



# Financial Strategies for Reducing the Accumulated Debt and Structural Deficit of the General Fund



*(Prepared May 4, 2011)*

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### TECHNICAL APPENDIX

- Montebello Hills Redevelopment Project Tax Allocation Bonds
- South Montebello Industrial Redevelopment Project Tax Allocation Bonds

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# Summary of Moody's Investors Service Recent Credit Rating Actions



## Moody's Has Again Downgraded the City's Credit Ratings by Two Notches

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- Moody's May 4, 2011 rating actions are swift as the normal process of changing the credit outlook from "stable" to "negative", or to "negative watch", was passed over due to the severity of the City's fiscal crisis
- Moody's credit rating assigned to Series 2000 COPs is being downgraded by two notches from "Baa2" (stable outlook) to "Ba1" (negative outlook)
  - Follows the two notch downgrade from "A3" to "Baa2" on December 23, 2010
  - The long-term obligations of the General Fund will no longer be viewed as "investment grade" and will now be viewed as having "substantial credit risk"
- City's "Issuer" rating is being downgraded by two notches from "A3" (stable outlook) to "Baa2" (negative outlook)
  - Follows the two notch downgrade from "A1" to "A3" on December 23, 2010
  - An issuer rating is an implied General Obligation bond rating based on the full faith and credit of the issuer (unlimited property tax pledge); the City does not have GO Bonds outstanding
  - An issuer rating is less relevant to bond investors and lenders than ratings assigned to outstanding obligations

## Summary of Moody's Long-Term Obligation Rating Scale

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“Moody’s long-term ratings are opinions of the relative credit risk of financial obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised. Such ratings use Moody’s Global Scale and reflect both the likelihood of default and any financial loss suffered in the event of default.”

<b>Rating</b>	<b>Description</b>
Aaa	Highest quality, with minimal credit risk
Aa	High quality; subject to very low credit risk
A	Upper-medium grade; subject to low credit risk
Baa	Moderate credit risk; possessing certain speculative characteristics
Ba	Speculative elements; subject to substantial credit risk
B	Speculative; subject to high credit risk
Caa	Poor standing; subject to very high credit risk
Ca	Highly speculative; likely in or very near default; some prospect of recovery of principal and interest
C	Lowest rated class; typically in default; little prospect for recovery of principal or interest

*Note: Moody’s appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.*

## Immediate Relevance to the City of Moody's Credit Rating Actions

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- 1) The likely interest rate on any external loan increases as underlying credit ratings are downgraded
- 2) The interest rates on the GF's Series 1999 COPs and Series 2000 COPs are fixed, so the interest payments will not change
  - The Series 1999 COPs do not have underlying credit ratings or credit enhancement
  - The Series 2000 COPs have an underlying Ba1 credit rating from Moody's and bond insurance provided by Assured Guaranty (Aa3/AA+)
- 3) The interest rates on the GF's Series 2001 COPs (Golf Course Project #2) and the Series 2004 (Hotel Project) are variable and reset weekly

### Series 2001 COPs

- The City's credit is enhanced by letters of credit from Union Bank and CalSTRS (AAA/A-1+)
- On May 3, the 7-day rate was set at 0.36% but this rate could spike if investors are concerned about GF credit, even with the two letters of credit

### Series 2004 COPs (Taxable)

- The City's credit is enhanced by a letter of credit from Union Bank (A+/A-1)
- On May 3, the 7-day rate was set at 0.46% but this rate could spike if investors are concerned about GF credit, even with the letter of credit

## Moody's Rationale Regarding May 4, 2011 Credit Rating Actions

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- Moody's report is expected to highlight the following credit concerns:
  - Depletion of GF reserves and sources of internal borrowing
  - Expected reliance on external borrowing to cover expenses in the short-term
  - Large accumulated debt to the RDA
  - Structural GF budget imbalance
  - Slow intra-year action taken to reduce expenditures

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# The General Fund Fiscal Recovery Plan





## The General Fund Fiscal Recovery Plan

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- Unbalanced GF budget since FY 2006 (five years and counting)
  - Liquidity Crisis: City staff currently projects the GF to be out of cash by approximately Sept. 30<sup>th</sup>
  - Accumulated debt to the RDA stands at \$16.8mm
- Execution of one or more financial (not fiscal) strategies may reduce the accumulated debt of the GF, but an external loan of some type will be necessary to both:
  - 1) Provide sufficient GF liquidity to maintain City services
  - 2) Pay off the balance of the accumulated debt to the RDA
- Solicitation of this loan will not be possible without City Council first implementing a Fiscal Recovery Plan addressing the GF structural deficit
  - The City on the path to financial recovery will increase the marketability of the loan and improve the City's chances of finding a lender with acceptable terms
  - Note: headline noise alone will continue to dissuade many of the typical banks/investors, leaving the City with access to only expensive sources of capital

