Agenda Report

DATE: FEBRUARY 14, 2004

TO: CITY COUNCIL
THROUGH: FINANCE COMMITTEE

FROM: CITY MANAGER

SUBJECT: RESOLUTION OF THE CITY COUNCIL APPROVING THE FORM OF AND AUTHORIZING THE EXECUTION AND DELIVERY OF A PURCHASE AGREEMENT AND RELATED DOCUMENTS WITH RESPECT TO THE SALE OF THE SELLER'S VEHICLE LICENSE FEE RECEIVABLE FROM THE STATE; AND DIRECTING AND AUTHORIZING CERTAIN OTHER ACTIONS IN CONNECTION THEREWITH

RECOMMENDATION

It is recommended that the City Council adopt a Resolution approving the form of and authorizing the execution and delivery of a purchase agreement and related documents with respect to the sale of the seller's Vehicle License Fee receivable from the State; and directing and authorizing certain other actions in connection therewith.

BACKGROUND

Vehicle license fees ("VLF") were historically assessed in the amount of 2% of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. Beginning in 1999, the VLF paid by vehicle owners was offset (or reduced) to the effective rate of 0.65%. In connection with the offset of the VLF, the Legislature authorized appropriations from the State General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient State General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged.

In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient State General Fund moneys would be available for this purpose, and, beginning in October 2003, the VLF paid by vehicle owners were restored to the 2% level. The offset suspension, however, was rescinded by Governor Schwarzenegger on November 17, 2003, and State offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in FY 2002-03. "Backfill" payments totaling $2.65 billion were paid to local governments in FY 2003-04. Approximately $1.2 billion, however, was not received by local governments during the time period between the suspension of the VLF offsets and the implementation of higher fees and is still owed them by the State (the "VLF Gap Repayments"). The City of Pasadena's share of the VLF Gap Repayment is $2,411,360.44 (the "VLF Receivable").

As part of the 2004 Budget Act negotiations, an agreement was made between the State and local government officials (the "State-local agreement") under which the VLF rate will be permanently reduced from 2% to 0.65%. The State-local agreement also provides for the repayment by August 15, 2006 of the approximately $1.2 billion VLF Gap Repayment. In order to protect local governments, the reduction in VLF revenue to cities and counties from this rate change will be replaced by an increase in the amount of property tax they receive. Under the State-local agreement, for FY 2004-05 and 2005-06 only, the replacement property taxes that cities and counties receive has been reduced by $700 million. Commencing in FY 2006-07, local governments will receive their full share of replacement property taxes and those replacement property taxes will now enjoy constitutional protection against transfers by the State due to the approval of Proposition 1A at the November 2004 election.

<u>VLF Program</u>: Authorized under SB 1096, the VLF Program was instituted by the California Statewide Communities Development Authority ("CSCDA") in 2004 to enable the City of Pasadena and other cities and counties to sell their respective VLF Receivables to CSCDA for an upfront fixed purchase price estimated to be 92% to 96% of the VLF Gap Repayments. CSCDA is planning to issue taxable and/or tax-exempt notes ("VLF Notes") and to use the note proceeds to purchase the VLF Receivables and pay financing costs. The actual purchase price of the VLF Receivables will depend on the total amount of VLF Receivables that cities and counties sell to CSCDA and on bond market conditions at the time the VLF Notes are priced. If the City of Pasadena sells its VLF Receivable under the VLF Program, CSCDA will pledge the City of Pasadena VLF Receivable to secure the repayment of a corresponding portion of the VLF Notes. The City's sale of its VLF Receivable will be irrevocable. Bondholders will have no recourse to the City if the State does not make the VLF Gap Repayment.

VLF Program Sponsor: CSCDA is a joint powers authority sponsored by the League of California Cities and the California State Association of Counties. The member agencies of CSCDA include approximately 230 cities and 54 counties throughout California, including the City of Pasadena.

ANALYSIS

Participating in the VLF program allows the City to receive a discounted repayment of the $2,411,360.44 receivable. Within the Resolution being approved by the City Council, there is a provision that the City will not accept an amount less than, $2,230,508.41. This represents a discount of 7.5%. Given today's market conditions and interest rates, the discount would be closer to 6%. Should the State of California delay the scheduled August 2006 repayment this risk will be absorbed by the credit enhancer and investments of the VLF loan pool.

Staff is recommending that the City elect to have its VLF Receivable purchased on a tax-exempt basis in order to finance a portion of the higher costs associated with the Rehabilitation of City Hall. Tax-exempt financing is expected to lower the interest costs on the VLF Notes, thus enabling CSCDA to potentially pay a higher purchase price for the City's VLF Receivable by approximately 2%.

To qualify for the tax-exempt option, City staff has provided additional information and has worked with Orrick, Herrington & Sutcliffe LLP, as Bond Counsel to CSCDA for the VLF Program, to complete the required tax analysis. After such analysis, Bond Counsel has determined on a preliminary basis that the City's proposed use of proceeds qualifies for tax-exempt financing. While staff believes that the City will be eligible for such participation on a tax-exempt basis, the final determination will be made by Bond Counsel. In the event that Bond Counsel determines that the City is not eligible, the City will participate in the taxable series of VLF Notes, and the purchase price of the VLF Receivable will be reduced by approximately 2%.

Estimated Proceeds of the Sale of the City's VLF Receivable:
Upon delivery of the VLF Notes, CSCDA will make available to the City its fixed purchase price by depositing the sale proceeds with the VLF Bond Trustee for requisition by the City for the tax-exempt uses described above. This payment will equal the City's VLF Receivable amount less capitalized interest costs (to pay interest on the VLF Notes until maturity), credit enhancement fees and bond issuance costs. As discussed above, the City VLF Receivable is $2,411,360.44. The purchase price to be paid by CSCDA is estimated to be $2,230,508.41 but cannot be determined with specificity until the total number of participants in the VLF Program is known and bond market conditions are taken into account at the time the VLF Notes are priced. There is a possibility that, if the State pays the VLF Receivable as scheduled on August 15, 2006, there will be some residual

interest earnings on the funds prior to the maturity date of the VLF Notes, which amount, up to 1% of the VLF Receivable, would be refunded to the City.

FISCAL IMPACT

The sale of the City's VLF receivable with the State will be at a discounted sale price that has been estimated at 92% to 96% of the face amount of the receivable. The discount amount will be partially offset by interest earnings from the date of closing until the expected repayment date of August 15, 2006. The sale of the receivable eliminates any risk to the City that the State may delay repayment of the receivable.

Respectfully Submitted,

Cynthia J. Kurtz, City Manager

Approved:

Jay M. Goldstone
Director of Finance