



MEMORANDUM

To: Steven Rogers, Town Manager, Town of Yountville
Richard Stranzl, Finance Director/Treasurer, Town of Yountville

From: David Leifer and Bobby Cheung, KNN Public Finance

Re: Town of Yountville Community Center and TOT Revenue Bonding Analysis

Date: December 21, 2007

KNN Public Finance has completed our analysis of bonding alternatives for the Town's proposed Community Center financing. We have updated and expanded our original analysis (dated July 23, 2007) by evaluating the bonding capacity of the Town's Transient Occupancy Tax (TOT) revenue stream under various additional term and coverage scenarios.

Assumptions

Below is a table that summarizes some key bond and TOT assumptions.

Table 1: Key Assumptions

Category	Assumption
Project Construction Period:	1 year
Capitalized Interest Period:	18 months
Bond Insurance Cost:	50 basis points
Surety Bond Cost:	2% of Reserve Fund
Bond Call:	10-year par
TOT Revenues:	2% of 12% total
Annual Available TOT Revs:	\$669,000

Bond Structure

KNN has considered three financing alternatives for this analysis: (i) revenue bonds secured solely by TOT's; (ii) Certificates of Participation (COPs) payable from a portion of General Fund revenues limited to available TOTs; and (iii) Certificates of Participation payable from all available General Fund revenues but carefully sized so that the Town could internally rely upon TOT revenues for payment of debt service. KNN recommends option three, General Fund backed COPs, for the following reasons.

First, because TOTs are a General Fund revenue source, they do not qualify as a “special fund” under the State constitutional debt limit and thus there would be no legal basis for issuing revenue bonds secured by TOTs. We have confirmed this finding with a Bond Counsel at a leading municipal finance law firm. Thus option one does not work from a legal perspective.

An alternative approach that would have similar credit features as revenue bonds would be Certificates of Participation payable only from a portion of the General Fund equivalent to available TOTs. However, given the relatively small amount of projected TOTs available for debt service (approximately \$669,000 annually), this approach could severely limit the Town’s ability to secure sufficient funds for project completion. To protect investors from volatility in TOTs, the investor community would require that the bonds be sized with significant debt service coverage (i.e., excess of projected TOT revenues above annual debt service) of anywhere from 20%-33%, or more, depending upon the credit qualities of the Town’s TOT base.

Moreover, the small size and relative concentration of the Town’s TOT base are such that a bond secured solely by TOT’s would not be viewed as a favorable credit in the market. Even with a minimum debt service coverage of 1.5 times (i.e., 33%), the financing might not qualify for investment grade ratings nor would it likely qualify for “AAA” rated bond insurance. As a result, bonds would be sold at significantly higher interest rates, further reducing the amount of net proceeds that a bond would generate for the Town.

Given all of these challenges, KNN recommends that the Town pursue a General Fund backed Certificates of Participation structure in order to minimize the cost of funds and maximize the amount of bond proceeds available for the project. As discussed below, such bonds would be carefully sized so that the Town can rely internally upon TOT revenues for payment of debt service. We have summarized the key features of COPs in Appendix A.

Bonding Capacity of TOT Revenue Stream – Alternative DS Coverage Levels

We examined COP bonding capacity assuming \$669,000 of annual revenues as a maximum annual debt service limit. Scenario 1 below assumes that annual debt service is approximately equal to the full annual \$669,000 revenue stream, also known as 1.0 times coverage. This scenario maximizes bond proceeds but provides the Town with no cushion in the event of a downturn in TOTs and would require the Town to expend other General Fund revenues to pay debt service in the event of a TOT downturn. Therefore, we also examined three additional bond scenarios with 1.1x, 1.25x and 1.5x debt service coverage for illustrative purposes. Note that as the amount of revenue cushion increases, the amount of bond proceeds available for project use decreases.

Given the nature of the revenue stream, a bond that relies solely upon the TOT revenue stream (i.e. options 1 and 2) for repayment would likely require a coverage ratio of 1.5x, or more, as dictated by the bond market. As you can see, the 1.5x scenario only produces approximately \$6.4 million in total project draws. Utilizing a General Fund backed COP structure (i.e. option 3) would allow the Town to leverage the revenue stream to a level that the Town determines internally. For instance, structuring a bond with 1.25x coverage would yield about \$7.7 million in total project draws.

Table 2: Bond Sizing Assumptions with Varying Coverage Factors

	30-Year COP Structure with Coverage (General-Fund Backed Transaction)			
	Scenario 1	Scenario 2	Scenario 3	Scenario 4
	TOT as Max Debt Service 1.0x Coverage	TOT as Max Debt Service 1.1x Coverage	TOT as Max Debt Service 1.25x Coverage	TOT as Max Debt Service 1.5x Coverage
Par Amount ¹	\$10,610,000	\$9,640,000	\$8,475,000	\$7,055,000
Dated Date	7/1/2008	7/1/2008	7/1/2008	7/1/2008
Final Maturity	7/1/2037	7/1/2037	7/1/2037	7/1/2037
All-In-T.I.C.	4.54%	4.54%	4.54%	4.54%
Total Project Draws	\$9,729,723	\$8,823,842	\$7,735,952	\$6,409,826
Net Project Fund Deposit	\$9,542,753	\$8,654,257	\$7,587,247	\$6,286,572
Capitalized Interest Fund Deposit	\$649,794	\$590,432	\$519,056	\$432,149
Surety Bond Cost ²	\$13,379	\$12,159	\$10,703	\$8,915
Bond Insurance ³	\$154,804	\$140,671	\$123,668	\$102,978
Average Annual Net Debt Service	\$666,516	\$605,670	\$532,461	\$443,383
Available Annual TOT Revenues ⁴	\$669,000	\$669,000	\$669,000	\$669,000
Annual Excess TOT Revenues	\$2,484	\$63,330	\$136,539	\$225,617
Total Net Debt Service	\$18,688,438	\$16,982,383	\$14,929,657	\$12,432,003

¹ Based upon insured COP market conditions as of November 30, 2007, numbers are subject to change based on market conditions and investment returns of various bond funds. