

# How Do We Pay For It? The Nuts and Bolts of Financing City Projects

Presentation for Rancho Palos Verdes

Orion Fulton

March 10, 2022

# Agenda

## 1. Delivering Major Projects

- Investment Decision
- Procurement Decision
- Delivery Options

## 2. Financing Major Projects

- Municipal Finance
- Project Finance

## 3. Funding Major Projects

- General Fund
- Special Taxes
- Special Revenues/Fees

## 4. Questions and Discussion

# Delivering Major Projects

(Why do we need this project? How should we build it?)

# Two Basic Questions

## Delivering Major Projects

### Investment Decision

- Should the project be pursued?
- Drivers:
  - Public policy
  - Goals and objectives
  - Project definition and alternatives
  - Costs and benefits
  - Preferred Project

### Procurement Decision

- How should the project be delivered?
- Drivers:
  - Project risk
  - Funding options
  - Financing options
  - Market factors (rates, prices, actors, expertise)

# Project Planning

## Investment Decision

### Outcomes / Objectives:

- Seismic Safety
- Improve Service
- Lower Operating Costs
- Downtown public park space
- Attracting Additional Investment in Downtown
- Monetize Land

### Project Definition and Alternatives:

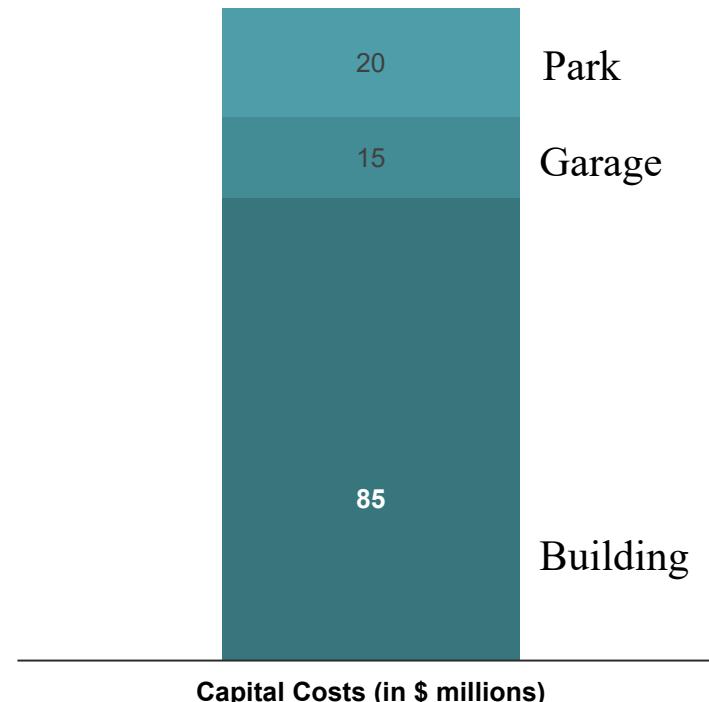
- Siting / Land Use
- Sizing
- Level of performance
- Cost
- Environmental Impacts
- Stakeholder Input

# Capital Costs

## Investment Decision

Example Project: \$120 million (USD)

- New Civic Center Building
- Centralized Parking Garage
- Civic Park



# Two Basic Questions

## Procurement Decision

### Investment Decision

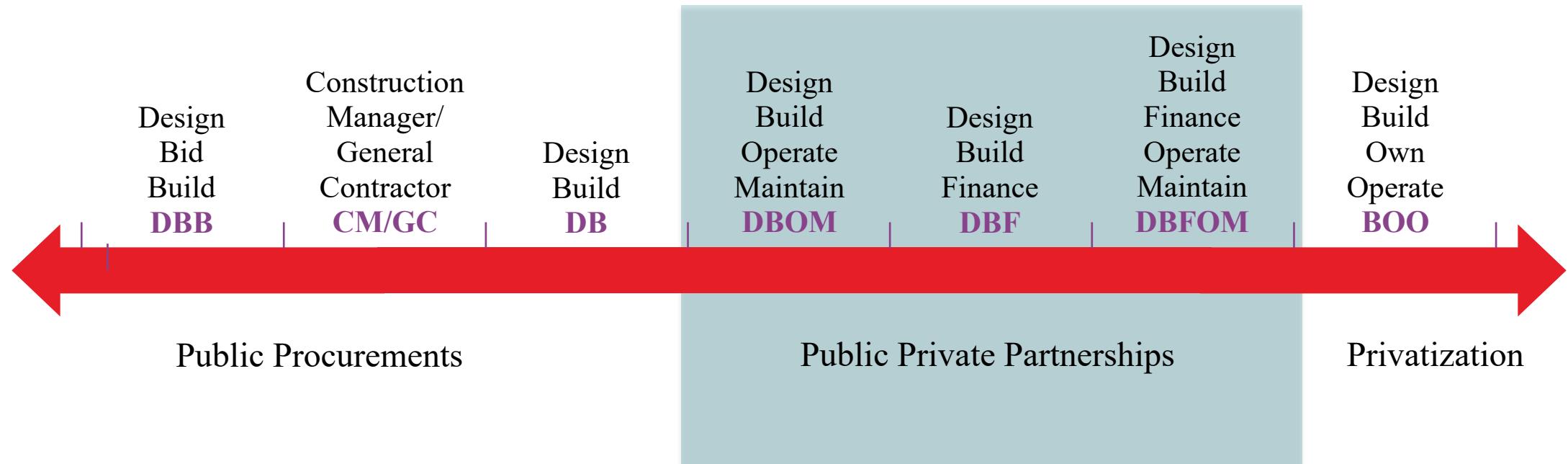
- Should the project be pursued?
- Drivers:
  - Public policy
  - Goals and objectives
  - Project definition and alternatives
  - Costs and benefits
  - Preferred Project

### Procurement Decision

- How should the project be delivered?
- Drivers:
  - Project risk
  - Funding options
  - Financing options
  - Market factors (rates, prices, actors, expertise)

# Project Delivery Options

## Procurement Decision



# Traditional vs. P3

## Procurement Decision

	DBB	P3
Design @ bid stage	100%	~ 30%
Construction Price & Schedule	Lowest Bid & Target Schedule	Fixed Price & Schedule
Financing	Muni bonds	Non-recourse private equity + debt
Maintenance	Public	Private
Operations	Public	Public or Private

# Sample Risk Allocation

## Procurement Decision

Risks	DBB-Public Works	DBFOM-P3
Change of Scope	Public	Public
Permits and Licenses	Public	Private
Right of Way	Public	Shared
Interferences / Utilities Relocation	Public	Shared
Engineering	Public	Private
Unknown Geological Conditions	Public	Private
Unknown Environmental Conditions	Public	Shared
Construction	Private	Private
QA/QC	Public	Private
Operation	Public	Private
Maintenance and Life Cycle	Public	Private
Financing	Public	Private
Force Majeure	Public	Shared

# P3 Parameters

## Procurement Decision

**Grout \* (1997) defined a three parameter criteria for a project to fulfil in order to be considered a Public-Private Partnership (P3)**

1. Project should be totally or partially financed by private sector and the Project Agreement/Concession Agreement should specify details regarding the service to be provided rather than the asset itself
2. A substantial portion of the project risk should be transferred to the private sector partner
3. Project should provide Value for Money to the tax-payers

(\*) Grout Paul A. (1997), the Economics of the Private Finance Initiative, Oxford Review of Economic Policy, Vol. 13, No. 4, 1997, pp. 53-66

# Types of P3s

## Procurement Decision

- **By Commercial Nature**
  - Commercially Viable / Self Sustainable
  - Co-financed by the Government
- **By Revenue Nature**
  - Availability Payment (Capital Payment and Service Payment – Performance Based)
  - Revenue Risk (total or partially) assumed by private party

# Primary P3 Players

## Procurement Decision

### Lenders

- Banks and Financial Institutions
- Institutional Investors
- Infrastructure Debt Funds