## The General Fund Fiscal Recovery Plan (continued)

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- The *Fiscal Recovery Plan* would involve the City Council acting by July 1st to eliminate the GF structural deficit through:
  - Adoption of an FY 2012 GF budget with an operating surplus and
  - Approval a multi-year financial plan demonstrating the ability of the GF to repay an external loan over 3-5 years
- Expect execution of the loan to take 2-3 months following implementation of the *Fiscal Recovery Plan*
  - With *Fiscal Recovery Plan*, likelihood of loan execution is 50-75%; without *Fiscal Recovery Plan*, likelihood is 0-10%
  - Plan B: focus all efforts on providing adequate liquidity to the GF by Sept. 30th; address paying off the balance of the accumulated debt at a later date
- FirstSouthwest's involvement as City's Financial Advisor
  - Phase 1 – Identify and Present Financial Strategies (complete)
  - Phase 2 – Assist with Fiscal Recovery Plan and quantify external financing needs
  - Phase 3 – Assess financing options, negotiate terms and execute financing

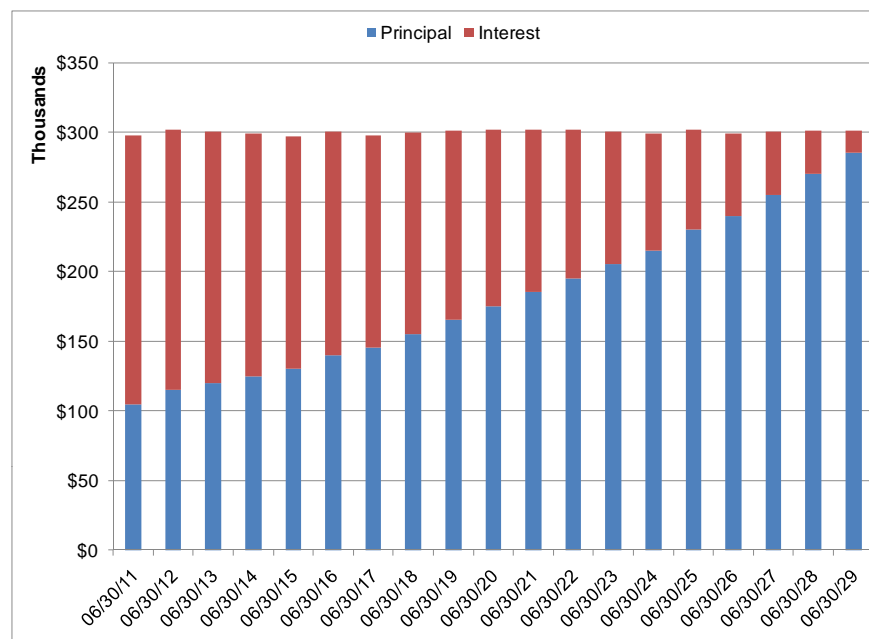
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# Financial Strategies Involving Long-Term Debt of the General Fund



## Series 1999 COPs (Golf Course Project #1) – Golf Course Fund Under Stress

<u>Amounts:</u>	\$4.275 million issued; \$3.35 million outstanding
<u>Purpose:</u>	Current refunding of Series 1997B COPs
<u>Project:</u>	Improvements to Montebello Country Club
<u>Leased Assets:</u>	Montebello Country Club
<u>Repayment:</u>	(1) Net Revenues of Golf Course (2) General Fund Revenues
<u>Key Dates:</u>	Issued 3/30/99; interest paid 4/1 & 10/1; principal paid 4/1; final maturity 4/1/29
<u>Tax Status:</u>	Tax-exempt
<u>Interest Rates:</u>	Fixed; 5.50%-5.625%
<u>Reserve Fund:</u>	\$302,069
<u>Early Redemption:</u>	Any business day @ 100%
<u>Credit Ratings:</u>	Not rated

