



Agenda Item #: \_\_\_\_\_

# Staff Report

## City of Manhattan Beach

**TO:** Members of the Finance Subcommittee

**FROM:** Bruce Moe, Finance Director

**DATE:** July 23, 2015

**SUBJECT:** Three Year Extension of the Existing Letter of Credit with Union Bank to Facilitate Variable Rate Debt for the Marine Avenue Sports Fields

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### **RECOMMENDATION:**

Staff recommends that the Finance Subcommittee approve a three-year extension of the existing Letter of Credit with Union Bank to facilitate the variable rate debt for the Marine Avenue Sports Fields. This recommendation is also supported by the City's Financial Advisor, Mark Young, of KNN Public Finance.

### **FISCAL IMPLICATION:**

Then annual cost for the Letter of Credit is 100 basis points of the outstanding debt (\$6.9 million), or approximately \$69,000 in FY 2015-2016.

### **BACKGROUND:**

In Fiscal Year 2000-2001, the City entered into a Sale/Leaseback transaction with the Beach Cities Health District (BCHD). This transaction was a result of the City purchasing from TRW (now Northrop Grumman) seven acres of property located near the corner of Marine and Aviation within the City of Manhattan Beach. The City subsequently sold the property to BCHD with an exclusive agreement to lease back six of the seven acres. The lease authorized BCHD to spend funds up to \$2.5 million to construct recreational facilities on the property. These improvements were completed in Fiscal Year 2000-2001.

In Fiscal Year 2001-2002, the City issued variable rate Certificates of Participation (COPs) to effect a full internal financing of the Sports Fields. The proceeds were used to pay in full all principal and interest obligations under the aforementioned lease with BCHD. The term of the financing is thirty years (fully amortized principal and interest) based on a variable rate which is calculated for budgeting purposes at a conservative 3.58%. There are 17 years remaining on the COPs (to August 2032).

The variable rate debt was selected over more traditional fixed rate financing due to its cost effectiveness. For example, between the letter of credit, remarketing and trustee fees, the current net annual interest rate is approximately 1.16%. Additionally, the variable rate component has averaged .08% since October 2012 (the rate has ranged from .02% to .22%). The variable rate debt has consistently cost less than a comparable fixed rate instrument, and this continues to be the case today.

**DISCUSSION:**

In 2012, the original issuer of the Letter of Credit (LC) for the variable rate debt, Bank of America, advised the City that, due to the small dollar value of the LC (approximately \$7 million), and the lack of a broader business banking relationship, they would no longer provide the required LC. At that time, the City researched other LC providers (US Bank and JP Morgan Chase), and the responses were all very similar to Bank of America. As a result, the City worked with our business banking partner, Union Bank, to obtain the LC that is in place now. Union Bank maintained the same LC cost as Bank of America (100 basis points on the outstanding balance). This equates to a current annual cost of \$69,000 for Marine Avenue Sports Fields debt. This amount is reduced over time as the LC amount declines with the principal outstanding.

The term of the LC when issued was three years and expires October 16, 2015. The City has the option to request an extension of the LC, which Union Bank may approve in its sole discretion. In anticipation of the scheduled expiration, City staff requested the extension earlier this year. Union Bank has now approved the request, pending formal approval/request by the City Council.

The following is a brief overview of the components of the City’s variable rate debt cost:

- Variable Interest Rate – this is the rate used to calculate the interest due with respect to the Marine Avenue Certificates of Participation (COPs). This rate is variable and resets every week as determined through the remarketing process. Over the past year, the rate has ranged from .02% to .22%.
- Remarketing Fees – this fee is paid to the agent who remarkets the COPs every week. The City’s remarketing agent on the 2002 Marine Avenue COPs is Loop Capital and the remarketing fee paid is 0.07% or 7 basis points. Loop was selected in 2012 based on their remarketing portfolio and their low cost (other proposals ranged from 8 to 9 basis points, or .08% to .09%).
- Direct Pay Letter of Credit – this is the credit facility that provides liquidity for the monthly interest expense payments and annual principal payments. Monthly draws are made on the LC and are reimbursed each month by the City via the trustee (US Bank). In addition, in the unlikely event of a failed remarketing (e.g., no buyers that week), the City may draw on the LC to purchase the bonds. This is the facility for which staff is seeking approval for extension.

The following is a breakdown of the current cost of the issue using the current variable rate:

Marine Avenue COPs:

	<u>Current Cost (June 2015)</u>
Average variable interest	9 basis points
Remarketing rate	7 basis points
Direct pay LOC	100 basis points
Total Overall Costs	116 basis points (1.16%)

Staff has considered converting this debt to a fixed rate. However, historically, the rate index has averaged 2.48% over 25 years, and 1.35% over ten years. When adding the above fixed costs to these adjustable rates, the total cost of borrowing would equate to 2.42% (10 year average) to 3.55% (25 year average). This is below fixed rate debt, and does not carry any further costs of issuance.

**CONCLUSION:**

City staff (and the City's Financial Advisor, Mark Young from KNN Public Finance) recommends that the City Council approve a three year extension of the existing LC with Union Bank. This recommendation is based on the continued cost effectiveness of the variable rate debt. Additionally, continuing this facility with Union Bank avoids the costs associated with substituting a new LC from another bank, which would cost over \$50,000 in bond counsel, bank counsel, financial advisor and rating agency fees. Further, it is highly unlikely that another bank would be interested in providing an LC without a broader business banking relationship; the City is satisfied with Union Bank's performance in that space.

If during the extension period the City determines that a more cost effective financing solution exists, the City may terminate the LC with thirty days notice to Union Bank.