### Private/ Concessionaire

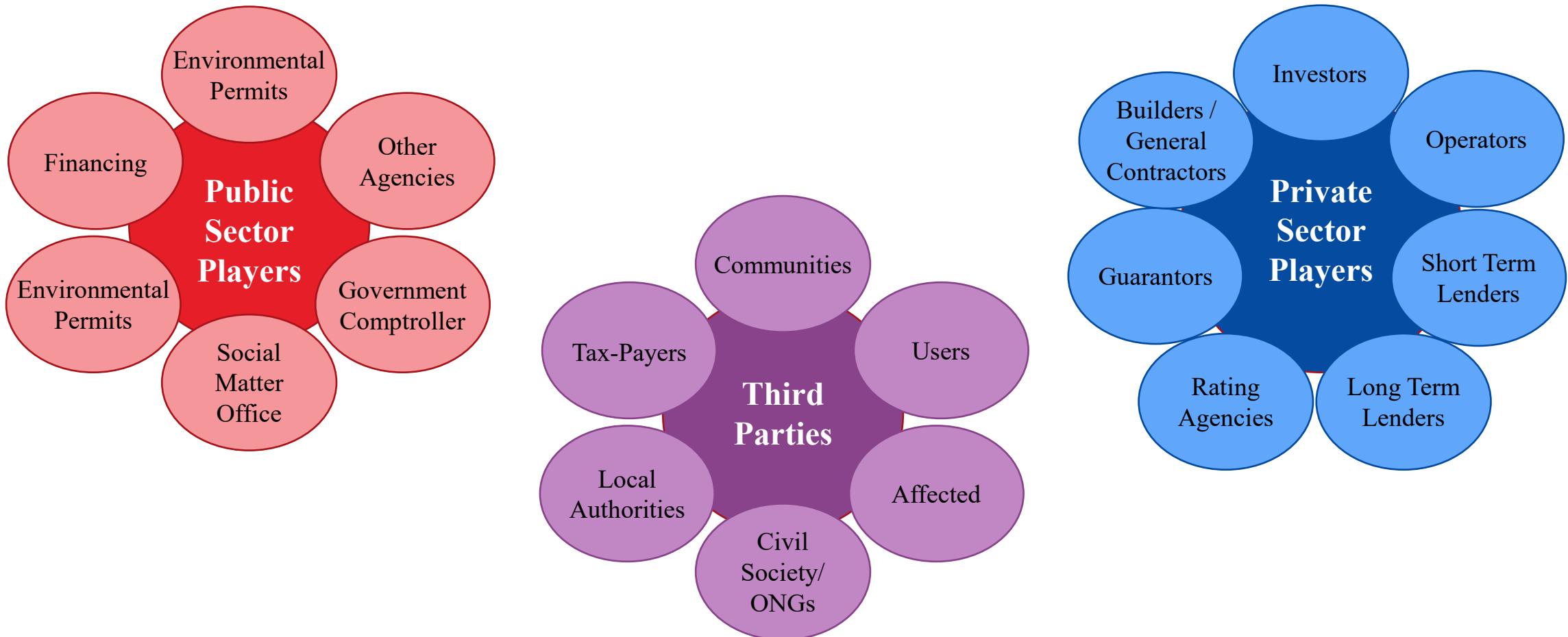
- Developers and Sponsors (Builder and/or Concessionaire)
- Operators and Service Providers
- Infrastructure Private Equity Funds