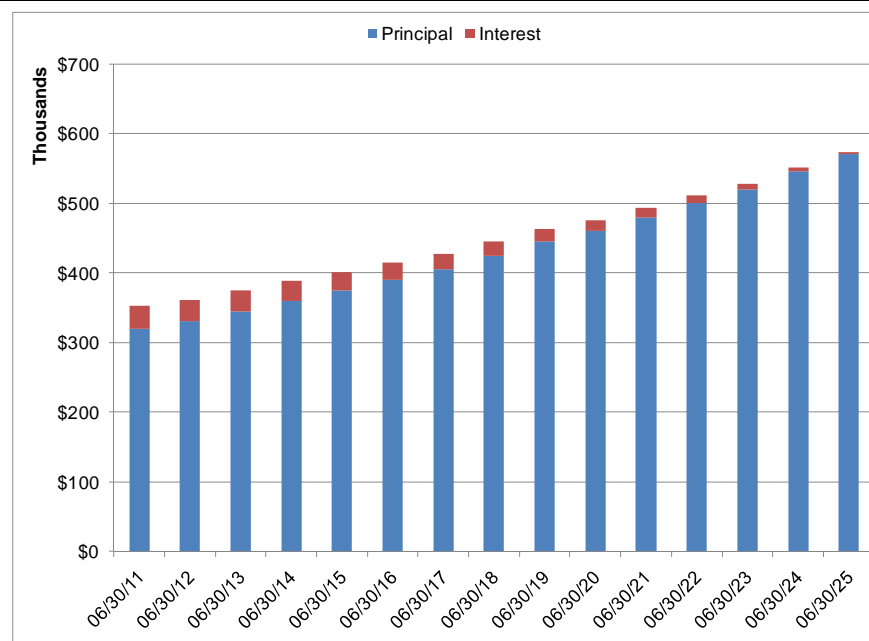


### Financial Strategies:

- See Series 2001 COPs (next page)

## Series 2001 COPs (Golf Course Project #2) – Golf Course Fund Under Stress

<u>Amounts:</u>	\$8.75 million issued; \$6.15 million outstanding
<u>Purpose:</u>	Current refundings of Series 1995A COPs & Series 1997C COPs
<u>Project:</u>	Improvements to Montebello Country Club
<u>Leased Assets:</u>	Montebello Country Club
<u>Repayment:</u>	(1) Approximately 23% of Net Revenues of Golf Course (2) General Fund Revenues
<u>Key Dates:</u>	Issued 12/12/01; interest paid first bus. day of month; principal paid 4/1; final maturity 4/1/25
<u>Tax Status:</u>	Taxable
<u>Interest Rates:</u>	Variable, currently reset weekly
<u>Reserve Fund:</u>	None
<u>Early Redemption:</u>	First bus. day of month @ 100%
<u>Credit Ratings:</u>	AAA/A-1+ due to credit wrap of Union Bank letter of credit (LOC) by CALSTRS LOC but A+/A-1 with only Union Bank LOC; CALSTRS LOC expires 12/11/11 and Union Bank LOC expires 12/11/13

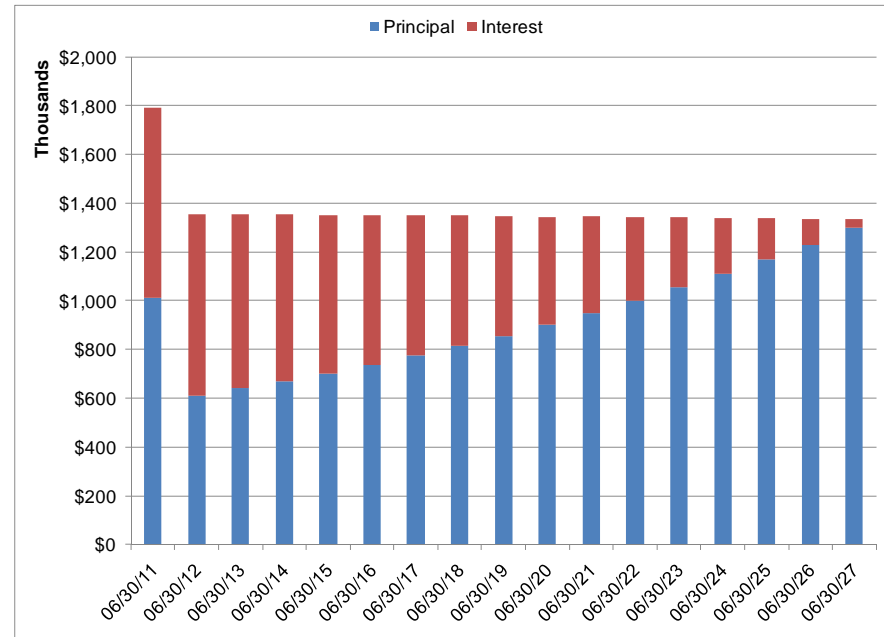


### **Financial Strategies:**

- The Golf Course Fund has been covering its share of lease payments due on the Series 1999 and Series 2001 COPs; however, the Fund's financial performance is deteriorating
- The GF may be required to pay an increasing share of lease payments unless financial measures are taken
- Depending on the terms of the Deed Restriction, lease/lease-back arrangement of the Golf Course could be an option

## Series 2000 COPs (Multiple Capital Projects) – \$445,000 savings in FY 2012

<u>Amounts:</u>	\$22.93 million issued; \$14.515 million outstanding
<u>Purpose:</u>	Current refunding of Series 1993 COPs & acquire communications equipment
<u>Project:</u>	GC parking, MW Comm. System, Computer Aided Dispatch, Fire Apparatus Replacement, Fire Station #2 & City Hall Expansion
<u>Leased Assets:</u>	Police Facility, City Hall & Fire Station #2
<u>Repayment:</u>	(1) Reimbursement Agreement payments from Montebello Hills & South Montebello project areas (2) General Fund Revenues
<u>Key Dates:</u>	Issued 10/27/00; interest paid 5/1 & 11/1; principal paid 11/1; final maturity 11/1/26
<u>Tax Status:</u>	Tax-exempt
<u>Interest Rates:</u>	Fixed; 4.60%-5.375%
<u>Reserve Fund:</u>	\$1.816 million
<u>Early Redemption:</u>	Any business day @ 102%
<u>Credit Ratings:</u>	Baa2 (Moody's)

