

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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16-1420

Council District: All

To: The Mayor
The Council

From: Richard H. Llewellyn, Jr., Interim City Administrative Officer



Subject: **UPDATE ON THE PREVIOUSLY PROPOSED DEBT FINANCING OF VARIOUS
JUDGMENT OBLIGATIONS**

RECOMMENDATION

That the City Council note and file this report inasmuch as the City Administrative Officer is not recommending proceeding with an issuance of Judgment Obligation Bonds. This report has been prepared for informational purposes only.

SUMMARY

On January 18, 2017, the City Council instructed the Office of the City Administrative Officer to proceed with a potential issuance of Judgment Obligation Bonds (JOBs) to address anticipated higher-than-budgeted liability payments in the 2016-17 Fiscal Year (C.F. 16-1322). JOBs are generally considered an extraordinary financing tool that should only be used sparingly in exceptional and unusual circumstances. Given the circumstances faced by the City at the time, the decision was made to move forward with a potential issuance of JOBs, concurrently with several other recommendations aimed at curtailing expenditures and strengthening General Fund revenues, in an effort to maintain the City's Reserve Fund above the five percent policy threshold.

As stated in the 2016-17 Second Financial Status Report (C.F. 16-0600-S169), the Reserve Fund at the time was only slightly above the five percent minimum at 5.29 percent, which made it unlikely to be available to fully offset the projected deficit as well as putting the City at risk of not being able to address unforeseen emergencies. Additionally, a strong Reserve Fund is a criteria used by rating agencies when evaluating issuers, and falling below the five percent minimum would have been viewed as a credit negative, potentially leading to a higher cost of borrowing. The City was also facing a potential deficit of \$245 million, consisting of expenditure concerns predominately driven by extraordinary liability payments and revenue concerns primarily due to forecasted lower departmental receipts as well as a portion of 2016-17 property tax being received in 2015-16. The cumulative liability of these unusual circumstances led this Office to recommend, and subsequently for the City Council to adopt, a proposal to explore a potential issuance of JOBs.

On April 4, 2017, the City Council adopted an Authorizing Resolution allowing the City to proceed with the judicial validation process for JOBs to refinance approximately \$55 million in expenditures previously made in connection with various judgments. In conjunction with this approval, this Office was instructed to report to the Budget and Finance Committee after the conclusion of the judicial validation process and prior to proceeding with the issuance of any JOBs. On April 11, 2017, the validation complaint was filed with the Superior Court of California. A default judgment was submitted on June 21, 2017, and on October 13, 2017, a default judgment was rendered in the City's favor, successfully completing the validation process.

By utilizing fiscal restraint in an effort to protect reserves, the City has successfully managed the budget challenges that were originally faced at the beginning of the 2016-17 Fiscal Year and the reasons to incur debt no longer exist. The risks and potential deficits originally contemplated at the beginning of this process have since been alleviated by identifying surpluses within budgeted funds, identifying additional revenue, and requesting departments to reduce expenditures and generate savings. Based on the current financial status of the City as highlighted in the 2017-18 First Financial Status Report (C.F. 17-0600-S113), this Office does not recommend proceeding with the issuance of the JOBs, as the issuance of bonds is no longer necessary to meet the City's Reserve Fund policy threshold of five percent. As previously reported, after accounting for transactions that have been approved since July 1, 2017, the Reserve Fund balance will be approximately \$354.7 million, which represents 6.09 percent of the General Fund budget.

Although this Office believes an issuance of JOBs is no longer warranted, the status of liability claims payments remains an ongoing concern. As mentioned in the 2017-18 First Financial Status Report, there is potential risk that ongoing litigation may result in additional liability claims payments beyond what has been budgeted in the current fiscal year. This Office, in collaboration with the Office of the City Attorney, will continue to monitor liability claims expenditures and report back on potential shortfalls throughout the current year as well as reviewing the status of existing cases as part of the annual budget process in an effort to avoid a situation where additional measures are needed to address an unanticipated shortfall in this account.

Unless instructed otherwise, this report concludes any and all work associated with the previously proposed JOBs.

BACKGROUND

The 2016-17 Second Financial Status Report (C.F. 16-0600-S169) identified shortfalls in the Liability Claims Account, which needed to rely on transfers from the Reserve Fund. On January 18, 2017, the City Council approved a recommendation instructing this Office, with the assistance of the City Attorney, to proceed with an issuance of JOBs of between \$50 million and \$70 million to reimburse the Reserve Fund for extraordinary liability payments made resulting from settlements and judgments (C.F. 16-1322). This decision was based on a reported potential deficit of \$245 million as a result of extraordinary and unusual revenue risk and expenditure concerns that ultimately threatened the City's ability to maintain the Reserve Fund above the five percent policy threshold.

Three Reimbursement Resolutions were adopted for amounts not-to-exceed \$25.5 million, \$23 million, and \$15 million, respectively (one under C.F. 12-0014-S23 and two under C.F. 16-1420), for an aggregate amount not-to-exceed \$63.5 million. These Reimbursement Resolutions, as well as the Council motions related to each of the Judgment Obligation cases, allowed the City to reimburse and/or refund the advances and interfund borrowings made from the City's Reserve Fund or other City funds to pay the judgment obligations with the intent to be reimbursed from the proceeds of the JOBs. Amounts are allowed to be reimbursed up to 18 months from the date that the expenditure occurred. Accordingly, expenditures related to settlements previously considered to be reimbursed by the JOBs will start losing eligibility for reimbursement beginning on April 4, 2018.

The City initiated the judicial validation process for the JOBs following the April 4, 2017 adoption of the Authorizing Resolution. As stated previously, this process was successfully completed on October 13, 2017, with a successful default judgment in the City's favor. This judgment was subject to a 30 day appeal period that concluded on November 12, 2017. No additional steps are required to be taken with the court following the validation process. If the City Council were to instruct this Office to proceed with the issuance of JOBs, this Office would be required to report back to the City Council for approval of the financing and disclosure documents.

As previously reported, annual debt service payments associated with a \$60 million issuance of JOBs were projected to be approximately \$7.9 million for 10 years, amounting to approximately \$19.6 million in interest over the life of the bonds.

The proposed recommendation is in compliance with the City's Financial Policies.

FISCAL IMPACT STATEMENT

Approval of this recommendation will have no impact on the General Fund. Costs totaling approximately \$116,000 incurred as part of the initial work and the validation process related to the Judgment Obligation Bonds will be paid from the Capital Finance Administration Fund.

DEBT IMPACT STATEMENT

Approval of this recommendation will have no impact on the City's debt limits.