### Public/ Central-Local Government

- Federal Government
- State Government
- Cities and Counties, local agencies

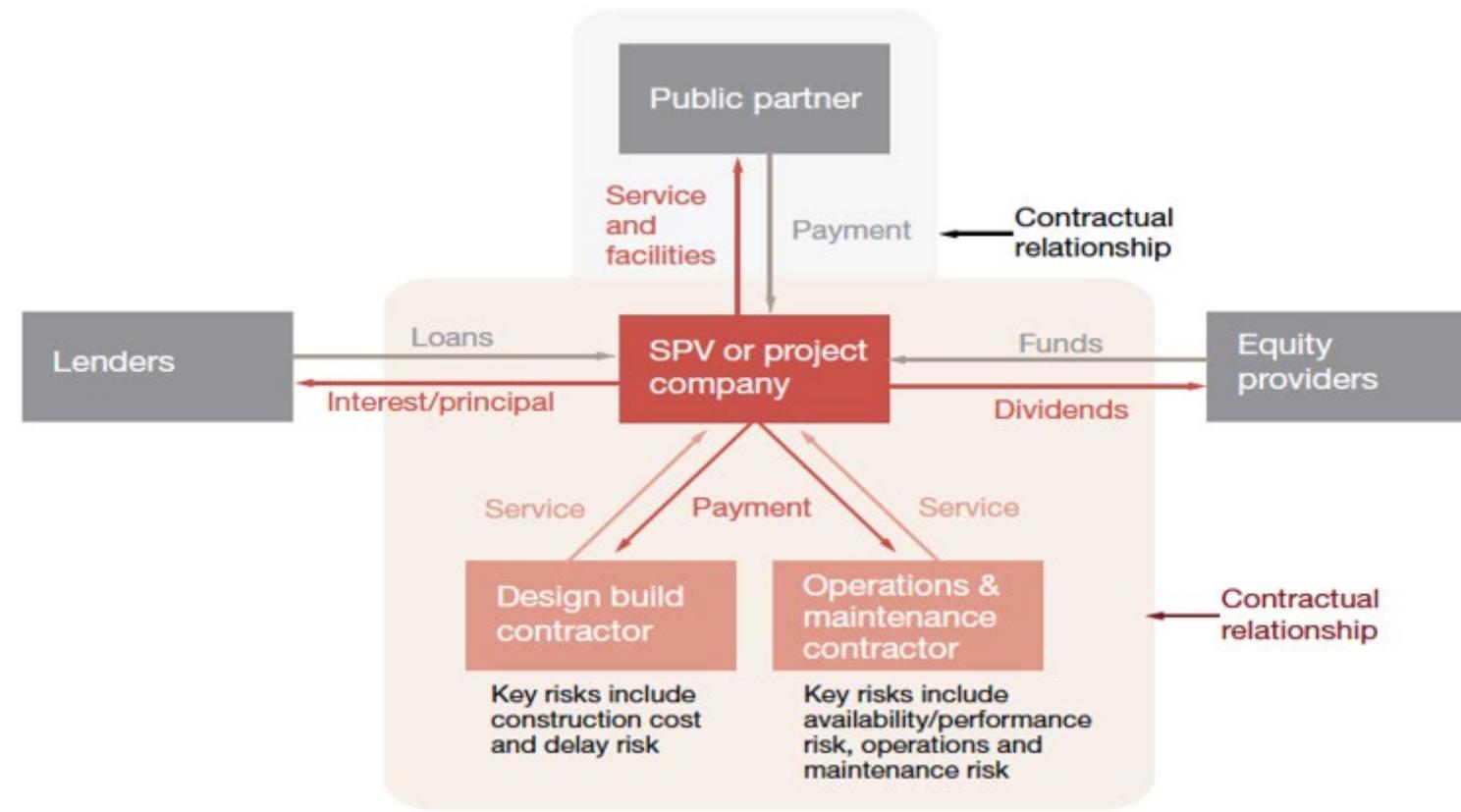
# Key Roles & Secondary Partners

## Procurement Decision



# Contractual Relationships

## Procurement Decision

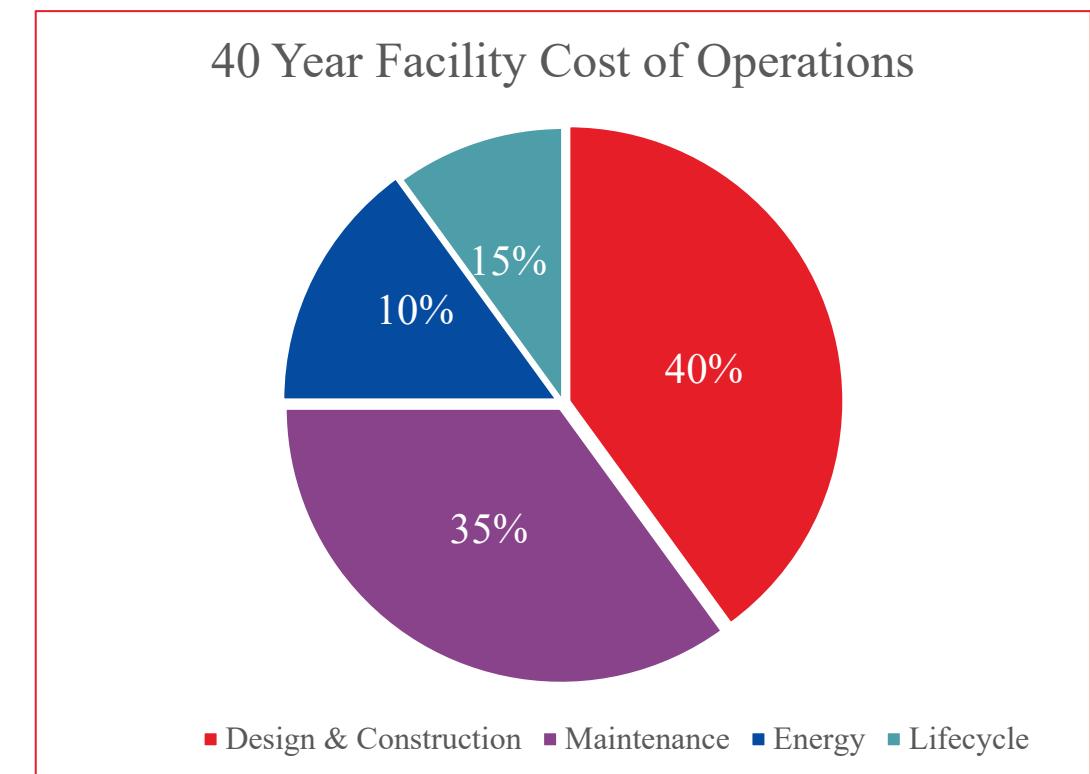


# Importance of a Funded Lifecycle O&M Program

## Procurement Decision

Example: 40-year Facility cost of ownership – Long Beach Civic Center

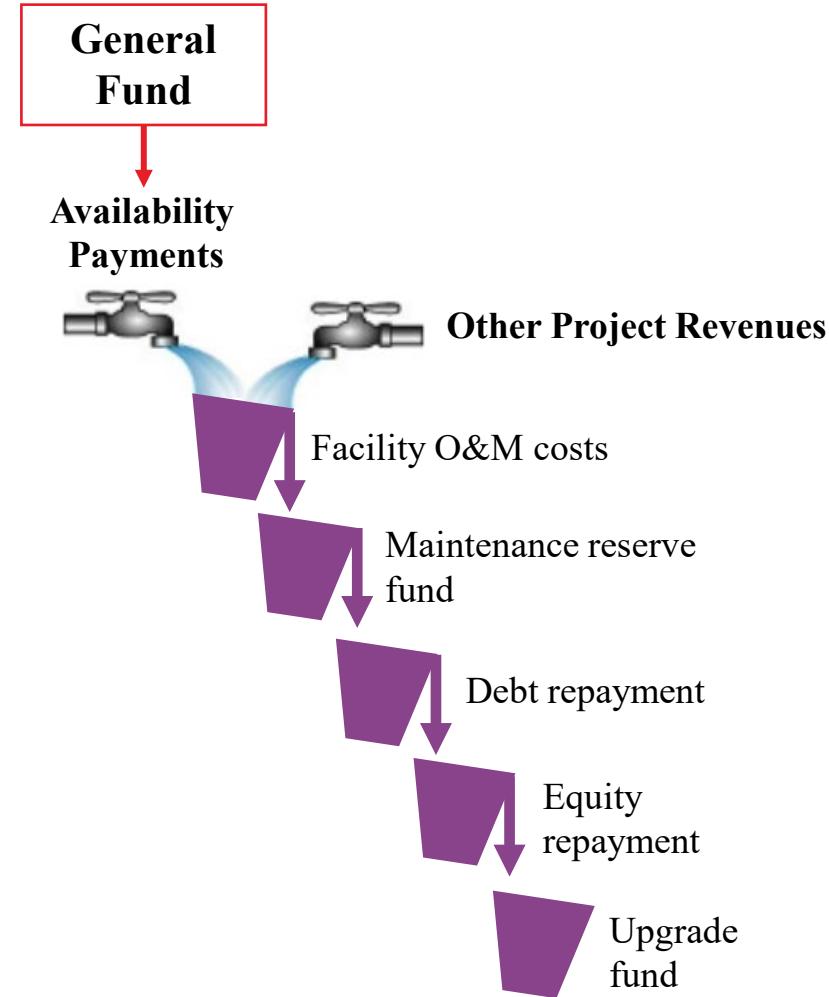
- Facility Operations represents the biggest expenditure over the life of a building – it should be a big driver in delivery selection
- Reduced total cost of occupancy
- Provides a better, more reliable building with extended asset life



# Payments

## Procurement Decision

- Availability payments pay back initial investment and ongoing O&M needs
  - Capped annually with inflation adjustment
  - Subject to deductions for shortfalls in performance
- Sequence of payments ensures the facility is available for use and kept in good repair
- **Additional sources of revenue can reduce the annual Availability Payment**
- A revenue upside sharing method can be structured to provide a fund for future upgrades





## Long Beach Civic Center P3

Project Owner/Sponsor: Plenary Properties Long Beach

Location: Long Beach, CA

Program:

- City Hall – 270,000 GSF
- Port Authority Headquarters – 230,000 GSF
- Main Library – 93,000 GSF
- Lincoln Park – 217,800 GSF
- Civic Plaza – 106,500 SF

Delivery structure: City/Library DBFOM, Port DBF

Total Cost: \$520 Million

Financing:

- Cash from land monetization
- 91% Private placement bonds (with delay draw feature)
- 9% equity



## **Los Angeles County Department of Mental Health**

Project Owner/Sponsor: Trammell Crow

Location: 6th Street & Vermont Avenue (Vermont Corridor), Los Angeles, CA

Program:

- 400,000 GSF office building
- 13 stories of offices for LA County
- 8-story parking structure plus one level of below grade parking
- 7,500 GSF of ground-floor retail

Delivery structure: 63-20 Progressive Design-Build P3

Total Cost: \$350 Million

Financing:

- 100% 63-20 bonds
- The County saves \$32,340,000 in rent payments over the 33-year term of the debt

Questions?

