Belmont Fire Protection District Agenda # ________
Special Meeting of May 8, 2007

Staff Report

RESOLUTION AUTHORIZING THE ISSUANCE OF TAX REVENUE ANTICIPATION NOTES FOR FISCAL YEAR 2008

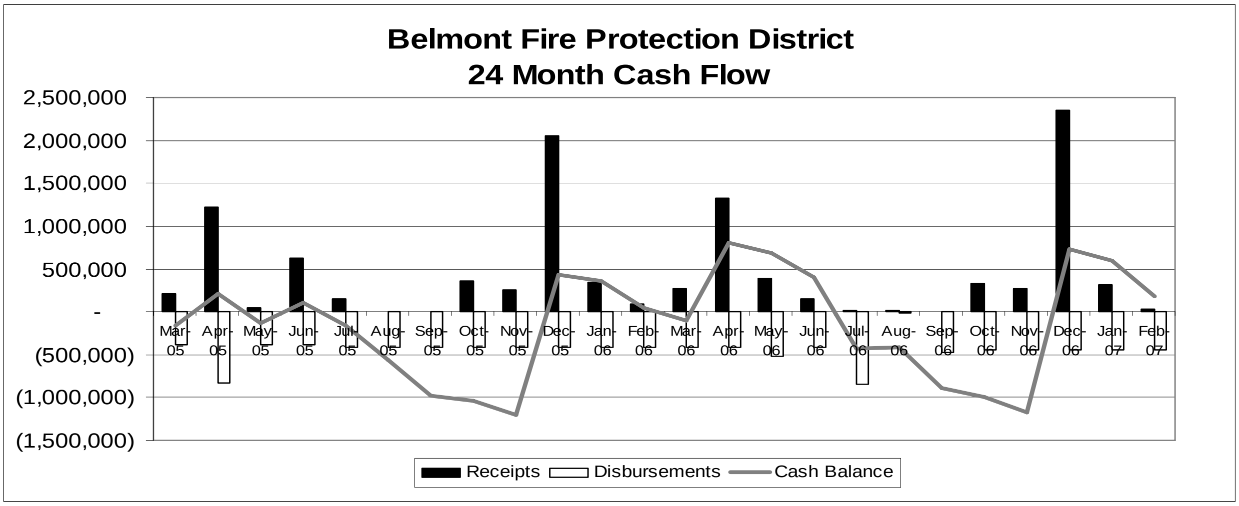
Honorable President and Board Members:

Summary

The Belmont Fire Protection District (District) experiences cash flow shortfalls due to timing differences between the semi-annual receipt of property taxes and the monthly disbursement of funds to operate the Belmont-San Carlos Fire Department. To bridge the temporary cash flow needs of the District, the attached resolution authorizes the issuance of Tax Revenue Anticipation Notes in an estimated amount of $1,500,000.

Background

The District's major revenue source is from property taxes received in semi-annual installments during December and April. The District is responsible for funding the normal operational needs of the Belmont-San Carlos Fire Department (Department) in equal installment throughout the year. As shown in chart below, the timing between the District's funding from property taxes and the Department's monthly operational needs causes temporary cash flow deficits. To cover the deficit, the District has borrowed monies from City's pooled funds in anticipation of receiving property taxes.



Discussion

What are TRANs?

Tax Revenue Anticipation Notes or TRANs are a commonly used form of short-term borrowing to assist the governments with their cash flow requirements. TRANs are generally tax-free bonds issued on a 12 or 13 month basis specifically for the purpose of covering potential cash flow deficits for governmental agencies that rely heavily on property tax distributions as a source of revenue. When not actually needed for cash flow purposes, bond proceeds may be reinvested as authorized by the District's investment policy. As a result, TRANs can also provide an additional source of revenue if the cost of tax-exempt borrowing is less than the income gained from reinvestment of the funds in taxable instruments, thus producing a net gain for the District.

What's the reason for change from what is being done now?

The District's past practice has been to cover temporary cash flow deficits by borrowing from the City's investment pool. While interperiod borrowing is a common practice with investment pools, the program is designed for short term borrowings and in amounts which do not adversely impact the City's liquidity requirements. Borrowings occur at the investment pool rate which fluctuates from time to time. Presently, the investment pool rate is 5.17%.

The ongoing budgetary issues of the Fire District have been well publicized for years. What has not been well publicized is the District's recurring cash flow deficits, which have been increasing and adversely affect the liquidity of the City's investment pool. One reason for this is that the Districts deficit is only shown in the monthly Treasurer's report as a credit (<>) value. As such, it doesn't receive the attention that an external borrowing would with the formal recording of resolutions, the booking of liabilities in the annual financial statements and the required disclosure of the debt obligation.

Clearly, the long term nature of this deficit and the size are contributing factors to considering a change.

