
SALT LAKE CITY COUNCIL STAFF REPORT

DATE: June 27, 2003

SUBJECT: **Amendments to the Criteria for Considering Private Activity Bonds**

AFFECTED COUNCIL DISTRICTS: Citywide

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ADMINISTRATIVE DEPT. AND CONTACT PERSON: Community & Economic Development
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KEY ELEMENTS:

On December 13, 2001, the Council adopted an ordinance establishing review criteria for evaluating applications for private activity bonds. The ordinance required that all private activity bonds be secured by a direct-pay letter-of-credit from a financial institution with at least a "AA" rating. The ordinance also established a fee schedule for issuance of the bonds. The amendment proposes three changes:

1. Allows publicly offered bonds to be secured by either a letter-of-credit or by bond insurance from a "AAA" rated municipal bond insurer.
2. Waves the requirements for letter-of-credit or bond insurance for privately placed bonds once the City has received written confirmation from the investor that it understands the risks associated with this type of investment and that under no circumstance will non-payment or a default on the bonds constitute any financial obligation or liability for the City.
3. Sets fees so that the City's financial advisor can be formally involved in the review process to ensure that the City's interests are protected.

MATTERS AT ISSUE/QUESTIONS FOR THE ADMINISTRATION:

Private activity bonds are tax-exempt bonds issued by municipalities but backed solely by a private entity on whose behalf the bonds are issued. No real or implied guarantee or obligation for payment of the bonds is assumed by the municipality. Entities that qualify for such tax-exempt financing include nonprofit organizations that provide health care or educational services. Certain small manufacturing firms also qualify, under IRS regulations, as potential beneficiaries of this type of financing. Small manufacturing is defined as entities with a maximum of \$15 million total debt including the requested bonds. In Utah, qualified manufacturing entities must receive a "volume cap" allocation from the Utah Private Activity Bond Authority before such bonds can be issued. Health care and educational borrowers are exempt from volume cap requirements. The IRS has established "volume caps" for each state as a way of controlling the maximum amount of tax-exempt financing that can occur for small manufacturing entities. Private activity bonds for manufacturing entities are also referred to as "industrial development revenue bonds."

If the City Council decides to issue bonds, the Council will adopt an inducement resolution, conduct a hearing under the Tax Equality and Fiscal Responsibility Act (TEFRA), and authorize issuance of the bonds. The main advantage of private activity bonds is the lower interest cost for the private entity due to the tax-exempt feature.

Local Governments generally issue private activity bonds to encourage the location of new or expanded facilities within their boundaries. These facilities increase the tax base, improve employment opportunities, or expand health care and educational opportunities for residents.

Credit enhancement – Under the City’s current criteria, the only acceptable credit enhancement for such bonds is a direct-pay letter-of-credit. In the municipal bond industry, however, another generally acceptable form of credit enhancement is bond insurance from a municipal bond insurer. The Administration proposes that bond insurance be added as an additional option for credit enhancement purposes.

Sophisticated investor letter – The reasons for requiring credit enhancement include protecting the City’s name, its investment-grade bond ratings as well as shielding small individual investors. Under a private placement scenario, however, a “sophisticated investor” has evaluated the risks associated with the private entity and understands that the City doesn’t have any obligation or liability relating to the bonds. The Administration is proposing that in the case of a private placement, credit enhancement would not be required if the investor provides the City with a “sophisticated investor letter” which generally provides the following: (1) the investor will hold the bonds in its own portfolio, (2) the investor routinely purchases similar investments, (3) the investor has researched the financial condition of the private entity, (4) the investor understands the risks, (5) the investor will only look to the private entity for repayment of the bonds, and (6) the investor covenants not to look to the City for payment in case of default. The exact language of the sophisticated investor letter will be negotiated between bond counsel and the City Attorney’s Office.

Fees – The City currently charges a non-refundable application fee of \$1,000 for a new issue or \$500 for a refunding issue. At the time of closing, a fee of \$15,000 to \$25,000 is charged to cover administrative costs for acting as a conduit issuer on private activity bonds. The amount of the fee is \$7,500 plus a portion relating to the principal face amount of the bonds. In addition to these fees, the Administration is proposing that a fee of \$1.75 per \$1,000 par amount of the bonds be paid to the City’s financial advisor with a minimum of \$7,500 per transaction. Should the proposed bond issue not close for any reason, the private entity would owe nothing besides the small application fee that they would have already paid to the City. Under the proposal, the City’s financial advisor would become formally involved in the process to help it move smoothly and ensure that the City’s interests are fully protected. The fee is consistent with amounts in the City’s current financial advisory contract relating to bonds issued by the City.

The Council may wish to ask representatives of the Administration about whether they have researched best practices by surveying criteria and fees set by Salt Lake County, neighboring Utah cities, and additional local governments in other states.

OPTIONS:

The Council may wish to advance this ordinance to a future Council Meeting for consideration. There is not an urgency to adopt the amendment since there have not been any contacts with entities that may be contemplating submitting an application for private activity bonds. The Council may wish to give the Administration more time to research best practices for setting criteria for private activity bonds.

cc: Rocky Fluhart, David Nimkin, Alison Weyher, LuAnn Clark, JD Baxter