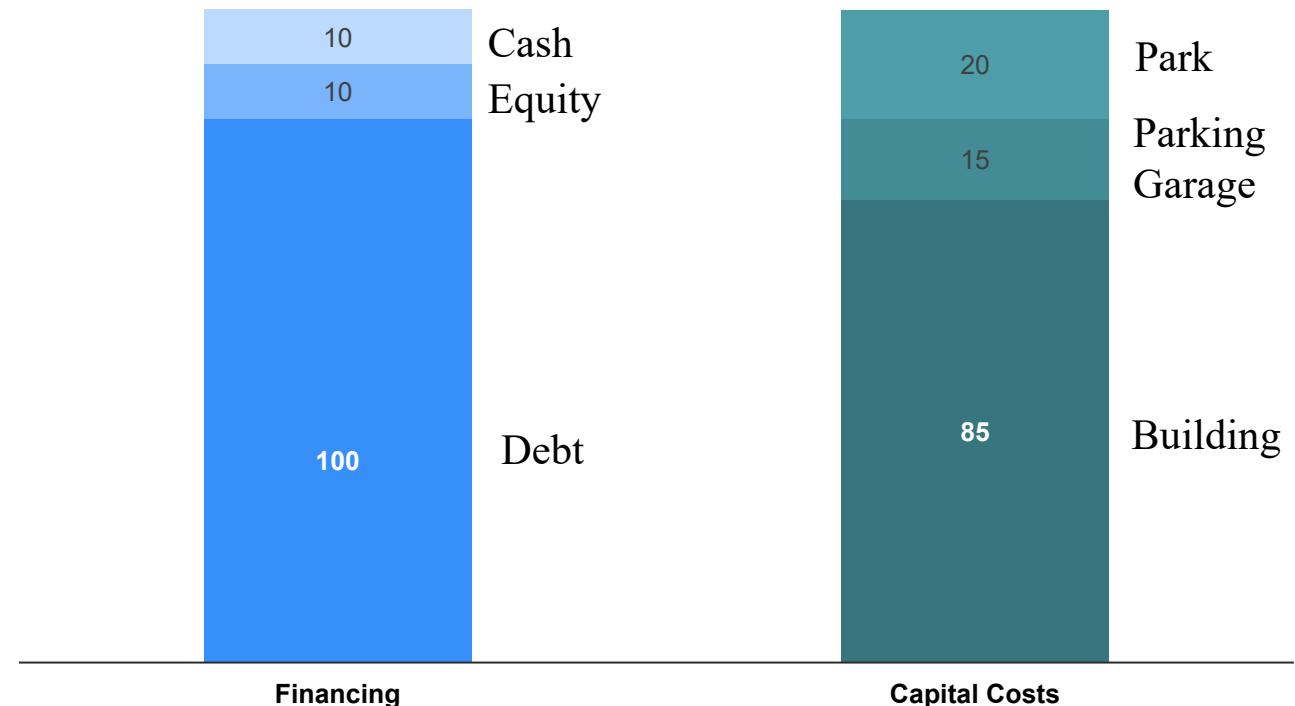
# Financing Major Projects

(How are we going to pay for this project?)

# Overview

## Financing Major Projects

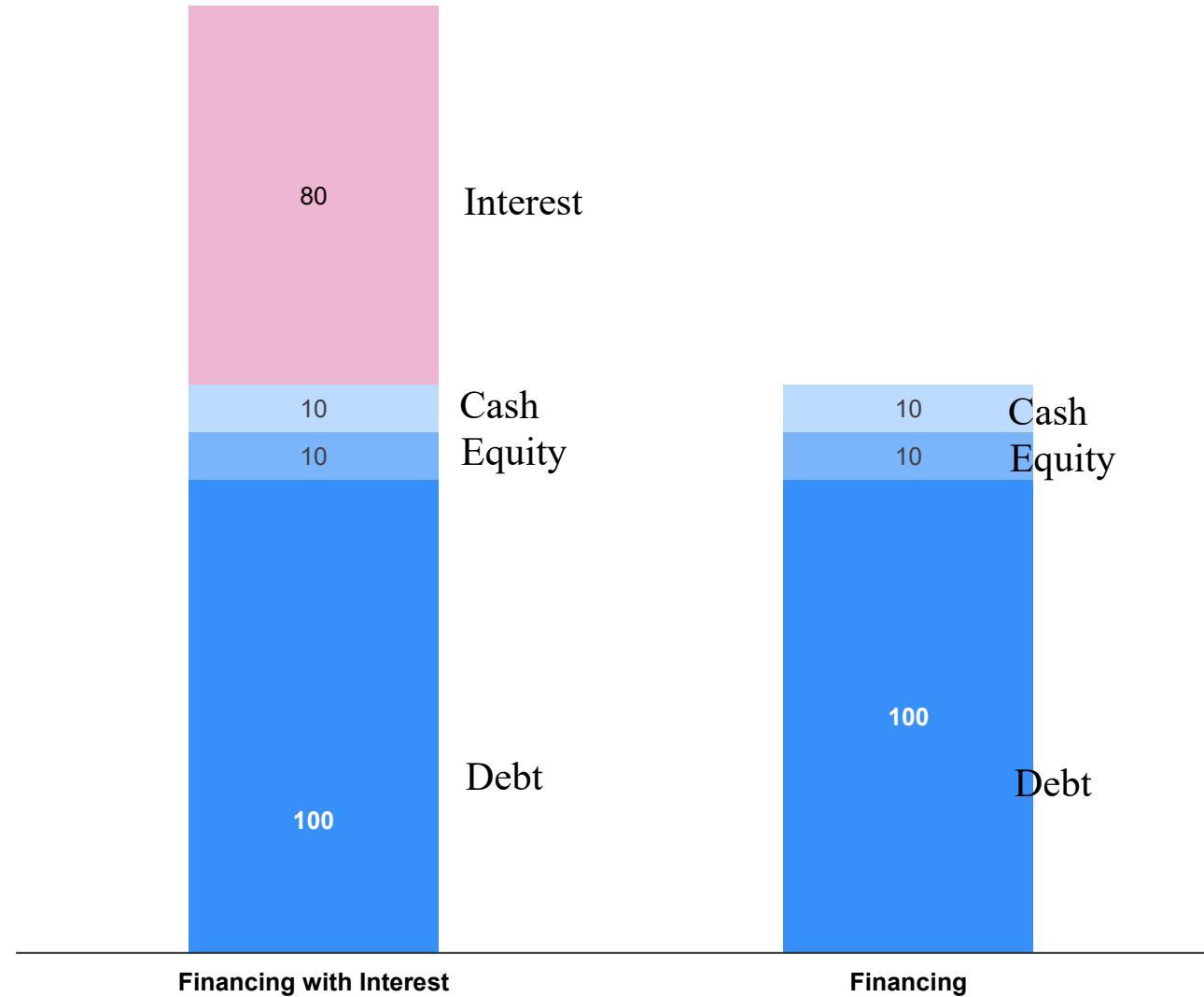
- Types of Capital
- Cost of Capital - Interest
- Time Value of Money
- Restricted Uses
- Creditworthiness



