AGENDA
SPECIAL CITY COUNCIL MEETING
CITY OF BANNING, CALIFORNIA

September 12, 2023
4:00 p.m.
In Chambers and via Zoom

Council Chambers
99 E. Ramsey Street
Banning, CA 92220

The following information comprises the agenda for the regular meeting of the Banning City Council, a joint meeting of the City Council and Banning Utility Authority, and the Banning City Council sitting in its capacity as the Banning Successor Agency Board.

This meeting is being held via Zoom so that members of the public may observe and participate in this meeting electronically. If you participate in this meeting via Zoom, you are agreeing to abide by the City's Zoom Community Standards for Public Meetings (provided in full on the last page of the agenda). *Esta reunión se lleva a cabo en la Cámara y a través de Video/Teleconferencia en Zoom para que los miembros del público puedan observar y participar en esta reunión de manera electrónica. Si elige participar en esta reunión a través de Zoom, acepta cumplir con los Estándares comunitarios de Zoom para reuniones públicas de la ciudad (que se proporcionan en su totalidad en la última página de la agenda).*

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1. **CALL TO ORDER**

   Roll Call

2. **PUBLIC COMMENT** – *Agenda Items Only*

3. **WORKSHOP**

   3.1. Debt Workshop
   (Staff Report: Lincoln Bogard, Administrative Services Director)

   Recommendation: Discuss the types of debt that municipalities may use to obtain financing for operations, capital projects, and community facilities.

4. **ADJOURNMENT**

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- To indicate a desire to make Public Comment, you must use the Raise Hand function. The Mayor will not recognize those who have not used the Raise Hand function.
- Public Comment from Zoom attendees will immediately follow in person comment from members of the public in Council Chambers.
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- The chat function will be disabled for all City Council meetings on Zoom.

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- Su cámara debe estar apagada a menos que sea reconocido por el alcalde.
- Para indicar el deseo de hacer un Comentario Público, debe utilizar la función Levantar la mano. El alcalde no reconocerá a quienes no hayan utilizado la función Levantar la mano.
- Los comentarios públicos de lo que atienden por Zoom seguirán inmediatamente los comentarios en persona de los miembros del público en las Cámaras del Consejo.
- Si no cumple con estas pautas de la comunidad, es posible que lo destituyan por interrumpir la reunion que tiene lugar en las Cámaras del Consejo. Puede volver a unirse a la reunión, pero es posible que lo eliminen por cada violación de estos estándares de la comunidad.
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Caroline Patton

Caroline Patton, Deputy City Clerk
Secretario adjunto de la ciudad

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Agenda Items
Any member of the public may address this meeting of the City Council on any item appearing on the agenda. A five-minute limitation shall apply to each member of the public and no member of the public shall be permitted to share their time with any other person. *Special meetings do not have public comment periods for non-agenda items.*

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CITY OF BANNING
STAFF REPORT

TO:	**CITY COUNCIL SPECIAL MEETING**
FROM:	**Douglas Schulze, City Manager**
PREPARED BY:	**Lincoln Bogard, Administrative Services Director**
MEETING DATE:	**September 12, 2023**
SUBJECT:	**Debt Workshop**

RECOMMENDATION:

Discuss the types of debt that municipalities may use to obtain financing for operations, capital projects, and community facilities.

BACKGROUND:

Municipal bonds (or "munis" for short) are debt securities issued by states, cities, counties and other governmental entities to fund day-to-day obligations and to finance capital projects such as building schools, highways or sewer systems. By purchasing municipal bonds, you are in effect lending money to the bond issuer in exchange for a promise of regular interest payments, usually semi-annually, and the return of the original investment, or "principal." A municipal bond's maturity date (the date when the issuer of the bond repays the principal) may be years in the future. Short-term bonds mature in one to three years, while long-term bonds won't mature for more than a decade.

Generally, the interest on municipal bonds is exempt from federal income tax. The interest may also be exempt from state and local taxes if you reside in the state where the bond is issued. Bond investors typically seek a steady stream of income payments and compared to stock investors, may be more risk-averse and more focused on preserving, rather than increasing, wealth. Given the tax benefits, the interest rate for municipal bonds is usually lower than on taxable fixed-income securities such as corporate bonds.

The two most common types of municipal bonds are the following:

- General obligation bonds are issued by states, cities or counties and not secured by any assets. Instead, general obligation bonds are backed by the "full faith and credit" of the issuer, which has the power to tax residents to pay bondholders.
- Revenue bonds are not backed by government's taxing power but by revenues from a specific project or source, such as highway tolls or lease fees. Some revenue bonds are "non-recourse", meaning that if the revenue stream dries up, the bondholders do not have a claim on the underlying revenue source.

