Lompoc City Council Agenda Item

City Council Meeting Date: *February 15, 2005*

TO: *Gary Keefe, City Administrator*

FROM: *Seth Bean, Acting Accounting Supervisor*
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SUBJECT: *A RESOLUTION APPROVING THE FORM OF AND AUTHORIZING THE EXECUTION AND DELIVERY OF A PURCHASE AND SALE AGREEMENT AND RELATED DOCUMENTS WITH RESPECT TO THE SALE OF THE CITY OF LOMPOC'S VEHICLE LICENSE FEE RECEIVABLE FROM THE STATE; AND DIRECTING AND AUTHORIZING CERTAIN OTHER ACTIONS IN CONNECTION THEREWITH.*

RECOMMENDATION:

It is recommended that City Council adopt the proposed Vehicle License Fee ("VLF") Receivables Sale Resolution No. 5227 (05), allowing the City to sell its VLF Receivable to California Statewide Communities Development Authority ("CSCDA") for approximately $657,648, which represents 92% of the $714,835 VLF Receivable owed to the City.

BACKGROUND AND DISCUSSION:

Vehicle License Fees and VLF Gap Repayment: Vehicle license fees were historically assessed in the amount of 2% of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. Beginning in 1999, the VLF paid by vehicle owners was offset (or reduced) to the effective rate of 0.65%. In connection with the offset of the VLF, the Legislature authorized appropriations from the State General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient State General Fund monies to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged.

In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient State General Fund monies would be available for this purpose, and, beginning in October 2003, the VLF paid by vehicle owners was restored to the 2% level. However, Governor

Schwarzenegger rescinded the offset suspension on November 17, 2003, and State offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in FY 2002-03. "Backfill" payments totaling $2.65 billion were paid to local governments in FY 2003-04. However, approximately $1.2 billion was not received by local governments during the time period between the suspension of the VLF offsets and the restoration of the VLF offsets. This $1.2 billion is still legally owed to local governments by the State (the "VLF Gap Repayments"). The City's share of the VLF Gap Repayment is $714,835 (the "VLF Receivable").

As part of the 2004 Budget Act negotiations, an agreement was made between State and local government officials (the "State-local agreement") under which the VLF rate will be permanently reduced from 2% to 0.65%. The State-local agreement also provides for the repayment by August 15, 2006 of the approximately $1.2 billion VLF Gap Repayment. In order to protect local governments, the reduction in VLF revenue to cities and counties from this rate change will be replaced by an increase in the amount of property tax they receive. Under the State-local agreement, for FY 2004-05 and 2005-06 only, the replacement property taxes that cities and counties receive have been reduced by $700 million, which represents cities and counties contributions to help reduce the State deficit. Commencing in FY 2006-07, local governments will receive their full share of replacement property taxes and those replacement property taxes will receive constitutional protection against transfers by the State due to the approval of Proposition 1A at the November 2004 election.

<u>VLF Program</u>: Authorized under SB 1096, the VLF Program was instituted by the California Statewide Communities Development Authority ("CSCDA") in 2004 to enable this City and other cities and counties to sell their respective VLF Receivables to CSCDA for an upfront fixed purchase price estimated to be 92% of the VLF Gap Repayments. CSCDA is planning to issue notes ("VLF Notes") and to use the note proceeds to purchase the VLF Receivables and pay financing costs. The actual purchase price of the VLF Receivables will depend on the total amount of VLF Receivables that cities and counties sell to CSCDA and on bond market conditions at the time the VLF Notes are priced. If the City sells its VLF Receivable under the VLF Program, CSCDA will pledge the City's VLF Receivable to secure the repayment of a corresponding portion of the VLF Notes. The City's sale of its VLF Receivable will be irrevocable. Bondholders will have no recourse to the City if the State does not make the VLF Gap Repayment.

<u>VLF Program Sponsor</u>: CSCDA is a joint powers authority sponsored by the League of California Cities and the California State Association of Counties. The member agencies of CSCDA include approximately 230 cities and 54 counties throughout California, including the City of Lompoc

<u>Benefits of Participation in the VLF Program</u>:

The benefits to the City of participation in the VLF Program include:

- Immediate cash relief – the sale of the City's VLF Receivable is estimated to provide the City with approximately 92% of its VLF Receivable in early 2005, which can be used to pay for immediate funding needs.

- Level cash flow from the State over next two years – as explained above, in each of FY 2004-05 and 2005-06, cities and counties across the State will lose a total of $700 million annually in property tax payments to the Educational Revenue Augmentation Fund ("ERAF"), which benefits the State. Accordingly, the City is projected to lose approximately $350,000 in each such fiscal year. This loss in property tax revenue in FY 2004-05 and 2005-06 will be followed by an increase in revenues in FY 2006-07 due to the payment by the State of the VLF Gap Repayment and due to the cessation of ERAF 3 payments in that year (ERAF 1 and 2 from the early 1990's will continue). If the City sells its VLF Receivable through the VLF Program, it can use the sale proceeds to offset the loss of revenues due to its property tax contributions over the next two years and eliminate the spike in revenues in the third year, thereby creating a more level cash flow in each of the next three fiscal years. The VLF Receivable would produce approximately $657,648, which almost entirely offsets the estimated $700,000 in ERAF 3 payments for FY 2004-05 and FY 2005-06.

- Mitigates impact of property tax in-lieu of VLF swap over next two years – beginning in FY 2004-05, the State will permanently eliminate the VLF backfill paid to the City and will replace it with an equal amount of property tax. While these actions are intended to cancel each other out, the City is now receiving these payments semi-annually as property taxes, rather than monthly as VLF backfill payments. This situation creates potential cash flow problems for the City, which could be temporarily alleviated by selling the City's VLF Receivable.

- Budgetary flexibility in FY 2004-05 and 2005-06 – the sale of the City's VLF Receivable would provide additional revenues in FY 2004-05, which can be applied to resolve budgetary challenges in FY 2004-05 and 2005-06 of funding the State ERAF 3 Property Tax take-a-way mentioned above.

Estimated Proceeds of the Sale of the City's VLF Receivable:

Upon delivery of the VLF Notes, CSCDA will make available to the City its fixed purchase price. This payment will equal the City's VLF Receivable amount less capitalized interest costs (to pay interest on the VLF Notes until maturity), credit enhancement fees, and bond issuance costs. As discussed above, the City's VLF Receivable is $714,835. The purchase price to be paid by CSCDA is estimated to be $657,648 but cannot be determined with specificity until the total number of participants in the VLF Program is known and bond market conditions are taken into account at the time the VLF Notes are priced. However, the City is protected against having to participate in the VLF Program if the VLF Notes are priced too low. The minimum purchase price as set forth in Appendix A of Resolution No. 5227 (05) is $642,493, or 89.88%.

Conclusion:

Based on past relations with the State and the current State budget crisis, it is recommended that the City receive the reduced amount of approximately $657,648, or 92% of the $714,835, in March 2005 for the VLF Receivable rather than waiting until August 2006 to receive the full amount. The amount the City receives now can be invested and the interest income earned from the invested money can help offset the estimated loss of $57,187. Selling the VLF GAP Receivable now eliminates any uncertainty related to the State's ability and willingness to repay this obligation in August 2006.

Respectfully submitted,

Seth Bean, Acting Accounting Supervisor

ATTACHMENTS:

1) VLF Receivables Sale Resolution
2) Purchase and Sale Agreement

APPROVED FOR SUBMITTAL TO THE CITY ADMINISTRATOR:

John Walk, Management Services Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

Gary P. Keefe, City Administrator