# Interest

## Financing Major Projects

- Interest on debt
- Interest on equity



# Time Value of Money

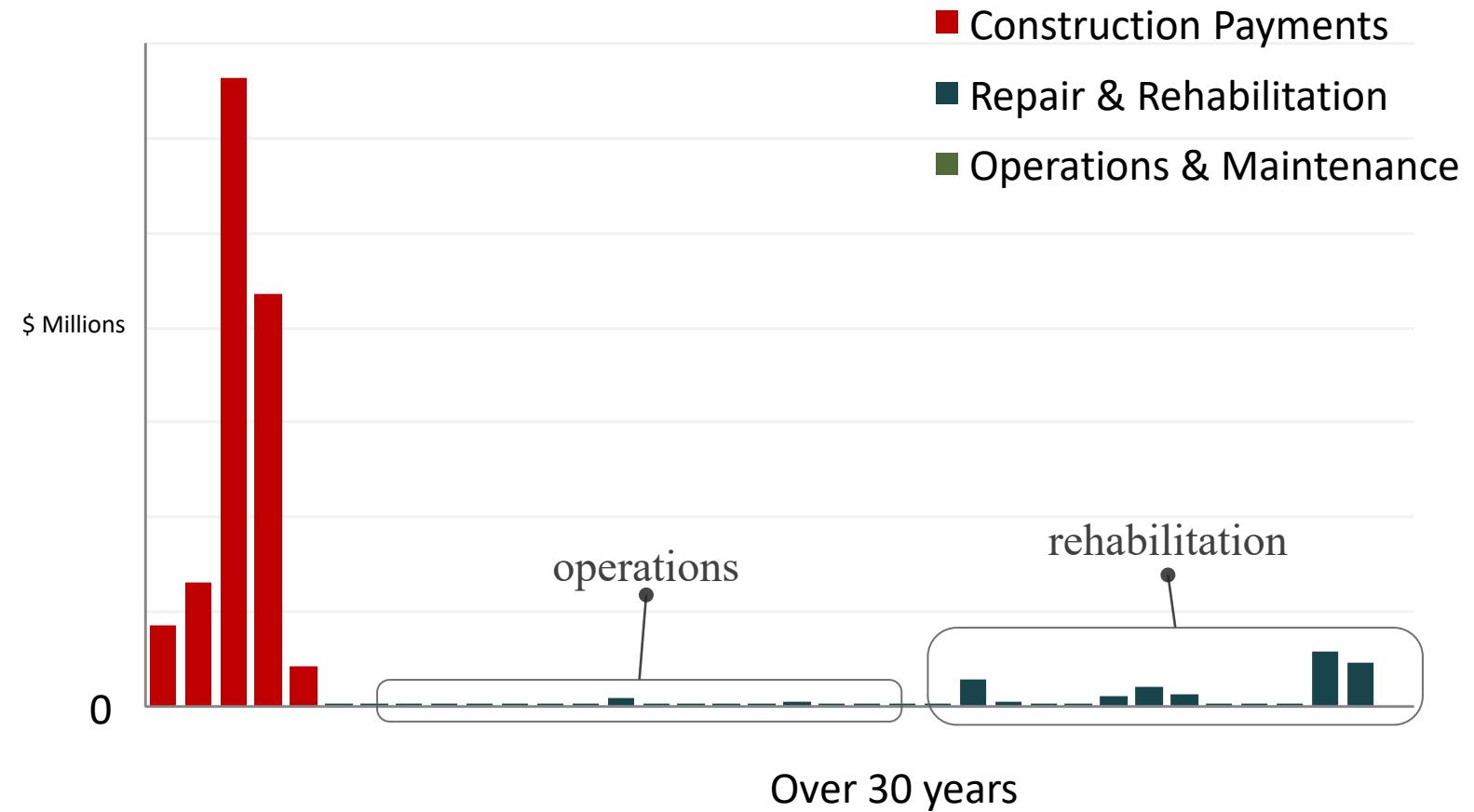
## Financing Major Projects

- Inflation
- Opportunity Cost
- Present Value
- Discounted Cash Flow (DCF) analysis

# Cashflow – Pay As You Go

## Financing Major Projects

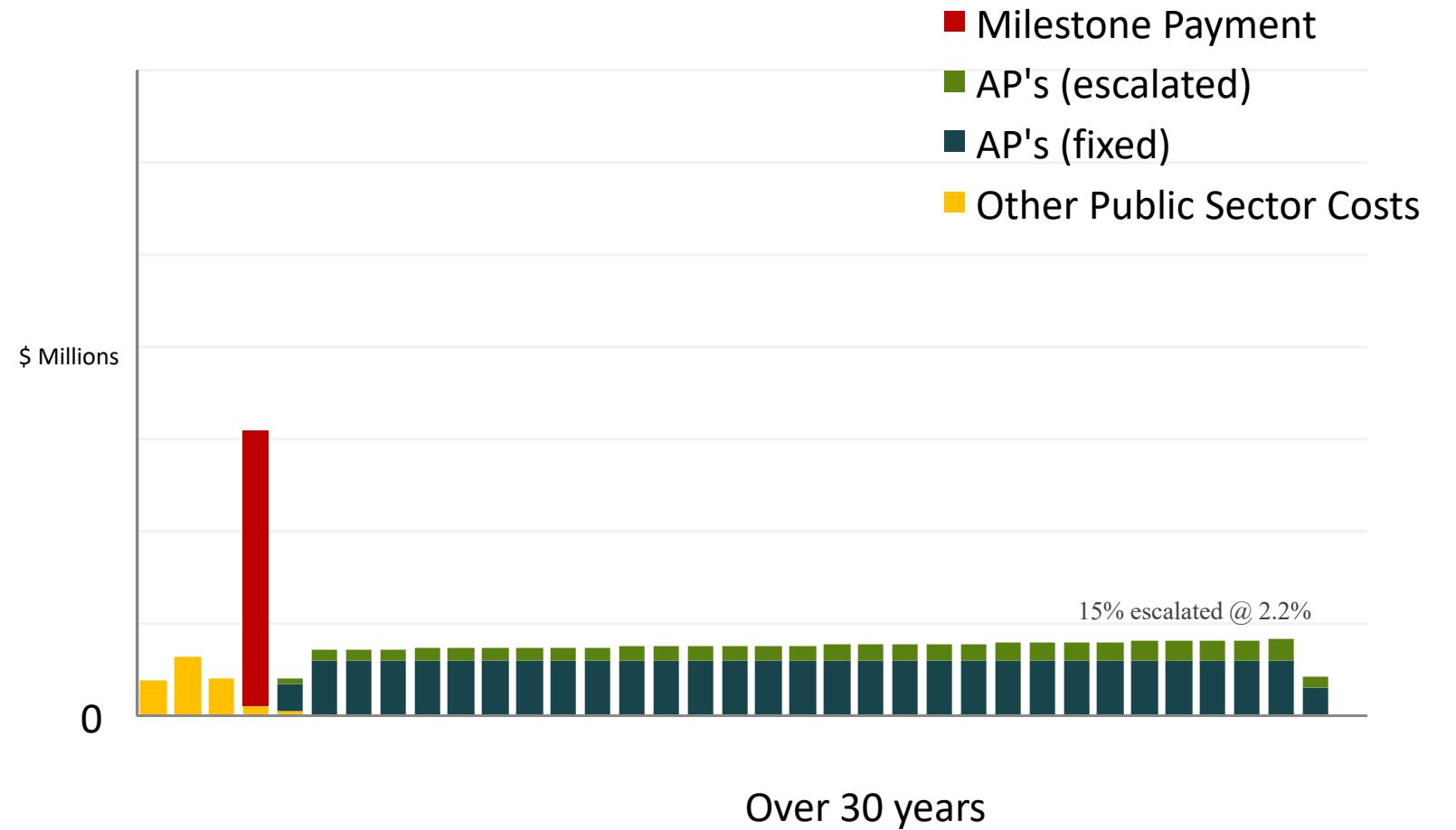
- Public sector payments
- Private sector payments



# Cashflow - DBFOM

## Financing Major Projects

- Public sector payments
- Private sector payments



(\$Millions, YC)

# Financing Major Projects

## Municipal Financing

- Tax-exempt vs Taxable Bonds
- Long Term Notes
  - General obligation bond
  - Revenue bond
  - Certificates of participation (COP)
- Anticipation Notes
- Conduit Financing
  - Authorities
  - Private Activity Bonds

# Tax Exempt vs Taxable Bonds

## Municipal Financing

Mechanism	Description
Tax-Exempt Bonds	<ul style="list-style-type: none"><li>• Also referred to as Municipal Bonds or Government Bonds</li><li>• A debt obligation (or security) issued by municipalities, states, airports, school districts, and other public entities</li><li>• Finances public capital expenditures such as schools, highways, water systems, energy utilities, public housing, and hospitals.</li><li>• Not taxed at the federal level and may also be exempt from state taxes if the bondholder resides in the state where the bonds are issued.</li><li>• These bonds usually have a lower yield compared with taxable bonds because of the tax-exempt status.</li><li>• They are fixed-income securities, meaning they have fixed periodic interest payments. Principal is due upon maturity.</li><li>• Private use is qualified by IRS (“qualified private activities”)</li></ul>

