CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 02/24/04
AGENDA ITEM 5
WORK SESSION ITEM

TO: Redevelopment Agency Board

FROM: City Manager/Executive Director

SUBJECT: Redevelopment Agency Bonding Capacity

RECOMMENDATION:

It is recommended that the Agency Board review and comment on this report.

BACKGROUND:

For the current year, the Redevelopment Agency has focused much of its attention on two important initiatives. One initiative centers on the implementation of the Cannery Area Design Plan. A second initiative continues ongoing efforts to revitalize downtown through the construction of a parking structure. Critical components of the Cannery Plan include construction of a new elementary school, an expanded Cannery Park as well as related infrastructure improvements. Progress on these public amenities greatly enhances the likelihood that the residential development (and corresponding private sector investment) envisioned in the Plan will indeed materialize. Of course, in order to realize the new school, the expanded park and a new parking structure downtown, it will be necessary to secure long term financing. In this regard, this informational report is intended to advise the Board about the ability of the Agency to support such financing.

As a key early step in the financial planning process, the Agency engaged a property tax consulting firm, to assist staff in preparing an analysis of the Agency's tax base, including a 10-year projection of tax increment revenues. This analysis, in turn, has enabled staff to evaluate the Agency's bonding capacity, or its ability to obtain tax-exempt financing for capital projects via the municipal bond market.

Bonding capacity is dependent upon a number of key factors, including: net revenues available to pledge towards debt service; the Agency's underlying credit rating; current interest rate levels; and the structure of the bond issuance. A discussion of each of these four determinants of bonding capacity follows along with an estimate of bonding capacity.

<u>Net Tax Revenues</u>
The term "net tax revenues" refers to the amount of tax increment revenue that remains after accounting for all mandated costs, including the 20% housing set-aside, statutory pass-through payments to other public agencies and any existing tax allocation bond debt service. The net revenues are available to the Agency to pay for both operating and capital expenditures, including debt service.

As mentioned above, staff has developed a ten-year net tax revenue projection. The table below shows the amount of net tax revenue (expressed in thousands) available at the beginning of the ten-year period, 2003-04, at the mid point, 2007-08 and the last year, 2012-13. As can be seen from the table, the Agency is able to generate significant net tax revenue to support additional debt service. In 2003-04, the Agency generates approximately $4.1 million. This amount grows to approximately $6.3 million in 2012-13. In developing this projection, staff limited annual tax revenue growth to known adjustments and a growth rate of approximately 3%. The 3% consists of the maximum 2% valuation growth allowed under Proposition 13, and a modest 1% for development. Staff believes that this is a very conservative and attainable growth scenario for the Hayward Redevelopment Agency.

	2003-04	2007-08	2012-13
Gross Tax Increment	$ 5,713	$ 8,108	$ 9,489
Less:			
Housing Set Aside	(1,143)	(1,622)	(1,898)
Pass Through Payments	(374)	(870)	(1,202)
County Administration Charges	(71)	(101)	(119)
Net tax revenues	$ 4,125	$ 5,515	$ 6,270

The positive net tax revenues shown by the schedule above are very important to the other factors that determine bond capacity. For example, the Agency's credit rating depends heavily on the net tax increment revenue that can be pledged to new debt service. Additionally, positive revenues on an ongoing basis allow greater flexibility in structuring the debt service repayment schedule. A strong net tax revenue schedule, which the Hayward Agency has, is key to a bond issue that is economical and achieves the Agency's funding objectives.

Credit Rating

Investors in municipal bonds rely heavily on the issuer's credit rating in evaluating the security of the investment. The higher the rating, the more secure the issue, and the lower the cost of borrowing to the issuer. Standard & Poor's rated the Agency's most recent 1996 bond issue A-minus (A-), indicative of the Agency's overall healthy financial operations. S&P ratings of A-or above are considered "investment grade", which generally provide for favorable interest rates in the tax-exempt bond market. The Agency is expected to retain its underlying A- rating, and also has the potential to qualify for and purchase bond insurance, which is a credit enhancement that further reduces the cost of borrowing.

Current Interest Rate Environment

Although it is impossible to predict with certainty the direction rates will go in the future, the risk of rising interest rates is an important consideration in the financial planning process. Current rates remain at historically low and downward trending levels, despite having rebounded modestly upward following a sustained period of sharply declining rates that began in early 2002.

If the Agency were to issue tax allocation bonds today, it is likely that the true interest cost, or the average interest rate over a 30-year term, inclusive of costs of issuance, would be approximately 4.5%. There is also some indication, however, based on recent policy statements coming out of the Federal Reserve Bank, that we may soon be entering an environment of rising interest rates.

Debt Structuring

The Agency's maximum bonding capacity depends not only on the factors described above, but also on the Agency's decisions regarding how the bond issue is structured. Although the ultimate size and structure of a potential bond issue is the subject of ongoing study, a number of key considerations are guiding the process of evaluating various alternative structures, including:

1. The issuance of additional bonded indebtedness is necessarily constrained by the Agency's existing budgetary and debt obligations. That is, any future bond issuance must not adversely impact the Agency's ability to fund existing scheduled debt service, plus a reasonable operating budget allowance over the foreseeable future.

2. The bond issue should have no significant adverse impact on the Agency's current cash levels.

3. Pursuant to state law, the Agency has the ability to extend the life of the project area by one (1) year via ordinance. Adoption of such an ordinance would increase the Agency's debt capacity.

4. The bond issue will be structured in such a way as to provide a debt service coverage ratio – the ratio of pledged revenues available annually to pay debt service to the annual debt service payment - of at least 1.25. That is, in any given year, the net revenues available to pay debt service will be at least 125% of the total debt service payment for that year. The financial community and investors consider this structuring component a requirement.

Bonding Capacity

The objective of the work discussed above is to arrive at an estimate of bonding capacity. That is, based on the Agency's revenues available for debt service, how much could the Agency borrow to fund capital projects? Based on today's interest rates, the Agency's current budget and current tax increment revenue, staff estimates that net bond proceeds in the range of $35 to $40 million could be realized. On an annual basis, this would result in a yearly debt service that would range from $2.2 million in the early years, peak at $3.9 million during the middle years of the issue and fall to $1.5 million at the end of the issue. Consequently, even with the use of conservative revenue estimates, there is every indication that the Agency has the financial capacity to support an obligation of the size mentioned above.

Conclusion

The information presented in this report indicates that the Redevelopment Agency has the financial strength to implement both the public components of the Cannery Plan and a parking structure downtown. While a number of technical and procedural steps need to be taken before a final decision is made with regard to the aforementioned projects and the issuance of tax allocation bonds, it is reassuring to note the Agency is in a position to facilitate the construction of a new school in the Burbank area. Along with the new school associated with the Blue Rock project, it will represent the first time in over forty years that new schools have been constructed in Hayward.

To assure continued progress with regard to the Cannery Plan, a meeting involving the elected officials from the City, HUSD and HARD is planned for next month to update everyone on the project and to review how the project can be financed.

In the weeks ahead, the Board will be asked to take numerous actions with regard to the issuance of bonds, including retaining various legal and bond financing experts. It is anticipated that the issuance of the bonds can take place in the May/June timeframe.

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