In addition, municipal borrowers sometimes issue bonds on behalf of private entities such as non-profit colleges or hospitals. These “conduit” borrowers typically agree to repay the issuer, who pays the interest and principal on the bonds. In cases where the conduit borrower fails to make a payment, the issuer usually is not required to pay the bondholders.

General Obligation Bonds (GO Bonds)
A general obligation bond is a common type of municipal bond in the United States that is secured by a state or local government's pledge to use legally available resources, including tax revenues, to repay bondholders. No assets are used as collateral.

Most general obligation pledges at the local government level include a pledge to levy a property tax to meet debt service requirements, and holders of general obligation bonds then have a right to compel the borrowing government to levy that tax to satisfy the local government's obligation. Because property owners are usually reluctant to risk losing their holding from unpaid property tax bills, credit rating agencies often consider a general obligation pledge to have very strong credit quality and frequently assign them investment grade ratings. If local property owners do not pay their property taxes on time in any given year, a government entity is required to increase its property tax rate by as much as is legally allowable in a following year to make up for any delinquencies. Between the taxpayer delinquency and the higher property tax rate in the following year, the general obligation pledge requires the local government to pay debt service coming due with its available resources.

State law generally sets the conditions under which a local government can issue general obligation debt, including the type of security that is available:

- A limited-tax general obligation pledge requires a local government to levy a property tax sufficient to meet its debt service obligations but only up to a statutory limit. Generally, local governments already levy a property tax and can choose to use a portion of the property tax it already levies, use some other revenue stream, or increase its property tax by an amount equal to its debt service payments.
- An unlimited-tax general obligation pledge is identical to a limited-tax pledge except that the local government is required to levy a rate at whatever level is necessary, theoretically up to 100%, to recover a shortfall from taxpayer delinquencies. An unlimited-tax pledge must often follow a voter authorization in which residents agree to raise property taxes by an amount equal to debt service requirements over the life of the bonds. That feature provides the political advantage of voter affirmation of the use of the bonds and allows the local government to avoid raising its property tax directly or to find room in its budget to pay for debt service.

All things being equal, credit rating agencies and investors can consider an unlimited property tax pledge to be materially stronger than a limited-tax pledge. That perception could thus potentially allow a local government to borrow at a lower interest rate, saving its taxpayers' money over the life of the bonds. Despite that advantage, many states, such as California under Proposition 13, do not allow local governments to issue unlimited-tax general obligation debt without a public vote.

General obligation bonds also serve as a way for local governments to raise funds for projects that create streams of income for things such as roads, parks, equipment, and bridges. General obligation bonds are usually used to fund government projects that will serve the public community.

Revenue Bonds
A revenue bond is a special type of municipal bond distinguished by its guarantee of repayment solely from revenues generated by a specified revenue-generating entity associated with the purpose of the bonds, rather than from a tax. Unlike general obligation bonds, only the revenues specified in the legal contract between the bond holder and bond issuer are required to be used for repayment of the principal and interest of the bonds; other revenues (notably tax revenues) and the general credit of the issuing agency are not so encumbered. Because the pledge of security is not as great as that of general obligation bonds, revenue bonds may carry a slightly higher interest rate than GO bonds; however, they are usually considered the second-most secure type of municipal bonds.

Revenue bonds may be issued to construct or expand upon various revenue-generating entities, including:

- Water and Wastewater (Sewer) utilities
- Toll roads and bridges
- Airports and other transportation hubs
- Power plants and electrical generation facilities

Generally, any government agency or fund that is run like a business, generating operating revenues and expenses (also known as an enterprise fund), can issue revenue bonds.

Generally, revenue bonds are backed by the revenue generated by the municipal facility funded by the bond issue. A feasibility study should be conducted to compare one project's IRR (internal rate of return, or hurdle rate) to another proposed project, as it is most important to ensure the success of the municipality. Utility revenue bonds (essential services bonds) are municipal debt securities that are designed to finance public utility projects. The utility is required to repay bondholders directly from project revenues rather than a general tax fund.

Revenue bonds may be issued by an agency, commission, or authority created by legislation to construct a "facility." The fees, taxes, or even tolls charged for use of the facility ultimately pay off the debt. The issuing government does not pledge its own credit to pay the bonds. If a municipality assumes liability for the debt service if the income from the project is insufficient, it is called “double-barreled.” That means they are more like GO bonds, except that, for bankruptcy and security purposes, they have the benefit of the additional security provided by the pledged revenues. An example of double-barreled bonds is electric revenue bonds issued on behalf of an electric enterprise system.

