

<b>Item 8</b> <b>File 11-0750</b>	<b>Departments:</b> Office of Public Finance (OPF), War Memorial
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**EXECUTIVE SUMMARY****Legislative Objective**

- The proposed ordinance would (1) authorize the execution and delivery of Certificates of Participation (COPs) in an aggregate principal amount not to exceed \$170,000,000 to finance the seismic upgrade of and certain improvements to the War Memorial Veterans Building; (2) authorize the selection of a trustee by the Director of Public Finance and approve the form of a trust agreement for the COPs between the City and the trustee; (3) approve the forms of a property lease and a project lease between the City and the trustee for the COPs; (4) approve the form for an official notice of sale and notice of intention to sell the COPs, if sold by competitive sale; authorize the selection of underwriters by the Director of Public Finance and approve the form of a purchase contract between the City and the underwriters relating to the COPs, if sold by negotiated sale; (5) approve the forms of a preliminary and final official statement and continuing disclosure certificate; (6) find that the proposed project is categorically exempt from the California Environmental Quality Act (CEQA); (7) find that the proposed project is in conformity with the City's Planning Code, General Plan, and Administrative Code; (8) grant general authority to City officials to take necessary actions in connection with the Certificates of Participation; (9) approve modification to documents and agreements; and (10) ratify previous actions taken in connection with the proposed project.

**Key Points**

- The War Memorial Veterans Building's structure and systems have not been renovated since the building was first opened in 1932. Aging and damage from the 1989 Loma Prieta earthquake have resulted in needed seismic upgrades and other select improvements to the Veterans Building totaling approximately \$132,455,590.
- Voters approved General Obligation Bond (GO Bond) funding for the Veterans Building in 1990, as part of a larger \$332,400,000 GO Bond, though that funding was utilized for other approved City projects. Voters rejected GO Bond funding specific to the Veterans Building in 2002.
- Under the proposed ordinance, the City-owned War Memorial Veterans Building and War Memorial Opera House (the Leased Property) would serve as collateral for the COPs to secure the City's covenants and obligations under the subject leases.
- Funding the proposed improvements using COPs is approximately \$87,760,000 more costly than if City voters approved a GO Bond for the same improvements. However, such voter approval is uncertain; would possibly increase Property Tax rates above the 2006 Property Tax cap established by the Capital Planning Committee; would require additional time, delaying needed improvements to the Veterans Building, and would likely increase project costs.

**Fiscal Impact**

- The Office of Public Finance reports that, based on conservative estimates, the total cost of issuing the proposed COPs would be \$316,280,000, including \$168,115,000 for project and issuance expenses and \$148,165,000 for net total interest payments. The average debt service cost of the COPs to the City's General Fund would be approximately \$12,165,000 per year, for a period of 26 years.

**Recommendation**

- Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

## MANDATE STATEMENT & BACKGROUND

### Mandate Statement

According to San Francisco Charter Section 9.118, any agreement with a term of over ten years or expenditures of over \$10,000,000 is subject to approval by the Board of Supervisors. The proposed issuance of \$170,000,000 in Certificates of Participation requires the City to enter into an agreement which exceeds ten years and \$10,000,000.

### Background

The San Francisco War Memorial complex includes two buildings, the Veterans Building and the War Memorial Opera House, and the adjoining outdoor Memorial Court, all of which were completed in 1932. The complex is designated as both a City Landmark and State Landmark. The Veterans Building currently provides: (a) office, exhibit, and meeting space for the San Francisco Posts of the American Legion and other veteran organizations; (b) office space for the City's War Memorial staff; (c) exhibition space for the San Francisco Arts Commission; (d) office and exhibition space for various local non-profit organizations; (e) office space for the Mayor's Office of Disability; (f) the City's Law Library; and (g) meeting space for the City's Department of Environment. In addition, the Veterans Building also houses the Herbst Theatre and the Green Room performance and reception hall.

