,000	2.8750%	76,314	265,000	1.500%	2,145,000	32,175	(45,861)	(1,723)
03/01/17		2.8750%	71,283		1.500%	1,880,000	28,200	43,083	
09/01/17	185,000	2.8750%	71,283	255,000	2.500%	1,880,000	47,000	(45,718)	(2,635)
03/01/18		2.8750%	65,964		2.500%	1,625,000	40,625	25,339	
09/01/18	195,000	2.8750%	65,964	250,000	2.500%	1,625,000	40,625	(29,661)	(4,323)
03/01/19		2.8750%	60,358		2.500%	1,375,000	34,375	25,983	
09/01/19	210,000	2.8750%	60,358	265,000	2.500%	1,375,000	34,375	(29,018)	(3,035)
03/01/20		2.8750%	54,320		2.500%	1,110,000	27,750	26,570	
08/31/20	220,000	2.8750%	54,320	275,000	2.500%	1,110,000	27,750	(28,430)	(1,860)
03/01/21		2.9000%	47,995		2.500%	835,000	20,875	27,120	
08/31/21	235,000	2.9000%	47,995	290,000	2.500%	835,000	20,875	(27,880)	(760)
03/01/22		2.9000%	41,180		2.500%	545,000	13,625	27,555	
09/01/22	250,000	2.9000%	41,180	305,000	2.500%	545,000	13,625	(27,445)	110
03/01/23		2.9000%	33,930		2.500%	240,000	6,000	27,930	
09/01/23	265,000	2.9000%	33,930	240,000	2.500%	240,000	6,000	52,930	80,860
03/01/24		2.9000%	26,245		2.500%	-	-	26,245	
09/01/24	285,000	2.9000%	26,245		2.500%	-	-	311,245	337,490
03/01/25		2.9000%	17,980		2.500%	-	-	17,980	
09/01/25	300,000	2.9000%	17,980		2.500%	-	-	317,980	335,960
03/01/26		2.9000%	9,280		2.500%	-	-	9,280	
09/01/26	320,000	2.9000%	9,280		2.500%	-	-	329,280	338,560
Total	\$3,240,000		\$1,707,393	\$3,240,000			\$630,867	\$1,076,526	\$1,076,526

* The coupon rate of the inter-fund loan is estimated above. The coupon rate will be a variable rate based on the City's portfolio yield which is calculated on a monthly basis.

RESOLUTION NO. 6330

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF MANHATTAN BEACH, CALIFORNIA, AUTHORIZING INTERFUND LOANS FROM THE GENERAL FUND TO THE WATER AND WASTEWATER FUNDS FOR THE PURPOSE OF PAYING OFF EXISTING 1996 CERTIFICATES OF PARTICIPATION PAYABLE FROM THOSE ENTERPRISE FUNDS; ESTABLISHING THE TERMS UNDER WHICH THE LOANS WILL BE REPAYED; AND AUTHORIZING THE PREPAYMENT OF THE 1996 CERTIFICATES OF PARTICIPATION

SECTION 1. The City Council hereby makes the following findings:

- A. In 1996, the City caused the issuance of Water and Wastewater Improvement Project Certificates of Participation (COP's) in order to fund certain improvements to the City's Water and Wastewater facilities; and
- B. The COP's were issued in series of maturities and interest rates; and
- C. The remaining COP's bear interest rates ranging from 5.625% to 5.8%, with the final maturity occurring in September 2026; and
- D. Costs may be reduced by paying off the COP's due to the current low interest rate environment; and
- E. The current low interest rate environment has also resulted in the City's investment portfolio realizing yields well below those interest rates of the COP's; and
- F. Utilizing idle funds earning a low yield to pay off existing high rate debt is a sound financial strategy which will reduce costs; and
- G. The Water and Wastewater Funds currently do not have sufficient funding to cause a redemption and prepayment of all of the remaining outstanding COP's; and
- H. The General Fund has sufficient moneys to loan the Water and Wastewater Funds in order to cause a redemption and prepayment of all of the remaining outstanding COP's; and
- I. It is prudent to execute inter fund loans to the Water and Wastewater Funds to pay off the existing COP's; and
- J. The inter fund loans will be in accordance with the terms listed on Attachment "A" to this resolution.

SECTION 2. The City Council hereby authorizes inter fund loans from the General Fund to the Water Fund (\$1,944,678) and to the Wastewater Fund (\$956,751).

SECTION 3. The City Council hereby authorizes the early pay off of the remaining 1996 Water and Wastewater COP's including principal, accrued interest and associated fees if any.

SECTION 4. This resolution shall take effect immediately upon adoption.

SECTION 5. The City Clerk shall certify to the adoption of this resolution.

PASSED, APPROVED AND ADOPTED this 18th day of October, 2011.

Ayes:
Noes:
Absent:
Abstain:

Mayor, City of Manhattan Beach, California

ATTEST:

City Clerk

APPROVED AS TO FORM:

Roxanne M. Diaz, City Attorney