How much does the Fire District need to borrow?

Staff has prepared a series of cash flow statements. Based on these calculations the deficit is approximately $1.1 million to $1.2 million. In addition, the TRANs program administrators include a working capital reserve. The final size of the TRANS is estimated to be $1,245,000.

What are the costs involved?

Since the District's borrowing would be combined with many other agencies throughout the state, the cost of issuance is relatively low given the size of the note. The issuance costs are not segregated and are part of the interest cost paid by the borrower. Presently, the program administrators have indicated an interest rate of 3.48% for a 13 month issue. Assuming a $1,245,000 loan amount, the cost of borrowing is $47,762. This amount is considerably less than the amount earned on the City's investment pool. By comparison, the cost of borrowing for the same loan would be $71,562 based on the present rate earned on the City's investment pool.

However, it is important to point out that under the current program, the District only borrows what it needs.

What's arbitrage?
Arbitrage is a gain which occurs when the cost of borrowing funds is lower than reinvestment earnings. As indicated above, the District's TRANs is expected to produce arbitrage which will further reduce the cost of borrowing. Those fundamentals appear likely through FY 2008. Assuming an arbitrage yield of 1.69% (5.17% investment pool - 3.48% TRANs), $22,794 in estimated arbitrage could be achieved.

What's the California Communities Join Powers Authority TRANs Program and who is using it?
California Communities' mission is to provide local governments and private entities access to low-cost, tax-exempt financing for projects that provide a tangible public benefit, contribute to social and economic growth and improve the overall quality of life in local communities throughout California. California Communities has issued nearly $6 billion in Tax and Revenue Anticipation Notes (TRANs) serving nearly 150 California local governments since the inception of the TRANs Program in 1993. TRANs amounts have ranged from $235 million to as little as $100,000. The TRANs Program saves both time and money when compared to stand-alone borrowings. See the TRANs FAQ section attached as an exhibit to this report for more information.

Are there other issues to consider?
Like all debt issues, there is risk. The risk associated with issuing a TRANs is that the interest rate environment changes dramatically. In the District's case, there would need to be a significant reduction in the Federal Funds rate of 5.25%, in the order of magnitude of 1.50+% for interest rate risk to occur. Another consideration is that issuing a TRANs converts a soft debt into a hard debt. In general, hard debt reduces the District's flexibility in managing its assets as repayments become fixed obligations.

What does the Finance Commission think?
On April 5th, the Finance Commission recommended the District authorize the issuance of TRANs as proposed by staff. In their thinking they identified the low cost of borrowing, the need to better highlight the District's poor cash position and the ongoing cash flow deficits as reasons for support.

Fiscal Impact
Positive fiscal impact. Effective borrowing rate on funds is reduced by the TRANs program from 5.17% to 3.48%. Assuming a loan amount of $1,245,000, the annual savings is $23,800. Temporary excess TRANs proceeds can be reinvested in the City's investment pool and rates higher than that borrowed, thereby producing interest income or arbitrage. The arbitrage effectively reduces the cost of borrowing the TRANs.

For purposes of completing the California Communities TRANS application, the resolution attached authorizes the issuance of $1,500,000 in TRANs. The actual size of the issue is based on the District's anticipated cash flow needs and will be calculated prior to finalizing the program which is expected in June. It is expected to be less than the authorized amount of $1,500,000.

Public Contact

Posting of City Council agenda.

Recommendation

Approve resolutions authorizing to issue Tax Revenue Anticipation Notes for Fiscal Year 2008 in an estimated amount of $1,500,000.

Alternatives

1. Continue to borrow from the City's investment pool.
2. Issue a stand alone debt obligation through a bank or other private placement lender.
3. With direction, refer the matter back to the staff for further study.

Attachments

A. TRANs Program FAQ
B. Resolution Authorizing Issuance of Tax Revenue Anticipation Notes.

Respectfully submitted,

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CALIFORNIA COMMUNITIES
JOINT POWERS AUTHORITY
Building Communities, Investing in Local Government Since 1988

Founding Co-Sponsors:

Tax and Revenue Anticipation Notes

Frequently Asked Questions

What are TRANs?

TRANs are Tax and Revenue Anticipation Notes, also known as TANs (Tax Anticipation Notes) and RANs (Revenue Anticipation Notes.)

Why are TRANs issued?

TRANs are issued by local governments to finance short term cash flow deficits which occur due to the irregular receipt of certain taxes and/or revenues, and the ongoing requirement for regular disbursements of operating expenses.

What are the benefits if issuing TRANs?

There are two primary benefits of issuing TRANs. First, TRANs are an inexpensive method of financing short-term cash shortfalls. Second, TRANs usually produce additional income through arbitrage earnings.

What is arbitrage?

Arbitrage is a gain which occurs when the cost of borrowing funds is lower than reinvestment earnings.