# Tax Exempt vs Taxable Bonds

## Municipal Financing

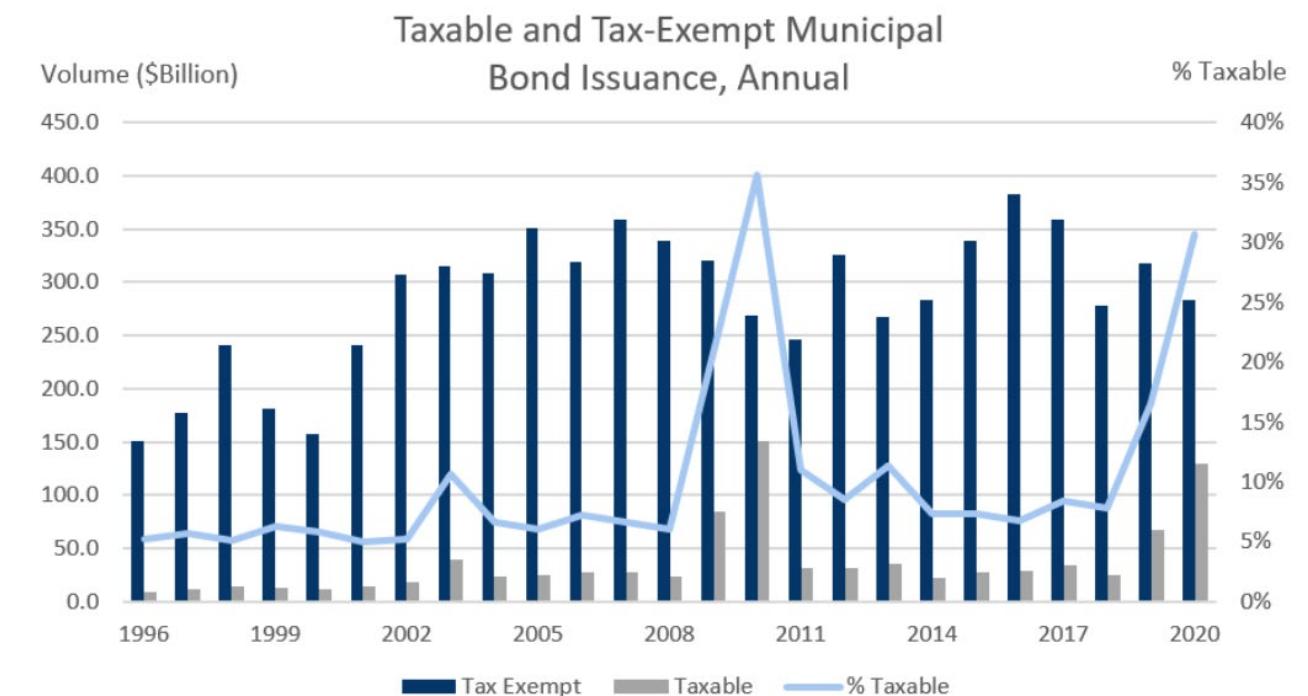
Mechanism	Description
Taxable Bonds	<ul style="list-style-type: none"><li>• A debt obligation issued by a local government, such as a city, county, or related agency, to finance projects that the federal government will not subsidize.</li><li>• Typically, they fund projects that don't directly benefit the general public, so the federal government does not grant tax-exempt status to the project.</li><li>• They offer risk-adjusted yields that are comparable to those available from other taxable entities, such as corporate bonds</li><li>• Example: Build America Bond (BABs) - were created under the American Recovery and Reinvestment Act (ARRA) of 2009 and, although taxable, have special tax credits and federal subsidies for either the bond issuer or holder.</li></ul>

# Tax Exempt vs Taxable Bonds

## Municipal Financing

Year	High Grade Tax Exempt Yield (%)	AAA Corporate Yield (%)	Yield Spread (%)
2000	5.77	7.62	1.85
2005	4.29	5.24	0.95
2010	4.16	4.94	0.78
2015	3.48	3.89	0.41
2019	3.38	3.39	0.01

Source: Council of Economic Advisors, Economic Report of the President, 2021, Table B-42.



Source: SIFMA. Note: Data are available through November 2020.

# Long Term Notes

## Municipal Financing

Mechanism	Description
General Obligation Bond (GO Bond)	<ul style="list-style-type: none"><li>• A municipal bond that is backed solely by the credit and taxing power of the issuing jurisdiction rather than the revenue from a given project; no assets are used as collateral, and they do not pay creditors back on the basis of income generated from funded projects.</li></ul>
Revenue Bond	<ul style="list-style-type: none"><li>• A municipal bond supported by the revenue from a specific project, such as a toll bridge, highway, or local stadium. Revenue bonds are project-specific and are not funded by taxpayers at large, and municipalities repay investors from the income created by the project or from a city's revenue source (e.g. sales tax)</li></ul>
Certificates of participation (COP)	<ul style="list-style-type: none"><li>• An investor purchases a share of the lease revenues of a program and allows investors to participate in a pro-rata share of a lease-financing agreement. COP is secured by lease revenues, as opposed to bond participation, COPs pay investors via lease revenues as opposed to bond interest.</li><li>• An alternative to municipal bonds.</li></ul>

# Long Term Notes

## Municipal Financing

MMD Scales		as of Monday, 03/07/2022		
MATURITY	"AAA"	INSURED	NY	CA
1	0.86	1.01	0.86	0.92
5	1.36	1.53	1.40	1.47
10	1.66	1.93	1.74	1.83
15	1.84	2.12	1.95	2.02
30	2.08	2.41	2.19	2.26

Source: © Refinitiv, <https://www.tm3.com/homepage/homepage.jsf?ur=y>

# Conduit Financing

## Municipal Financing

Mechanism	Description
Joint Powers Authority	<ul style="list-style-type: none"><li>• A Joint Powers Authority (JPA) is a legally created entity that allow two or more public agencies to jointly exercise common powers, as governed by the Joint Exercise of Powers Act of the California Government Code section 6500.</li><li>• To create a JPA, the public agencies must enter into an agreement that states both the powers of the JPA and how it will be exercised.</li><li>• There are two JPA arrangements:<ol style="list-style-type: none"><li>1. Two or more public agencies contract to jointly exercise common powers.</li><li>2. Two or more public agencies form a separate legal entity that has independent legal rights, including the ability to enter into contracts, hold property, issue debt, and sue or be sued.</li></ol></li></ul>
Private Activity Bonds	<ul style="list-style-type: none"><li>• Tax-exempt bonds issued by or on behalf of a local or state government for the purpose of providing <i>special financing benefits for qualified projects</i>. The financing is most often for projects of a private user, and the government generally does not pledge its credit. They allow governments to borrow on behalf of private companies, acting as an alternative to corporate bonds</li><li>• Also known as conduit bonds.</li></ul>

# Anticipation Notes

## Municipal Financing

Mechanism	Description
Anticipation Notes	<ul style="list-style-type: none"><li>• A short-term obligation issued to meet temporary financing needs with the expectation that future cash flows will repay the note. Typically, they have maturities of one year or less, are rated by credit agencies, and include interest that is payable at maturity rather than semiannually.</li><li>• The four different types of anticipation notes are:<ol style="list-style-type: none"><li>1. Tax anticipation notes (TANs) - used in anticipation of future tax collections.</li><li>2. Revenue anticipation notes (RANs), issued with the expectation that nontax revenue (such as federal or state aid) will pay the debt.</li><li>3. Tax and revenue anticipation notes (TRANs), which are paid off with a combination of taxes and revenue.</li><li>4. Bond anticipation notes (BANs), which act as bridge loans issued when the municipality expects a future longer-term bond issuance to pay off the anticipation note at maturity.</li></ol></li></ul>

# Financing Major Projects

## Project Financing

- Bank loans
  - Construction Loan
- Bonds
  - 63-20 nonprofit
  - Private Placement

