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OFFICE OF THE
CITY TREASURER

THOMAS P. FRIERY
TREASURER

DONALD E. SPERLING
ASSISTANT TREASURER

CITY OF SACRAMENTO
CALIFORNIA

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87015TPFlv:memaud

800 TENTH STREET
SUITE ONE
SACRAMENTO, CA
95814-2688

916-449-5318
OPERATIONS

916-449-5168
INVESTMENTS &
ADMINISTRATION

916-448-3139
DEX TRANSCEIVER

Joint Budget & Finance/Transportation
& Community Development Committee
Sacramento, California

SUBJECT: Financing Alternatives - Memorial Auditorium/Fixed-Seat Theater
or Multi-Use Facility

Honorable Members in Session:

SUMMARY

After discussion with bond counsel, it appears that obtaining tax-exempt financing is possible for the Memorial Auditorium either as a fixed-seat theater or as a multi-use facility. However, further clarification must be made about the extent of restrictive conditions that may be applicable to the food and beverage concession contracts. Further, if tax-exempt financing is obtained, certain restrictions will be placed on the Community Center staff for the period the bonds are outstanding concerning rental as well as management policies of the facility.

In addition, prioritization should be given to obtaining either General Obligation or Special Assessment or Mello-Roos (GO/SAB/MR) financing as an alternative to COP or Lease Revenue financing vehicles. The GO's, SAB's or MR's financing alternatives would create a new revenue source to discharge the debt service payments on the facility as opposed to a pledge of existing general fund revenues which would impact the City's ability to finance other City projects. We have estimated that the costs to the average homeowner in Sacramento to retire a tax-free GO/SAB/MR bond to be approximately \$9.36 to \$12.79 in the first year. However, in each subsequent year as the assessed valuation of the City grows (increases in property values or new property additions) the actual cost to the homeowner will decline from the levels stated.

Finally, as a result of the impacts of tax reform on future City financing vehicles, it may be appropriate to consider taxable financing obligations as opposed to tax-free vehicles. The management flexibility of taxable bonds may be a preferred alternative.

BACKGROUND

At the request of Joint Budget & Finance/Transportation & Community Development Committee (Joint Committee), Treasury staff was directed to ascertain the possibility of obtaining financing for the Memorial Auditorium's refurbishing. Financing for two specific design options were to be explored: the Memorial Auditorium as a fixed-seat theater and the Memorial Auditorium as a multi-use facility.

Because of the uncertainties of the new tax laws, a question existed about whether the Memorial Auditorium as a multi-use facility would be considered a Private Activity project, and therefore, not subject to tax exemption. In order to clarify this issue bond counsel was consulted and the following was developed:

Under the following operating conditions, the Memorial Auditorium, whether a fixed-seat theater or a multi-use facility would be considered tax-exempt: The City continues to own and operate the Memorial Auditorium as a facility that is open to anyone who wishes to use it for short periods of time on a rate-scale basis. The rights of users are those of a transient occupant rather than the full legal possessory interests of a lessee. The Auditorium will be used by numerous non-profit and commercial organizations. The security for the financing could be either the direct guarantee of the City through a General Obligation Bond(s) or the revenues from Auditorium rentals and the Auditorium itself for a Lease Revenue Bond or a COP instrument. Possibly, if the Memorial Auditorium were determined to be a General or Special Benefit to property in Sacramento, then a Mello-Roos (MR) or Special Assessment Bond (SAB) could be issued which would create a new revenue source for debt service and not impede the City's ability to finance the project.

However, if the Auditorium were financed with the intent (or it later became evident) that a long-term home to a specific organization or commercial enterprise would result from regular usage, even though less than 10% of the year (less than 36 days) were actually used by the group, then the financing would likely be viewed by the IRS as taxable and a Private Activity Bond. In addition, all management contracts of the Auditorium would require compliance with the following IRS rules:

- Management contracts cannot exceed 5 years in duration and must be subject to termination by the municipality at the end of a 3-year period, and
- At least 50% of the manager's fees must be fixed. Any percentage incentive must be based on gross revenues, not net profit.

Should the City decide in the future to cease doing all of its own bookings and hire a private promoter to operate the facility, the bonds would become taxable unless the contract with the private promoter complied with these management rules. Also, presently there is a question

as to whether the food and beverage concession contract at the Memorial Auditorium requires adherence to management rules. Presently, bond counsel is researching this matter.