Some examples of Revenue Bonds include:

- IDRs and IDBs (Industrial Development Revenue Bonds)
    - or, after the passage of the Tax Reform Act of 1986, PABs (Private Activity Bonds)
- Lease rental bonds
- Special Assessment Bonds
    - (or Special District Bonds or, in California, Mello-Roos Bonds)
- Housing Authority Bonds

Community Facilities Districts (CFD)
Community Facilities Districts, more commonly known as Mello-Roos, are special districts established by local governments in California as a means of obtaining additional public funding. Counties, cities, special districts, joint powers authority, and school districts in California use these financing districts to pay for public works and some public services.

When Proposition 13 passed in California in 1978, it limited the property tax rate and the ability of local governments to increase the assessed value of real property by not more than an annual inflation factor. As a result, the budget for public services and for the construction of public facilities could not continue unabated. New ways to fund local public improvements and services were considered and adopted by the California State Legislature. A Mello-Roos tax is a parcel tax that circumvents Proposition 13 (which limits property taxes based on the assessed value of real property) because it is not levied on the assessed value of real property.

California Proposition 218 (1996) constitutionally requires two-thirds (2/3) voter approval to approve the formation of a Mello-Roos Community Facilities District. In instances where the number of registered voters within a Community Facilities District is very small, the required election is held as a property owner election. Sometimes a real estate developer is the only "voter" in such property owner elections that approve a Mello-Roos tax.

Once approved, a Mello-Roos Community Facilities District is formed. Once formed, a special tax (which is different from regular property tax) is imposed on all property within the community facilities district. The Mello-Roos special tax is in addition to the regular ad valorem property tax on the property. The Mello-Roos special tax is based on a formula that is specific to that district, that was approved in proceedings. The formula can be based on a variety of factors but cannot be based on the value of the property. In practice, most Mello-Roos community facilities districts base the special tax on a few common formulas, such as the square footage of the improvements, or proximity to a specific improvement, or based on the acreage of the lot. This is spelled out in the "Rate and Method of Apportionment" of the special tax, which is a legal document approved in the proceedings.

These districts can be used to pay for ongoing services (such as enhanced landscaping within a community). Or, if approved by voters, the special tax may be used as the security on which to issue land-secured municipal bonds (debt). If debt is approved, the special tax will repay the bond principal and interest each year.

Mello-Roos community facilities districts may pay for the following public improvements and services: streets, water, sewage and drainage, electricity, infrastructure, schools, parks, and police protection to newly developing areas.

A Mello-Roos tax or charge levied to finance a service is generally subject to reduction or repeal using the local initiative power under Proposition 218, including the significantly reduced petition signature requirement thereunder. This provides local voters within a Community Facilities District with a readily available legislative remedy to address issues of inequity associated with the financing of local public services in a community.

Examples where the reduction or repeal of a Mello-Roos tax on services may be appropriate include where voters desire to eliminate or reduce a public service currently provided by a local government, where voters believe certain public services currently provided by a local government can be more cost-effectively delivered by the private sector such as by a local property owners association, where voters did not previously vote in a registered voter election on a Mello-Roos tax, and where voters believe they are bearing a disproportionate and/or unfair tax burden compared to others in the community.

A Mello-Roos tax or charge levied to repay bonds is a legally more complex situation because federal contract impairment issues may preclude the exercise of the local initiative power under Proposition 218. Advice from legal counsel is generally needed in such situations. A local compensatory initiative under Proposition 218 is an alternative option when contract impairment problems are present.

Pros and Cons of Mello-Roos

<u>Pros</u>

Advocates of the Mello-Roos law say it makes new housing construction possible, and at a lower cost to the eventual buyers. A developer planning a large new community could either balk at the price of funding new infrastructure in and around the community or pass on the cost by raising the prices of the homes.

Additionally, Mello-Roos districts typically have newer homes and newer amenities. The infrastructure and services of a Mello-Roos community are well maintained and can increase the property value of a home. Mello-Roos communities often have lower crime rates and better school districts. And depending on the district, the Mello-Roos fees expire and no longer need to be paid.

Cons
Opponents point to the added tax burden on purchasing a home in a Mello-Roos district. This tax burden, they argue, makes it difficult to sell a home. These new homes also have homeowner's association fees, which further increase the cost of the home.

And lastly, Mello-Roos taxes generally are not deductible from federal taxes as they do not satisfy IRS requirements for the deduction.

Fine Print on Mello-Roos
The bond issued by a CFD is considered a lien against a property and failure to pay the tax can quickly result in foreclosure since Mello-Roos districts are subject to accelerated foreclosure laws.

Realtors are required by law to inform potential buyers if a home is in a CFD and thus is subject to a special tax assessment.

Mello-Roos taxes are usually listed as a line item on a property's annual tax bill, though occasionally a district will send homeowners a separate bill. County assessors' offices maintain records of Mello-Roos districts.