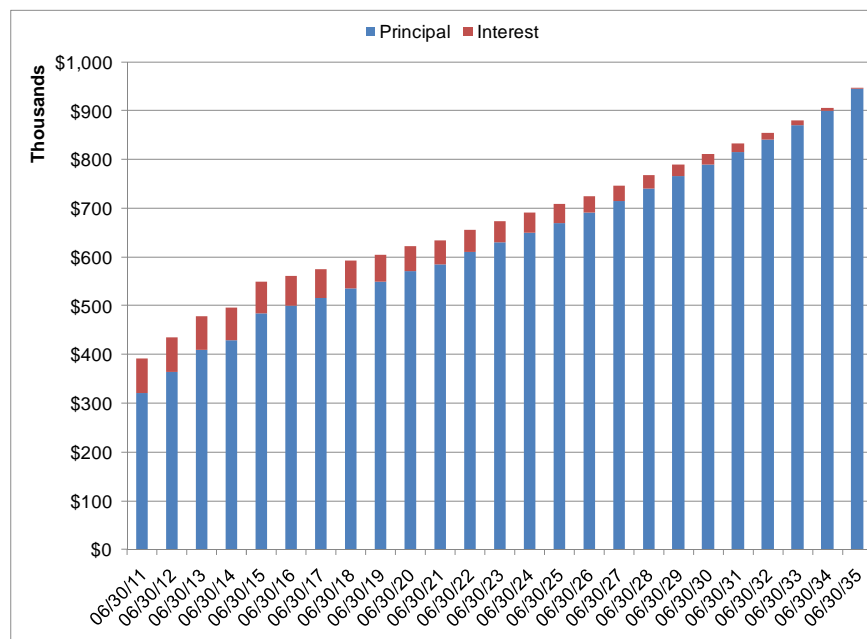


### Financial Strategies:

- The reserve fund balance of \$1.816mm exceeds the reserve requirement of \$1.371mm by approximately \$445k
- The \$445k excess can be applied to the Nov. 1<sup>st</sup> payment, reducing the net cost to the GF
- Discuss debt restructuring options with interested lenders

## Series 2004 Lease Revenue Bonds (Hotel) – Monitor Hotel’s Financial Condition

<u>Amounts:</u>	\$17.06 million issued; \$15.575 million outstanding
<u>Purpose:</u>	Current refunding of Series 2001 Revenue Bonds & financing of additional hotel improvements and Quiet Cannon meeting room
<u>Project:</u>	Hilton Garden Inn and Quiet Cannon Project
<u>Leased Assets:</u>	Hilton Garden Inn
<u>Repayment:</u>	(1) Project Net Revenues (2) Agency Advances (3) General Fund Revenues
<u>Key Dates:</u>	Issued 9/23/04; interest paid first bus. day of month; principal paid 12/1; final maturity 12/1/34
<u>Tax Status:</u>	Tax-exempt
<u>Interest Rates:</u>	Variable, currently reset weekly
<u>Reserve Fund:</u>	\$950,000
<u>Early Redemption:</u>	First bus. day of month @ 100%
<u>Credit Ratings:</u>	A+/A-1 due to Union Bank LOC; Union Bank LOC expires 9/22/12



### **Financial Strategies:**

- The Hilton Hotel Enterprise Fund has been making scheduled principal payments on the Series 2004 LRBs
- Principal payments will escalate annually
- Union Bank LOC will expire in Sept. 2012; at this time; renewal seems unlikely due to weak financial performance of Hotel Fund and GF as well as expected impacts of Basel III

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# Reimbursement Agreements between the RDA and the City