# Project Financing

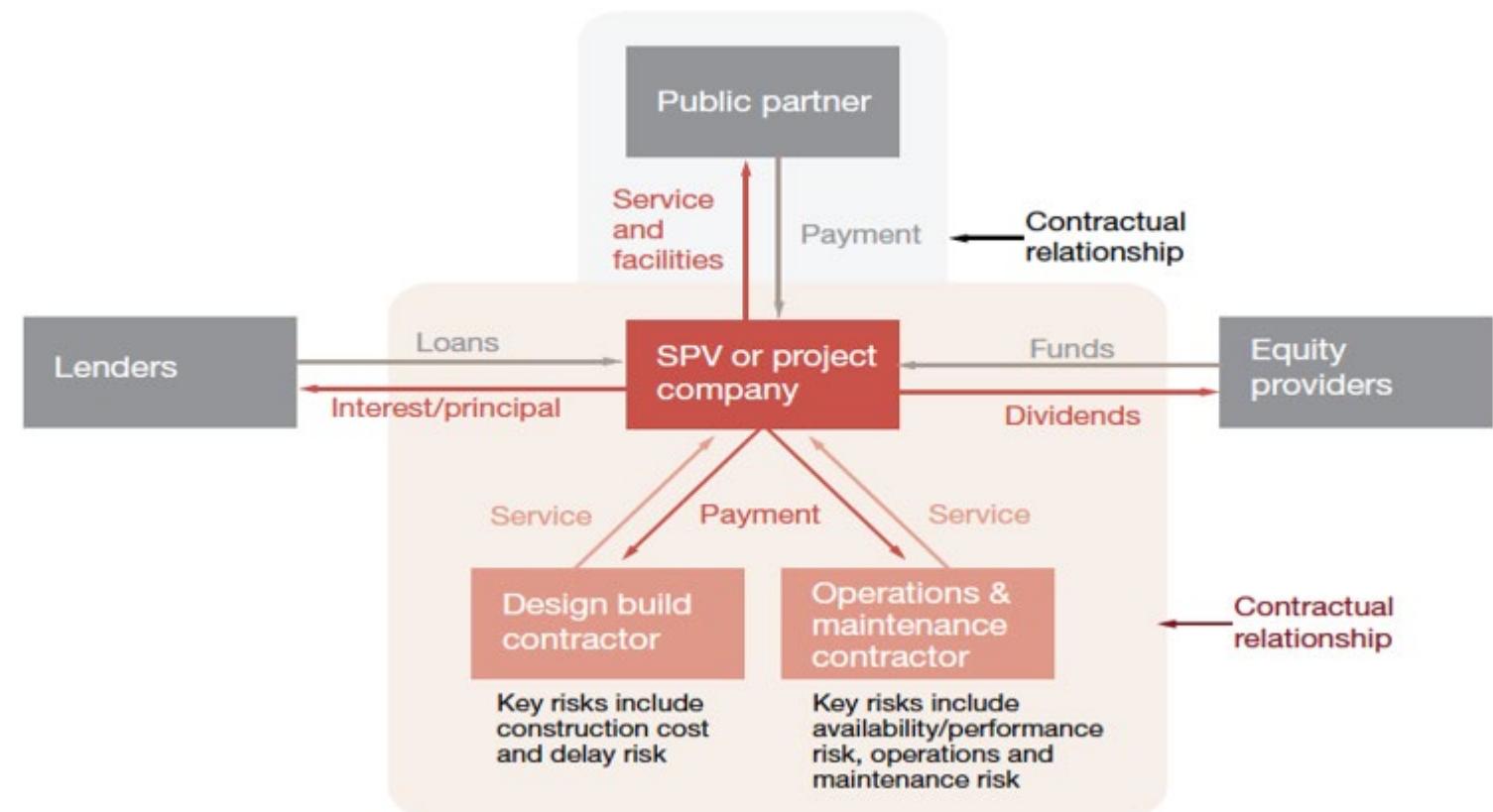
## Financing Major Projects

Mechanism	Type	Description
Bank Loan	Construction Loan	<ul style="list-style-type: none"> <li>A short-term loan used to finance the construction period of a real estate project before obtaining long-term funding. Because they are considered relatively risky, construction loans usually have higher interest rates than permanent loans.</li> </ul>
Bonds	63-20 nonprofit	<ul style="list-style-type: none"> <li>A nonprofit corporation may issue tax-exempt bonds for the purpose of financing governmental facilities. The nonprofit corporation must transfer title to the financed facility to a governmental entity when the debt is retired.</li> <li>The interest rate depends upon the credit strength of the collateral security.</li> </ul>
	Private Placement	<ul style="list-style-type: none"> <li>Bonds are sold to pre-selected number of investors and institutions rather than on the open market.</li> <li>They are relatively unregulated compared to sales of securities on the open market</li> <li>Flexible terms (e.g. delay draw features, repayment profiles)</li> </ul>

# Financing Major Projects

## Review

- City
- Conduit
- Project Company



Questions?

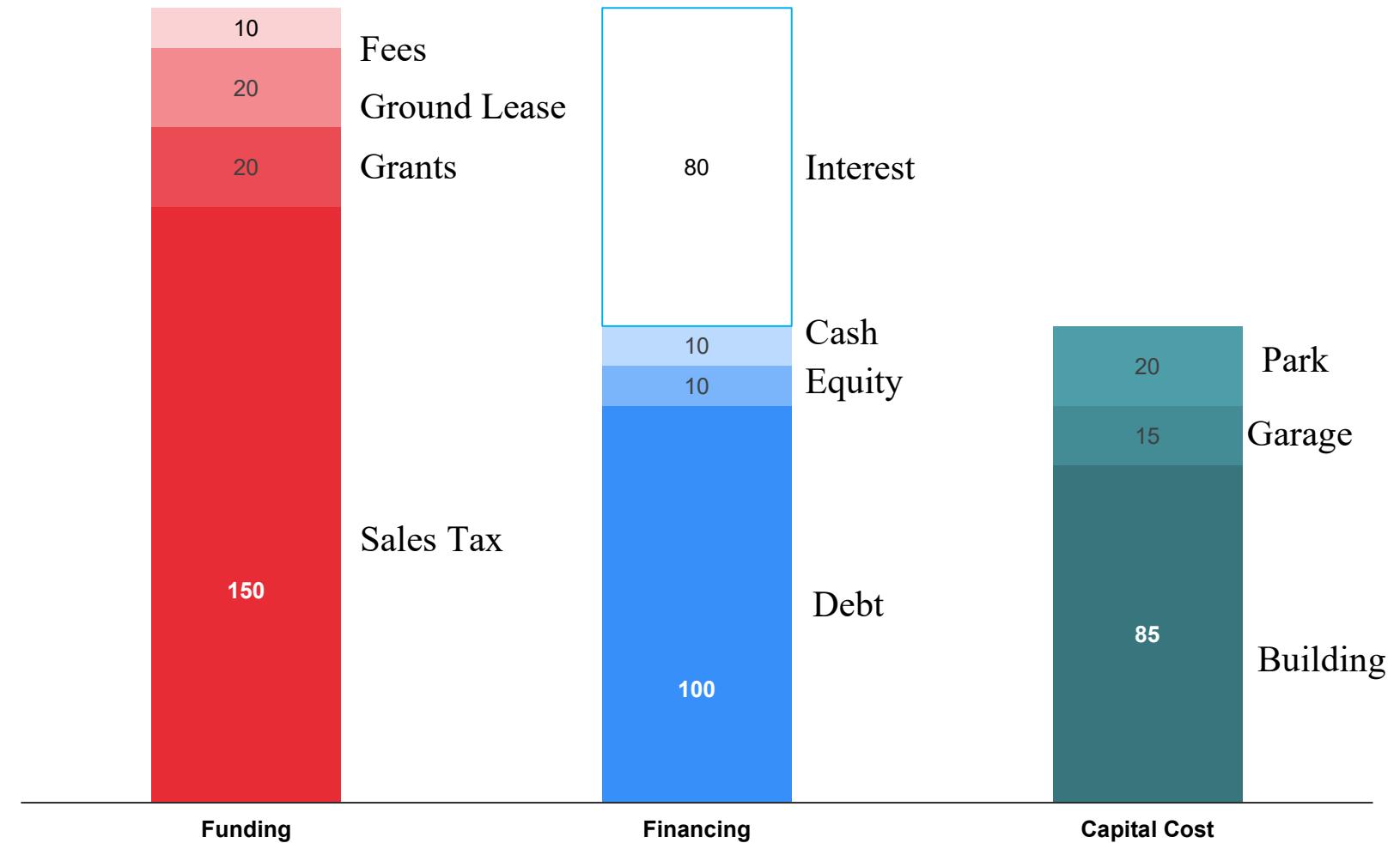
# Funding Major Projects

(Where is the money coming from?)