MANAGEMENT CONSIDERATIONS TO OBTAIN AND MAINTAIN TAX-FREE BORROWING AUTHORITY

In discussion with bond counsel the following was developed as a preliminary management guideline to be followed to obtain and retain compliance with current tax-free borrowing authority rules: The intended use of a facility is the key issue in determining whether tax-exempt or taxable financing can be obtained for either the fixed-seat theater or multi-use facility. If the intended use of the facility is to be on a short-term, rate-scale basis for transient users, then the intent of the facility would be deemed compatible with the tax laws for tax-exempt bonds. The facility must be open to all people on a first-come, first-served basis with no individual user having preferential treatment over another. The following definitions are provided to assist the Memorial Auditorium Manager in determining compliance with the new tax law:

- Transient User: numerous users of the general public booked on a first-come, first-served basis
- Short-Term: a one-year or less commitment of the facility
- Rate Scale: published rate scale with no preferential treatment given to a single party

Under the new tax law, the Auditorium cannot be booked for more than one year in advance, all users must have an equal opportunity to rent the facility, and a published rate scale with no preferential treatment given to a single party will have to exist. However, it should be considered that different rates could exist for "profit" and "non-profit organization" users or "out of town" users who require overnight hotel accommodations and other City services. The management requirement rather is to be able to document that preferential or special treatment is not being given to any single user. Therefore, records will have to be maintained that document that all had the opportunity to rent the facility on an equal basis.

In addition to the users test, the issue of "management contracts" must also be complied with. It is pointed out that the issue of "management contracts" may extend to food and vendor concessions, maintenance or security contracts as well as contracts to hire outside promoters or organizations to manage the facility.

Although bond counsel is still researching the issue of management contracts for other than the situation of being a promoter or external organization to manage the Memorial Auditorium or Community Center, nonetheless, under current tax law such a contract must:

- be terminable in 3 years with a maximum of two 1-year extensions, and
- not provide the manager with a fee of more than 50% of the gross revenues of the facility.

Failure to comply with these terms could cause financing to be taxable or cause tax-free bonds to become taxable at a later date even though if in the future the City would find it in its best interests to manage the Memorial Auditorium differently than it historically has.

FINANCIAL

The following details the financing vehicles and options to finance the Memorial Auditorium:

Table 1
 Tax-free and Taxable Financing Costs

	<u>GO</u>	<u>MR/SAB</u>	<u>COP Lease Revenue</u>
<u>I. Fixed Seat Theater</u>			
Est. Construction Cost	\$ 11,875,000	\$ 11,875,000	\$ 11,875,000
	=====	=====	=====
Est. Par Value Bonds	\$ 12,112,500	\$ 12,890,300	\$ 17,652,800
	=====	=====	=====
Est. Ann. Debt Svc. (tax-free)	\$1,178,800	\$ 1,388,500	\$ 1,750,700 (1)
	=====	=====	=====
Est. Ann. Debt Svc. (taxable)	\$ 1,293,000	\$ 1,554,200	\$ 1,953,000 (1)
	=====	=====	=====
<u>II. Multi-Use Facility</u>			
Est. Construction Cost	\$ 13,750,000	\$ 13,750,000	\$ 13,750,000
	=====	=====	=====
Est. Par Value Bonds	\$ 14,025,000	\$ 14,925,600	\$ 20,439,400
	=====	=====	=====
Est. Ann. Debt Svc. (tax-free)	\$1,365,000	\$ 1,608,000	\$ 2,027,000 (1)
	=====	=====	=====
Est. Ann. Debt Svc. (taxable)	\$ 1,497,200	\$ 1,799,600	\$ 2,261,300 (1)
	=====	=====	=====

(1) As a result of both the legal and market requirements of a COP or Lease Revenue Bonds, capitalized interest and a debt service reserve would have to be borrowed in addition to the construction cost. These extra borrowed monies will pay 3 1/2 years of debt service.

Table 1 was developed using the City Treasurer's "Financing Alternatives - Municipal Projects" report dated January 6, 1987 which described the authorized financing vehicles and estimated the costs of borrowing \$1 million in spendable construction dollars for each financing alternative. A review of Table 1 reveals that as a result of the multi-use facility costing more than the fixed-seat theater the multi-use financing is more costly in each financing option. Also, the table shows that in each instance taxable bond issues would be more costly than tax-free bond issues.

However, of major concern is the fact that GO's and MR/SAB's are substantially less expensive than COP's or Lease Revenue Bonds as well as the fact that both GO's and SAB's or MR's offer a new revenue source to the City to meet the debt service payment. Should it be necessary to finance the Memorial Auditorium with a COP or Lease Revenue, as a result of the impact on the City's overall borrowing ability it is recommended that Council request staff to develop a financing priority for City projects. We believe financing the Memorial Auditorium with COP or Lease Revenue Bonds at this time would seriously impede the City from financing current capital projects.