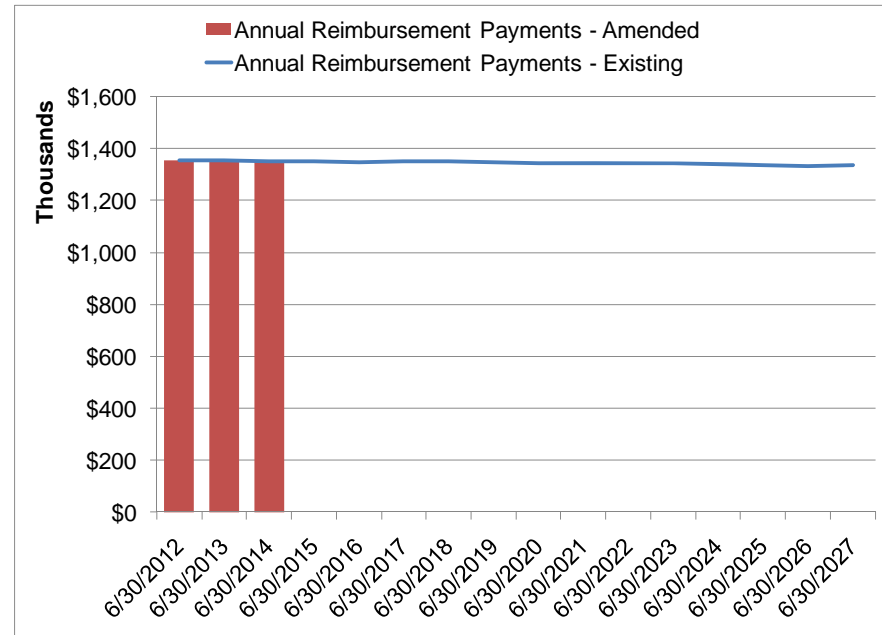
## Reimbursement Agreements between the RDA and the City

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- Over the last 20 years or so, the RDA entered into two Reimbursement Agreements with the City, one for each of the Montebello Hills and South Montebello Industrial Projects
  - The most recent reimbursement agreements from Sept. 1, 2000 terminate provisions of the prior agreements from 1990, 1992 and 1993
  - In aggregate, reimbursement payments from the two project areas have covered the payments due from the City on its Series 2000 COPs such that the net annual cost to the GF is zero
- To the extent legally permissible, the City would like to explore having the RDA accelerate reimbursement payments to provide additional funds in the near-term
  - The remaining payments due on the Series 2000 COPs total to \$21.522mm (Nov. 1, 2011 – Nov. 1, 2026)
  - An acceleration of some or all of these payments would reduce or eliminate any future payments made by the RDA
  - Consider amending payment schedule beginning with FY 2015 to allow GF sufficient time to budget annual payments due on the Series 2000 COPs (roughly \$1.4mm)

## Offset City's Obligation to RDA by Amending Reimbursement Agreements

- The City may amend its existing Reimbursement agreements with the RDA such that future payments are forgiven and, in exchange, offset a portion of the City's liability to the RDA
- The interest rate used to discount future reimbursement payments (FY 2015 – FY 2027), will determine how much of the loan from the RDA's may be offset
  - Lower rate will result in larger offset; will need some economic rationale for selecting rate
  - For example, discounting reimbursement payments at the original bond yield of the Series 2000 COPs (roughly 5.25%) would result in offset of \$10.98mm
  - For example, discounting reimbursement payments at the Applicable Federal Rate (roughly 4.19%) would result in offset of \$12.06mm; at 67% of the AFR, the offset is \$13.57mm



### **Financial Strategies:**

- **An “opinion” from external Bond Counsel is expected to be necessary for the offset strategy to executed**
- **The offset amount (\$11-14mm) would reduce a like amount of the \$16.8mm RDA loan**
- **Execution is not contingent upon implementation of the Fiscal Recovery Plan**

# Restructuring of Series 2000 COPs with Amended Reimbursement Payments

**Amounts:** \$14.515 million outstanding refunded @ call price of 101%

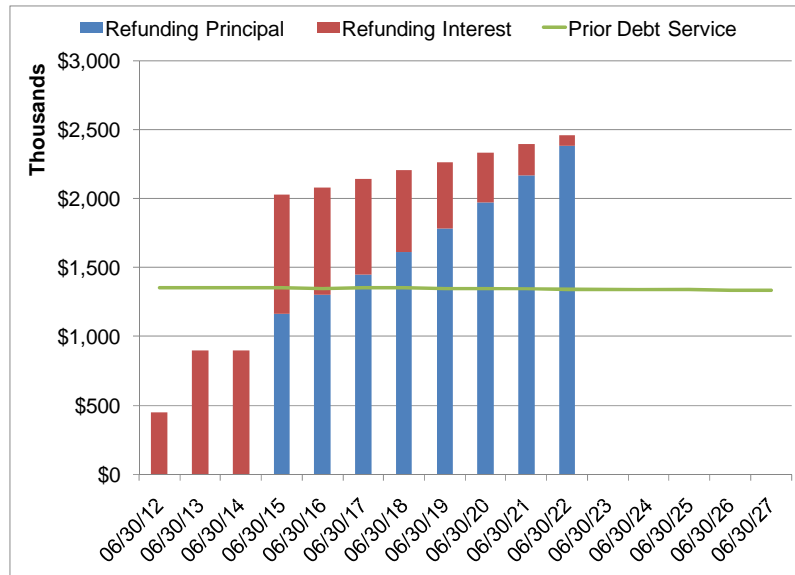
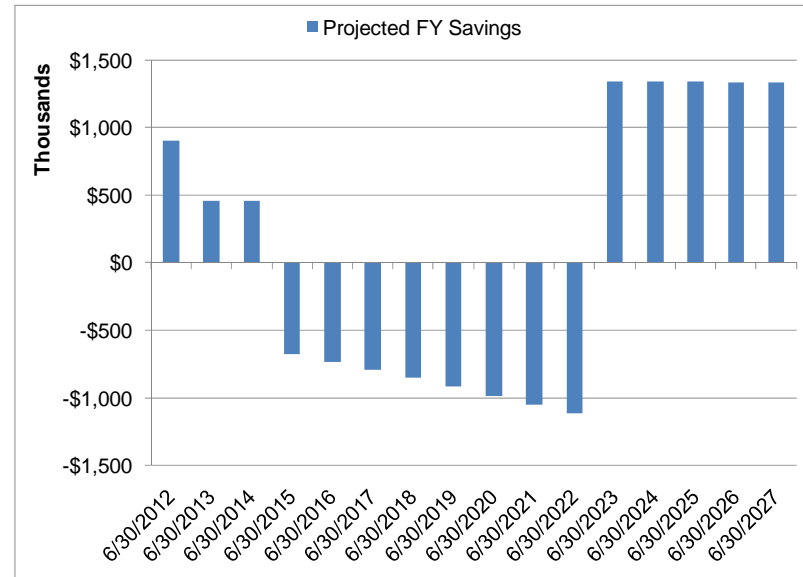
**Interest Rate:** Tax-exempt bank loan at 6.50% interest rate