# Overview

## Funding Major Projects

- Source of Funds
- Timing of Funds
- Restricted Uses



# General Fund

## Funding Major Projects

- General revenue sources
  - taxes, fees, rentals, charges for services, fines, interest, and donations
- Savings from lower operating costs
- Surplus budget

# General Fund

## Funding Major Projects

Mechanism	Description
General Revenue Sources	<ul style="list-style-type: none"><li>The money generated from normal business operations of a municipality. They could include the forthcoming sources to be discussed.</li></ul>
Lower Operating Costs	<ul style="list-style-type: none"><li>Operating costs are the ongoing expenses incurred from the normal day-to-day of running a business, so reducing the operating costs of a project could provide additional funding.</li></ul>
Surplus	<ul style="list-style-type: none"><li>After all expenses are paid for, surplus budget that is not restricted to a specific use, can be used to support projects.</li></ul>

# Special Taxes

## Funding Major Projects

- Sales tax
- Parcel tax
- Assessment Districts
  - Tax-increment financing (TIF)
  - Enhanced infrastructure financing district (EIFD)
  - Special assessment districts (SADs)
  - Community facility district (CFD)

# Sales Tax

## Funding Major Projects

Mechanism	Description	Examples
Sales Tax	<ul style="list-style-type: none"><li>Sales tax is a tax that is imposed on sales of certain goods and services.</li><li>Sales tax can generate a significant amount of funding but requires voter's approval.</li><li>Two-third voter's approval is required.</li><li>May impose a disproportionate economic burden on low-income communities. However, this can be mitigated by excluding "necessity goods and services".</li><li>Revenue fluctuations may occur in function of the economic cycles.</li></ul>	<ul style="list-style-type: none"><li>Measure P in Burbank allows the city to implement a three-quarter-cent local sales tax to help pay for infrastructure needs and deferred pension costs and was approved with over 60% of the vote.</li><li>Measure M in Los Angeles County is a half-cent sales tax increase to fund a major expansion of the county's public transit system. It passed with almost 70% of the vote and is expected to bring in \$860 million annually for decades.</li></ul>

# Parcel Tax

## Funding Major Projects

Mechanism	Description	Examples
Parcel Tax	<ul style="list-style-type: none"><li>• Parcel tax is defined as a form of property tax assessed at a rate based on the characteristics of a parcel—or unit of property.</li><li>• Parcel tax increases can be used to pay for infrastructure projects. Cities would issue general obligation (GO) bonds backed by parcel tax revenue to access the revenue sooner.</li><li>• Increased cost for property owner.</li><li>• Requires 2/3 voter approval.</li><li>• City's ability to repay debt on a bond issuance.</li></ul>	<ul style="list-style-type: none"><li>• Proposed Measure EE would have imposed a tax of 16 cents per square foot of interior space on residential and commercial property for 12 years to support Los Angeles Unified School District, but was rejected by voters. It was anticipated to have raised \$500 million annually for the state's largest school district.</li></ul>

# Tax Increment Financing (TIF)

## Funding Major Projects

Mechanism	Description	Examples
Tax Increment Financing	<ul style="list-style-type: none"> <li>Invest in public infrastructure and other improvements up-front, and then the local government pays later for those investments by capturing the future anticipated increase in tax revenues generated by the project. The resulting incremental local tax revenues generated by the new project can support a bond issuance.</li> <li>TIF bonds have been used to fund land acquisition, sewer and water upgrades, environmental remediation, construction of parks, and road construction.</li> <li>Success depends on a robust real estate and economic conditions. Best used when project completion is expected to result in a sufficiently large increase in the value of surrounding real estate.</li> <li>Given high transaction costs, this tool is less appropriate for funding smaller projects.</li> </ul>	<ul style="list-style-type: none"> <li>Infrastructure Financing Districts (IFDs)</li> <li>Enhanced Infrastructure Financing Districts (EIFDs)</li> <li>Infrastructure and Revitalization Financing Districts (IRFDs)</li> <li>Community Revitalization and Investment Authorities (CRIA)</li> <li>Affordable Housing Authorities (AHAs)</li> <li>Neighborhood Infill Finance and Transit Improvement Districts (NIFTI 1 and 2)</li> </ul>

# Enhanced Infrastructure Financing District (EIFD)

## Funding Major Projects

Mechanism	Description	Examples
EIFD	<ul style="list-style-type: none"> <li>EIFDs are similar to tax increment financing but have more flexibility in what it can fund. Unlike former redevelopment, this tool imposes no geographic limitations on where it can be used.</li> <li>Projects include infrastructure maintenance and housing development, economic development, transportation infrastructure, sewage treatment, and climate adaptation projects, etc.</li> <li>Assembly Bill 733 (2017) allows for EIFDs to fund climate change adaptation projects.</li> <li>Requires agreement among taxing authorities to consent transferring their share of the property tax increment to the EIFD (School districts are excluded).</li> <li>No public vote is required to establish an authority, yet a 55% vote is required to issue bonds.</li> </ul>	<ul style="list-style-type: none"> <li>There is a proposed City of Redondo Beach/County of Los Angeles EIFD includes urban greening and wetland restoration and aims to revert its now-closed AES Power Plant's 50-acre site into open space and park development, wetland restoration, and private development.</li> <li>The City of La Verne established an EIFD near the City's future Gold Line light rail station to establish a funding mechanism that can facilitate the construction of infrastructure improvements in these areas to support future development.</li> </ul>

# Special Assessment Districts (SADs)

## Funding Major Projects

Mechanism	Description	Examples
Special Assessment Districts	<ul style="list-style-type: none"><li>Property owners pay an additional fee to fund specific improvements or services within the boundaries of the special assessment district.</li><li>The special assessment's purpose must be determined prior to the district's creation and the amount that each property owner pays must be directly proportional to the benefit the property will receive from the proposed improvement.</li><li>Requires voters' approval.</li><li>Increases cost of ownership</li></ul>	<ul style="list-style-type: none"><li>Santa Clarita has an Open Space Preservation District to acquire, preserve, and protect open space, which was approved by voters in 2007, and created an approximate \$1.5 million in funding in its first year.</li><li>Transbay Transit Center - The city of San Francisco established a special tax assessment over the entire redevelopment site to pay for additional public infrastructure, and the ongoing upkeep and maintenance of parks, streets and other public facilities.</li></ul>

# Community Facility District (CFD)

## Funding Major Projects

Mechanism	Description	Examples
Community Facility District	<ul style="list-style-type: none"><li>CFD is a special tax district provided in State Law that funds public improvements and ongoing services within an identified area.</li><li>Parks, streets, sewer improvements, and public safety services are some of the public improvements and services that may be financed by a CFD.</li><li>Creation of special district requires formal approval by petition or vote.</li><li>Two-third voters' approval within the proposed district boundaries required. If there are fewer than 12 registered voters within the proposed boundaries, the vote may pass by the current landowners.</li></ul>	<ul style="list-style-type: none"><li>City of Los Angeles established two Community Facilities Districts to provide funding to the Mountains Recreations &amp; Conservation Authority to help protect and maintain local open space, wildlife corridors, and parklands and to increase fire prevention, ranger safety patrols, and clean water within these local areas of the Santa Monica Mountains Conservancy Zone.</li></ul>

# Special Revenues/Fees

## Funding Major Projects

- Capital Improvement Project (CIP) Fund
- Impact and Development Fees
- Grants (Federal, State, and Local)
- Capital donations, philanthropy
- Other (i.e. user fees, leases)

# Special Revenues/Fees

## Funding Major Projects

Mechanism	Description
Capital Improvement Project (CIP) Fund	<ul style="list-style-type: none"><li>Long-range plan for all individual capital improvement projects and funding sources. CIP Projects are unique construction projects that provide improvements or additions such as land, buildings, and infrastructure. The CIP is a multiple year forecast of the City's capital need.</li></ul>
Impact and Development Fees	<ul style="list-style-type: none"><li>Fees that are connected to new development to offset the impact on the local community (impact fees) and cover the cost of a certain activity or service (development fees), such as building permit fees help pay the cost of staff who review drawings.</li></ul>
Grants (Federal, State, and Local)	<ul style="list-style-type: none"><li>Federal, state, utility, regional and local grant programs as well as philanthropic grant funding are available for specific purposes. Government grants do not require repayment, however often they require either matching funds from the City, staff time to administer the grants, or both.</li></ul>

# Special Revenues/Fees

## Funding Major Projects

Mechanism	Description
Capital donations, philanthropy	<ul style="list-style-type: none"><li>• Donations and philanthropic contributions could cover a range of projects.</li></ul>
Other (i.e. user fees, leases)	<ul style="list-style-type: none"><li>• Cities/states collect impact fees, user fees, regulatory fees, etc. Fees are typically connected to a certain activity or service.</li></ul>

Thank you!

Questions?



## Contact

Orion Fulton

Associate Principal  
Advisory Services  
d. (415) 946-0599  
[orion.fulton@arup.com](mailto:orion.fulton@arup.com)

ARUP