For information purposes I have calculated what the annual cost of debt service would be to property owners in the City of Sacramento should a GO or MR/SAB be approved and used to finance the Memorial Auditorium. Based on the annual debt service payments outlined in Table 1 of this section, the following represents the annual and monthly costs to retire debt service payments on property owners to finance the Memorial Auditorium:

Table 2
 Cost of Financing to Property Owners

I. <u>Fixed-Seat Theater</u>	<u>TAX-FREE</u>		<u>TAXABLE</u>	
	<u>Annual Cost</u>	<u>Monthly Cost</u>	<u>Annual Cost</u>	<u>Monthly Cost</u>
<u>\$85,000 Home</u>				
GO	\$ 9.36	\$.78	\$ 10.30	\$.86
SAB/MR	\$11.08	\$.92	\$ 12.40	\$ 1.03
<u>\$100,000 Home</u>				
GO	\$11.16	\$.93	\$ 12.28	\$ 1.02
SAB/MR	\$13.21	\$1.10	\$ 14.79	\$ 1.23
<u>\$125,000 Home</u>				
GO	\$14.16	\$1.18	\$ 15.58	\$ 1.30
SAB/MR	\$16.76	\$1.40	\$ 18.76	\$ 1.56

TABLE 2 (Cont.)

II. Multi-Use Facility

\$85,000 Home				
GO	\$10.84	\$.90	\$ 11.93	\$.99
SAB/MR	\$12.79	\$1.07	\$ 14.35	\$ 1.20
\$100,000 Home				
GO	\$12.93	\$1.08	\$ 14.23	\$ 1.19
SAB/MR	\$15.25	\$1.27	\$ 17.11	\$ 1.43
\$125,000 Home				
GO	\$16.40	\$1.37	\$ 18.05	\$ 1.50
SAB/MR	\$19.35	\$1.61	\$ 21.71	\$ 1.81

From the above Table 2 it is clear that the cost in the first year to the average homeowner in Sacramento is in the range of \$9 to \$11. However, it is pointed out that in each subsequent year as property values increase or new additions to housing stock occur, increases in assessed valuation will result and the cost to the homeowner as shown above will diminish.

CONCLUSION

As a result of the preliminary research accomplished, it appears that it is possible to finance the Memorial Auditorium either as a fixed-seat theater or multi-use facility with tax-free bonds. However, certain legal issues will have to be researched and a plan put in place to manage the facility should tax-free bonds be issued. Further, City Council should request the Community Center Manager to create a report evaluating the impacts financing tax-free would have on the present and future operation of the facility before a financing is implemented. It may be possible that although more expensive initially, to issue taxable bonds and not be bound by IRS regulations in managing the Community Center. Of more major concern, however, is the type of financing vehicle used. A General Obligation Bond (GO), whether taxable or non-taxable is the most cost effective vehicle that can be used. Further, should the Memorial Auditorium legally be determined to be a "General" or "Special" benefit to property in Sacramento, it may be possible to issue a Mello-Roos or Special Assessment Bond (MR OR SAB). This type of financing vehicle is the second most cost effective vehicle. In addition, it is pointed out that GO's, MR's or SAB's create new revenue sources for the City to discharge debt service payments.

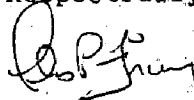
Should a Lease Revenue or COP be issued to finance the Memorial Auditorium, not only would the debt service cost be the highest, but such a vehicle would impair the City's ability to finance other capital projects. Should it not be possible to issue a GO, MR or SAB, it is recommended the Memorial Auditorium financing be postponed until such time as a priority is established for which City projects can be financed.

RECOMMENDATION

The Sacramento City Council should direct that the financing mechanism for refurbishing the Memorial Auditorium should be:

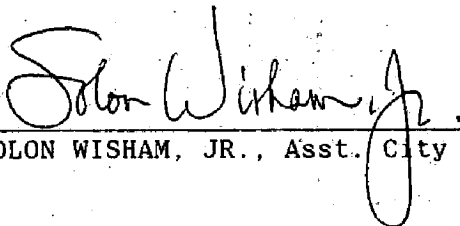
- A General Obligation bond (GO) subject to voter approval or, if legally permissible and approved by property owners, a Special Assessment Bond (SAB) or Mello-Roos (MR) financing, and
- Request prior to the implementation of the financing that the Community Center Manager report on the impact of taxable bond requirements on the future operation of the Community Center, or
- Should the Council choose to have COP's or Lease Revenue Bonds issued to finance the refurbishing of the Memorial Auditorium that plans to refurbish the Memorial Auditorium immediately be suspended. Further, a staff report should be developed as soon as possible describing all financings necessary in the City and a prioritization of which projects should be financed should be developed.

Respectfully submitted,



THOMAS P. FRIERY
City Treasurer

RECOMMENDATION APPROVED:



SOLON WISHAM, JR., Asst. City Manager

February 10, 1987
All Districts