**Delivery:** 8/1/11

**Amortization:** 8/1/14 through 8/1/21; annual lease payments increase by 3%

**Reserve Fund:** No debt service reserve fund

**PV Savings:** (\$1.566 million)



	2012	2013	2014	2015
Reimbursement Payments	\$1,353,291	\$1,354,061	\$1,352,781	\$0
Restructured Series 2000 COPs	(449,313)	(898,625)	(898,625)	(2,025,763)
Net to General Fund	\$903,979	\$455,436	\$454,156	(\$2,025,763)

## Financial Strategies:

- Execution is contingent upon implementation of the Fiscal Recovery Plan and access to a willing lender

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# Sale or Lease/lease-back of Water Utility



## Lease/lease-back arrangements Can Be Utilized for Various Capital Assets

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- General elements of a lease/lease-back transaction involving public utility and other leasable assets
  - Limited term lease of the asset is transferred to a private company, in exchange private company pays an up-front cash payment to the City
  - City leases the asset back from the company
  - At the end of the lease, all ownership rights to the assets revert back to the City
- Specific benefits to a city of the Water Rights lease/lease-back transaction
  - Up-front payment can provide one-time budget relief to a city's general fund
  - Can reduce the water enterprise's risks of reliance on imported water
    - During the term of the lease, the water enterprise can buy the water back at a discount to the spot rate normally charged to the city, and the water enterprise is normally offered the opportunity to purchase additional water at the same discounted price
  - Increases efficiency of city-owned water system
    - As part of the terms of the lease, the water company can be required to make specified improvements to the water delivery system before the end of the lease term

## Sale or Lease/lease-back of Water Utility

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- Water is currently provided to City customers by five companies
  - California Water Service Company (Cal Water)
  - The City of Montebello's Water System (operated by Cal Water)
  - Montebello Land & Water Company
  - San Gabriel Valley Water Company
  - South Montebello Irrigation District
- Cal Water has operated the Water Utility for the City since 1992
  - Cal Water provides water utility services to the City's 200 industrial and 1,400 residential Water System customers
  - Uses a combination of local groundwater and purchased water from MWD
  - Has access to 386.5 acre/feet/year of the City's water pumping rights from Central Basin
  - Utilizes the City-owned water system infrastructure which includes:
    - One well; 9 booster pumps
    - 3 storage tanks; 2 MWD connectors

## Sale or Lease/lease-back of Water Utility (continued)

- Cal Water has identified significant issues that could affect the City Water Utility's future delivery of water services
  - Water system needs substantial infrastructure improvements
  - Ratepayer revenue does not currently cover costs of water delivery
  - Deferred maintenance reserve fund is being depleted for current operations