The War Memorial Veterans Building's structure and systems have not been renovated since the building was first opened in 1932. Aging, deferred maintenance, and damage from the 1989 Loma Prieta earthquake have resulted in numerous structural shortcomings. According to the City's Capital Planning Committee, the Veterans Buildings deficiencies include:

- A Seismic Hazard Rating of 3 out of 4, with 4 being partial or total collapse, indicating that in the event of a major earthquake, the building poses significant life hazards to building occupants;
- Incomplete fire alarm and sprinkler systems;
- Aged deteriorated building systems;
- 80 year old boilers that are inefficient to operate;
- Inadequate electrical power distribution and emergency power supply;
- Disabled elevators; and
- Deteriorated domestic and drinking water systems.

The War Memorial Veterans Building's current needed improvements, as identified by the City's Capital Planning Committee, include:

- Seismic upgrades and earthquake damage repair;
- Hazardous materials mitigation;
- Improvements to preserve and improve building facilities, including:
  - Roof and skylights renovation;

- Replacement or upgrade of attic catwalks and service platforms; and
- Elevator upgrades;
- Accessibility upgrades;
- Local, State, and Federal Building Code-mandated upgrades, including:
  - Energy efficiency upgrades;
  - Mechanical system upgrades; and
  - Central plant replacement; and
- Replacement of the building's water piping and drinking water system.

*Past Attempts to Secure Funding for Earthquake Retrofits and Other Improvements*

San Francisco voters originally approved \$332,400,000 General Obligation Bond (GO Bond) funding for seismic and other improvements to various City facilities including the Veterans Building and the War Memorial Opera House in June of 1990, with the passage of the Earthquake Safety Phase II (ESP II) GO Bond Program. However, GO Bond revenues originally intended for the Veterans Building were utilized for other approved GO Bond-funded improvement projects, including the seismic renovation of City Hall. On November 5, 2002, San Francisco voters rejected Proposition C, which would have issued \$122,755,000 in GO Bonds to fund improvements for the War Memorial Veterans Building. The 2002 Proposition C required 66.7 percent voter approval, but only received 55.0 percent voter approval.

## DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would (1) authorize the execution and delivery of Certificates of Participation (COPs) in an aggregate principal amount not to exceed \$170,000,000 to finance the seismic upgrade of, and certain improvements to, the War Memorial Veterans Building; (2) authorize the selection of a trustee by the Director of Public Finance and approve the form of a trust agreement for the COPs between the City and the trustee; (3) approve the forms of a property lease and a project lease between the City and the trustee for the COPs; (4) approve the form for an official notice of sale and notice of intention to sell the COPs, if sold by competitive sale; authorize the selection of underwriters by the Director of Public Finance and approve the form of a purchase contract between the City and the underwriters relating to the COPs, if sold by negotiated sale; (5) approve the forms of a preliminary and final official statement and continuing disclosure certificate; (6) find that the proposed project is categorically exempt from the California Environmental Quality Act (CEQA); (7) find that the proposed project is in conformity with the City's Planning Code, General Plan, and Administrative Code; (8) grant general authority to City officials to take necessary actions in connection with the Certificates of Participation; (9) approve modification to documents and agreements; and (10) ratify previous actions taken in connection with the proposed project.

The proposed COPs in an amount not to exceed \$170,000,000 would be used for seismic upgrades and other improvements to the Veterans Building, and related financing and reserves. Based on current cost estimates and schedules and under current market conditions, the Office of Public Finance expects to issue \$168,115,000 of COPs, which would provide approximately \$132,455,590 of project funding directly for the seismic upgrades and building improvements,

and \$35,659,410 for related COP expenses, as shown in Table 1 below. A breakdown of the \$132,455,590 of project funding for the seismic upgrades and improvements is provided in Table 2 below.