How Long Do You Have to Pay Mello-Roos?
Depending on the district, Mello-Roos fees are paid until the bond is paid off. The length of time is typically between 20 to 25 years but can be as much as 40 years.

Housing Authority Bonds
Mortgage revenue bonds (MRBs) are bonds issued by local or state Housing Finance Agencies (HFAs). Also known as housing bonds, the HFA will issue tax-free bonds to investors. Funding from the sale of these bonds is then used to finance affordable mortgages for low- and middle-income people.

Certificates of Participation (COP)
A certificate of participation (COP) is a type of financing where an investor purchases a share of the lease revenues of a program rather than the bond being secured by those revenues. Certificates of participation are, therefore, secured by lease revenues.

A certificate of participation (COP) can also be referred to as a participation certificate.

- A certificate of participation (COP) allows investors to participate in a pro-rata share of a lease-financing agreement.
- A lease-financing agreement is used by a municipality or local government to acquire real property.
- As opposed to bond participation, COPs pay investors via lease revenues as opposed to bond interest.
- COPs are commonly found in municipal financing as an alternative to muni bonds.
- A certificate of participation is also a tax-exempt lease-financing agreement.

A lease-financing agreement is used by a municipality or local government to acquire real property. Under the agreement, the local government makes regular payments over the annually renewable contract for the acquisition and use of the property. A lease-financing contract is typically made available in the form of a certificate of participation.

A municipal government will typically issue muni bonds from which the proceeds from the bond investors will be used to undergo a project. The certificate of participation is an alternative to municipal bonds in which an investor buys a share in the improvements or infrastructure the government entity intends to fund.

The authority usually uses the proceeds from a COP to construct a facility that is leased to the municipality, releasing the municipality from restrictions on the amount of debt that they can incur. The COP contrasts with a bond, in which the investor loans the government or municipality money to make these improvements.

A certificate of participation is a tax-exempt lease-financing agreement that is sold to investors as securities resembling bonds. In a COP program, a trustee is typically appointed to issue the securities that represent a percentage interest in the right to receive payments from the local government under the lease-purchase contract.

Investors that participate in the program are given a certificate that entitles each investor to a share, or participation, in the revenue generated from the lease-purchase of the property or equipment to which the COP is tied. The lease and lease payments are passed through the lessor to the trustee, who oversees the distribution of the payment to the certificate holders on a pro-rata basis.

Certificates of participation do not require voter approval and also can be issued more quickly than referendum bonds. In addition, COP financing is more complex and generally resembles bond financing. An underwriter of the COPs will be required, as will various fiscal agents.

An official statement providing disclosure to investors must be approved by the municipal government and, in most cases, the government must contract to make continuing disclosures to SEC Rule 15c2-12 under the Securities Exchange Act of 1934.

Line of Credit

A line of credit (LOC) is a preset borrowing limit that can be tapped into at any time. The borrower can take money out as needed until the limit is reached. As money is repaid, it can be borrowed again in the case of an open line of credit.

An LOC is an arrangement between a financial institution—usually a bank—and a customer that establishes the maximum loan amount that the customer can borrow. The borrower can access funds from the LOC at any time if they do not exceed the maximum amount (or credit limit) set in the agreement.

All LOCs consist of a set amount of money that can be borrowed as needed, paid back, and borrowed again. The amount of interest, size of payments, and other rules are set by the lender. A line of credit can be secured (by collateral) or unsecured, with unsecured LOCs, typically subject to higher interest rates.

The LOC has built-in flexibility, which is its main advantage. Borrowers can request a certain amount, but they do not have to use it all. Rather, they can tailor their spending from the LOC to their needs and owe interest only on the amount that they draw, not on the entire credit line. In addition, borrowers can adjust their repayment amounts as needed based on their budget or cash flow. They can repay, for example, the entire outstanding balance all at once or just make the minimum monthly payments.

Non-revolving LOCs have the same features as revolving credit (or a revolving LOC). A credit limit is established, funds can be used for a variety of purposes, interest is charged normally, and payments may be made at any time. There is one major exception: The pool of available credit does not replenish after payments are made. Once you pay off the LOC in full, the account is closed and cannot be used again.

JUSTIFICATION:

There are several types of financing available to the City. This item is to educate Council on those various forms of financing. The City currently has no bonds for its governmental operations, but does have several revenue bonds for water, wastewater, and electric. In the future, additional financing needs are inevitable. We will discuss strategies as needed.

FISCAL IMPACT:

None. This is a discussion item only.

ALTERNATIVES:

1. Discuss the types of debt that municipalities may use to obtain financing for operations, capital projects, and community facilities.

ATTACHMENTS:

None

Approved by:

Douglas Schulze
City Manager