	CITY OF MONTEBELLO -- WATER UTILITY FUND				
	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
<b>REVENUES</b>					
Service Charges	\$ 1,432,116	\$ 1,526,153	\$ 1,517,591	\$ 1,315,709	\$ 1,412,456
Interest Income	24,845	50,492	30,571	53,879	239
<b>TOTAL REVENUES</b>	<b>\$ 1,456,961</b>	<b>\$ 1,576,645</b>	<b>\$ 1,548,162</b>	<b>\$ 1,369,588</b>	<b>\$ 1,412,695</b>
<b>EXPENSES</b>					
Operating & Maintenance	\$ 99,076	\$ 90,019	\$ 140,281	\$ 95,892	\$ 96,203
Purchased Water	627,263	722,649	1,390,749	1,142,468	1,351,135
Utilities	81,191	89,664	109,241	87,548	117,598
Contract Services	313,918	319,242	26,456	59,477	11,389
Depreciation	52,907	52,724	53,675	53,676	53,675
<b>TOTAL EXPENSES</b>	<b>\$ 1,174,355</b>	<b>\$ 1,274,298</b>	<b>\$ 1,720,402</b>	<b>\$ 1,439,061</b>	<b>\$ 1,630,000</b>
<b>NET INCOME</b>	<b>\$ 282,606</b>	<b>\$ 302,347</b>	<b>\$ (172,240)</b>	<b>\$ (69,473)</b>	<b>\$ (217,305)</b>
<b>CAPITAL ASSETS</b>					
Land	\$ 35,000	\$ 35,000	\$ 35,000	\$ 35,000	\$ 35,000
Building	130,006	141,284	141,284	141,284	141,284
Machinery & Equipment	2,185,928	2,185,928	2,185,928	2,185,928	2,185,927
Less Depreciation Allowance	(1,754,224)	(1,806,948)	(1,860,623)	(1,914,299)	(1,967,974)
<b>NET CAPITAL ASSETS</b>	<b>\$ 596,710</b>	<b>\$ 555,264</b>	<b>\$ 501,589</b>	<b>\$ 447,913</b>	<b>\$ 394,237</b>
<b>UNRESTRICTED NET ASSETS</b>	<b>\$ 1,196,040</b>	<b>\$ 1,539,833</b>	<b>\$ 1,421,268</b>	<b>\$ 1,405,471</b>	<b>\$ 1,241,842</b>

## Sale or Lease/lease-back of Water Utility (continued)

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- Cal Water intends to propose a purchase of the City's Water Utility
  - The City would receive a lump sum payment for the system and its pumping rights
  - The City would discontinue subsidizing costs of delivering water
  - Cal Water would become responsible for maintaining the water system henceforth
  - Cal Water would be responsible for future water rate increases
  - Cal Water already services 27,000 customers in the Central Basin Area
    - City Water System customers will benefit from economies of scale
    - Rates can be increased gradually and spread over larger customer base



## Sale or Lease/lease-back of Water Utility (continued)

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- Advantages of a Lease/Leaseback Alternative:
  - Would insure that Water Utility customers would continue to benefit from the current water pumping rights
  - Cal Water could be required to make necessary capital improvements to the Water Utility before it is returned to the City
  - General Fund would still receive an upfront lease payment
- Disadvantages of a Lease/Leaseback Alternative:
  - Water Utility customers would not benefit from the economies of scale achieved from being part of a larger water system
  - General Fund will receive a lower upfront payment than it would if the Water Utility was sold to Cal Water
  - The City would still be required to subsidize water services or raise rates

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# Conclusion



## Conclusion

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- We recommend that the City:
  - Implement the *Fiscal Recovery Plan* to address the GF structural deficit
  - Direct FirstSouthwest to assist with the *Fiscal Recovery Plan*, quantify external financing needs, assess sources of external financing, negotiate terms and execute external financing
  - Consult with bond counsel regarding applying the \$445k excess in the reserve fund of the Series 2000 COPs to the Nov. 1st payment, thereby reducing the net cost to the GF
  - Consult with bond counsel regarding amendments to the Reimbursement agreements with the RDA such that future payments are forgiven and, in exchange, offset a portion of the City's loan from the RDA
  - Evaluate the benefits and costs of a sale or lease/lease-back of the Water Utility

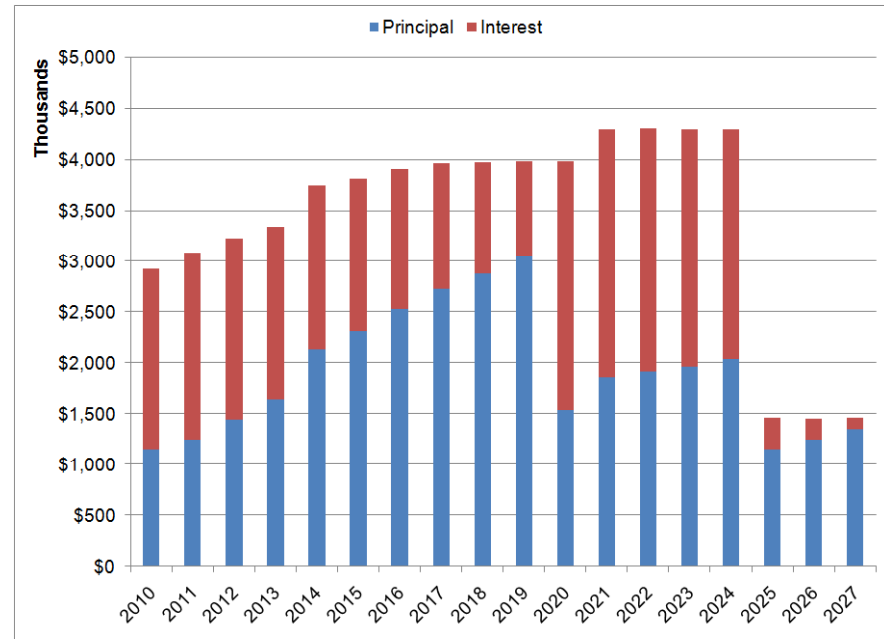
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# TECHNICAL APPENDIX