**Table 1: Uses of Certificates of Participation Proceeds**

<b>Cost Component</b>	<b>Amount</b>
Seismic Upgrades and Improvements (Project Funding)	<u>\$132,455,590</u>
COP Project Fund	107,383,270
Commercial Paper Project Fund	23,916,730*
Commercial Paper Interest	1,155,590*
COP Expenses	<u>\$35,659,410</u>
Debt Service Reserve	12,299,400
Capitalized Interest	22,117,250
Other Costs of Issuance	402,185
Underwriter's Discount	840,575
<b>Total</b>	<b>\$168,115,000</b>

\* Total Commercial Paper of \$25,072,320

Source: Office of Public Finance

The Office of Public Finance does not anticipate issuing the proposed COPs until December 2012 (see "Short Term Financing through Commercial Paper" section below). The proposed not-to-exceed amount of \$170,000,000, which is \$1,885,000 greater than \$168,115,000 amount shown in Table 1 above, allows for variations in potential interest rates and market conditions between now and December 2012.

**Table 2: Veterans Building Improvement Costs**

<b>Hard Costs - Construction Cost</b>	<b>\$102,052,800</b>
Includes all seismic elements, put back of historic finishes, life safety and code mandated improvements including sprinkler & fire alarm systems, Americans with Disabilities Act (ADA), central plant replacement, elevator upgrades, replacement of domestic drinking water systems, design & construction contingencies.	
<b>Soft Costs - Project Management, Design, Permits, etc.</b>	<b>\$28,247,200</b>
Basic Engineering/Architectural (E/A) Services	11,055,000
Supplemental E/A Services	3,864,200
Permits, Fees, Environmental review, surveys	2,537,600
Construction Management	6,190,800
DPW Project Manager	2,211,000
Project Management Admin. Support	884,400
Haz Mat Abatement, City Attorney fees, Program exp. Etc.	1,504,200
<b>Subtotal:</b>	<b>\$130,300,000</b>
Commercial Paper Program Interest	1,155,590
Relocation Cost	1,000,000
<b>Total Project Cost Funded by COPs</b>	<b>\$132,455,590</b>

Source: Department of Public Works

### *Lease of City Property*

Under the proposed ordinance, the City would lease City-owned property to a third-party trustee to secure the COPs financing. The lease would be in effect from the issuance of the COPs in late 2012 for approximately 29 years, or through approximately 2041, while the COPs remain outstanding. Under the proposed ordinance, the City would lease the City property back from the third-party trustee in consideration for annual base rental payments due from the City to holders of the COPs that are equal to the amounts required to amortize the repayment obligations on the COPs. During the life of the proposed lease, the City would make lease payments to the trustee two times per year. The City's General Fund secures the City's covenants and obligations for the life of the COPs. Under the proposed ordinance, the Director of Public Finance would have the authority to select the third-party trustee, to be selected based on the lowest fees and other considerations via a competitive Request for Proposal (RFP) that was released June 3, 2011.

The leased property securing the COPs is expected to have a fair market value approximately 125 percent of the COPs outstanding, or approximately \$210,143,750. Under the proposed ordinance, the City-owned War Memorial Veterans Building and War Memorial Opera House would serve as collateral for the COPs to secure the City's covenants and obligations under these leases.

*Short Term Financing through Commercial Paper*

If the proposed ordinance is approved by the Board of Supervisors, the Office of Public Finance expects that the COPs will be issued in December 2012. According to the Office of Public Finance, the City's Commercial Paper program would be used to finance any costs incurred between the approval of the proposed ordinance and the issuance of the COPs. The Office of Public Finance estimates issuing \$23,916,730 in Commercial Paper to provide short-term funding for the Veterans Building project, at an estimated interest expense and issuance cost of \$1,155,590. The total cost of Commercial Paper would be \$25,072,320 (see Table 1 above). The Commercial Paper would be repaid by revenue from the issuance of the COPs.

According to the Office of Public Finance, the planned use of Commercial Paper is in accordance with the City's Commercial Paper program, approved by the Board of Supervisors on April 6, 2010 (File 10-0269). The Office of Public Finance notes, "Commercial paper is an alternative form of short-term (or interim) financing for capital projects that permits the City to pay project costs as project expenditures are incurred."

**FISCAL IMPACTS**

The proposed ordinance calls for the issuance of up to \$170,000,000 in Certificates of Participation (COPs). As noted above, the Office of Public Finance currently estimates that \$168,115,000 (see Table 1 above) would actually be issued, based on current project costs and market conditions.