How do TRANs produce arbitrage earnings?

TRANs are issued at tax-exempt borrowing rates which are typically one to two percentage points lower than available reinvestment rates.

Is it legal to earn arbitrage on TRANs?

Yes - provided the TRANs are issued in accordance with federal tax regulations relating to the sizing and issuance of tax-exempt short-term notes.

How are TRANs issued?

TRANs are permitted under Government Code §53850 and are authorized when the governing body adopts a resolution. Most local governments engage a bond attorney to prepare documentation, and use the services of an investment professional for the placement or underwriting of the notes.

What are the advantages of issuing TRANs through the California Statewide Communities Development Authority (CSCDA) Program?

The CSCDA program provides competitive costs of issuance, greater access to the financial markets through a larger combined issuance, and a streamlined process for issuing TRANs which saves California local governments' staff time. The CSCDA Program also offers two maturity options; 12 and 13 month maturities.

What are the advantages of issuing notes which mature in 13 months rather than 12 months?

The possibility of earning additional arbitrage earnings. The gain of 13 month TRANs is, on average, 8% greater than 12 month TRANs.

What are the legal restrictions concerning the maturity of TRANs?

State law restricts the maturity of TRANs to 15 months. Federal tax law limits the maturity to 24 months. Federal tax guidelines provide a "safe harbor" for TRANs that mature within 13 months of issuance. Therefore, the longest maturity permitted in the CSCDA Program is 13 months.

Are there any other legal considerations when issuing 13 month TRANs?

Yes. An interest payment must be made to investors within 12 months of issuance.

Are there any accounting considerations when issuing 13 month TRANs?

Yes. As with 12 month TRANs, state law requires that funds be set aside for the repayment of the TRANs from current fiscal year revenues, the current year being the fiscal year in which the TRANs are actually issued. While the maturity of the 13 month TRANs will fall into the next fiscal year, it is necessary to set aside funds from current year revenues for the repayment of the TRANs.

Do I have to wait 13 months to issue my next TRANs?

No. If a local government issues a 13-month TRANs on July 1, 2003 which matures on July 31, 2004, the local government may issue another TRANs on July 1, 2004, prior to the maturity of the 2003 TRANs.

Will the issuance of a 13 month TRANs in 2003 affect the sizing of my 2004 TRANs?

No.

How does a local agency determine the amount of TRANs to issue?

Federal tax laws determine the amount of tax exempt TRANs a local agency may issue in order to retain arbitrage earnings on the borrowing. TRANs borrowers fall into two categories under federal tax laws; Small Issuers and Large Issuers. Detailed instructions for properly sizing TRANs are provided (hard copy and computer diskette formats) in the Program Binder. To request a Program Binder, complete a TRANs Application form.

	Small Issuer	Large Issuer
Maximum Cumulative Cash Flow Deficit	$3,800,000	$3,800,000
Working Capital Reserve - lesser of 5% of 2002-03 Expenditures - or -	1,450,000	
Average Cash Balance	n/a	950,000
Maximum Borrowing Amount	$5,250,000	$4,750,000
Tax Counsel's suggested reduction	(250,000)	(475,000)
Recommended Size	$5,000,000	$4,275,000

BELMONT FIRE PROTECTION DISTRICT RESOLUTION NO. __________

RESOLUTION OF THE BELMONT FIRE PROTECTION DISTRICT AUTHORIZING ISSUANCE OF TAX REVENUE ANTICIPATION NOTES FOR FISCAL YEAR 2008

WHEREAS, the Belmont Fire Protection District (District) experiences cash shortfalls due to the timing difference between the normal level of operating expenditures and the semi-annual receipt of property taxes; and,

WHEREAS, Tax Revenue Anticipation Notes (TRANs) are tax-free bonds that are issued on a 12 or 13 month basis specifically for the purpose of covering potential cash flow deficits for governmental agencies that rely heavily on property tax distributions as a source of revenue; and,

WHEREAS, the Directors authorize the issuance of $1,500,000 to offset the short term cash flow needs until the property taxes for the fiscal year are collected in December and April; and,

NOW, THEREFORE, BE IT RESOLVED that the Belmont Fire Protection District hereby authorizes the issuance of Tax Revenue Anticipation Notes for Fiscal Year 2008 in an estimated amount of $1,500,000.

* *

I hereby certify that the foregoing Resolution was duly and regularly passed and adopted by the Belmont Fire Protection District at a special meeting thereof held on May 8, 2007 by the following vote:

AYES, DIRECTORS: ______________________________

NOES, DIRECTORS: ______________________________

ABSTAIN, DIRECTORS: ______________________________

ABSENT, DIRECTORS: ______________________________

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Secretary, Belmont Fire Protection District

APPROVED:

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President, Belmont Fire Protection District