# Tax Allocation Bonds of Montebello Hills Redevelopment Project

<u>Series:</u>	1997, 1998A, 1998B, 1999A, 1999B, 2007A, 2007B (Taxable), 2009A (Subordinate)
<u>Amounts:</u>	\$43.569 million issued; \$33.029 million outstanding
<u>Repayment:</u>	Tax increment revenues of the project area
<u>Key Dates:</u>	Principal paid 3/1; final maturity 3/1/27
<u>Tax Status:</u>	Tax-exempt, except as noted above
<u>Interest Rates:</u>	3.50% - 8.10% (tax-exempt); 5.854% (taxable)
<u>Reserve Fund(s):</u>	\$1.16 million cash and sureties (both liens)
<u>Early Redemption:</u>	1997, 1998A/B, and 1999A on 9/1/11 @ 100%; 1999B & 2007B are non-callable; 2007A on 3/1/17 @ 100; 2009A on 3/1/18 @ 100
<u>Credit Ratings:</u>	Sr. Lien is A-; Sub. lien is BBB+ (S&P)
<u>Additional Bonds Test:</u>	Tax Revenues must represent at least 1.25x of maximum annual debt service (MADS)

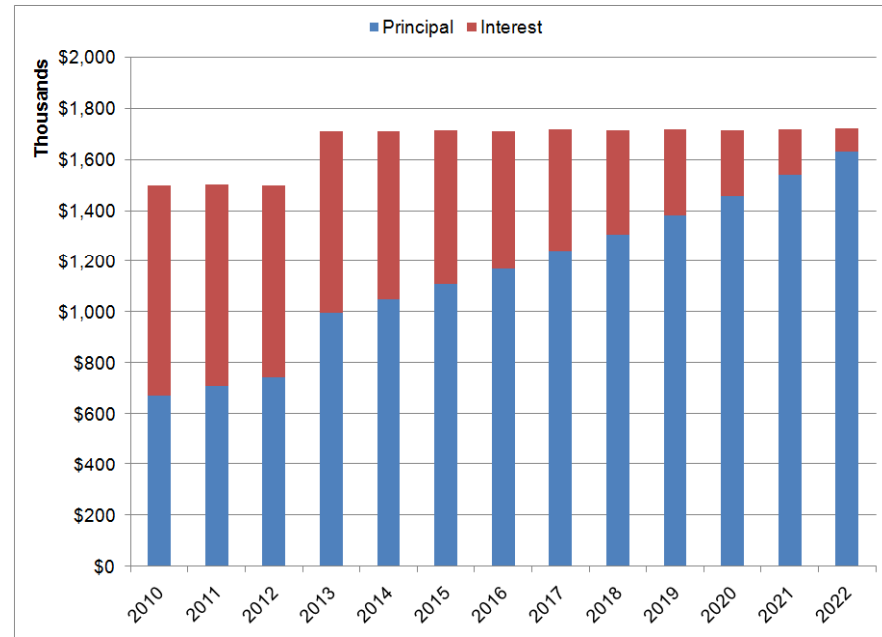


## **Financial Strategies:**

- There are no opportunities to refinance or restructure these TABs at this time which would benefit the General Fund

# Tax Allocation Bonds of South Montebello Industrial Redevelopment Project

<u>Series:</u>	1999A, 1999B, 2007A (Taxable)
<u>Amounts:</u>	\$18.47 million issued; \$14.33 million outstanding
<u>Repayment:</u>	Tax increment revenues of the project area
<u>Key Dates:</u>	Principal paid 9/1; final maturity 9/1/22
<u>Tax Status:</u>	Tax-exempt, except as noted above
<u>Interest Rates:</u>	4.90% - 5.50% (tax-exempt); 5.804% (taxable)
<u>Reserve Fund(s):</u>	\$1.11 million
<u>Early Redemption:</u>	1999A/B callable at 101% (100% as of 9/1/11); 2007A non-callable
<u>Credit Ratings:</u>	A- (S&P)
<u>Additional Bonds Test:</u>	Tax Revenues must represent at least 1.50x of maximum annual debt service (MADS)



## **Financial Strategies:**

- There are no opportunities to refinance or restructure these TABs at this time which would benefit the General Fund

## Disclosure

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