The Office of Public Finance reports that, based on conservative estimates, the total cost of issuing the proposed COPs issuance would be \$316,280,000, including \$168,115,000 for project costs and issuing expenses as shown in Table 1 above and \$148,165,000 for total estimated interest costs. According to Mr. Anthony Ababon of the Office of Public Finance, the total annual interest costs assume an average annual interest rate of 5.36 percent on the COPs. The average cost of the COPs to the City's General Fund would be approximately \$12,165,000 per year, for a period of 26 years. According to Mr. Ababon, payments would start in FY 2015-16.

The Capital Planning Committee's policy, as adopted by the Board of Supervisors, recommends a limit on the City's debt service of 3.25 percent of General Fund discretionary revenues in any given fiscal year. According to the Office of Public Finance, should the Board of Supervisors approve the issuance of the proposed COPs, the City's debt service would remain below the 3.25 percent limit.

**POLICY CONSIDERATION****Although the Capital Planning Committee Has Recommended Funding the Veterans Building Improvements with Certificates of Participation, Debt Financing via General Obligation Bonds Would be Less Costly**

As noted above, the total cost of financing the \$132,455,590 in improvements to the Veterans Building using Certificates of Participation (COPs) is projected to be \$316,280,000, including project and issuing expenses of \$168,115,000 and estimated total interest payments of \$148,165,000. According to calculations provided by the Office of Public Finance, the cost of financing \$132,455,590 in improvements to the Veterans Building through the use of GO Bonds would cost approximately \$228,520,000, or \$87,760,000 less than the \$316,280,000 cost of funding improvements using the proposed COPs. Furthermore, because GO Bonds are financed through additional Property Taxes, GO Bond financing would have effectively no impact on the General Fund, whereas the proposed COPs do not include a new source of revenue, and will require a General Fund expenditure of approximately \$12,165,000 per year, on average, for 26 years.

The California State Constitution requires the approval by two-thirds of the City's voters for the City to issued a GO Bond. As noted in the Background section above, in 1990, San Francisco voters approved the issuance of GO Bonds for improvements for the Veterans Building and other City facilities, but such funds were utilized for other approved City projects. In 2002, San Francisco voters rejected the issuance of GO Bonds for the exclusive purpose of improving the Veterans Building. The soonest San Francisco voters could be asked to vote on a new GO Bond would be the June 2012 primary election, and based on the 2002 vote, the outcome would be uncertain.

According to Mr. Brian Strong, Director of the City's Capital Planning Program, the Capital Planning Committee has three funding options for projects: GO Bonds, COPs, or direct General Fund appropriations. For priority projects, such as those where emergency services, health, or safety may be impacted or where deferring capital improvements could result in higher costs, the Capital Planning Committee recommends either GO Bonds or COPs.

It is the opinion of the Capital Planning Committee that the City should not wait any longer to complete the improvements to the Veterans Building. Furthermore, the FY 2012-2021 Capital Plan recommended by the Capital Planning Committee and approved by the Board of Supervisors on March 29, 2011 proposes a series of capital projects to be funded with GO Bonds, subject to voter approval, through 2021. If the City proposes any GO Bonds in excess of those already listed prior to 2017, Mr. Strong notes that the City would not be able to honor its commitment to keep Property Tax rates at or below 2006 levels, a key financial constraint established by the Capital Planning Committee and approved by the Board of Supervisors in the Board of Supervisors' approval of the City's Capital Plan. Under this constraint, the Capital Planning Committee does not recommend any amount of GO Bonds that would result in San Francisco Property Taxes exceeding the 2006 Property Tax rate.

In conclusion, funding the proposed improvements using COPs is approximately \$87,760,000 more costly than if City voters approved a GO Bond for the same improvements. However, such voter approval is uncertain, would possibly increase Property Tax rates above 2006 levels, and would require additional time to obtain voter approval, thereby delaying needed improvements to the War Memorial Veterans Building.

## RECOMMENDATION

Approval of the proposed ordinance is a policy matter for the Board of Supervisors.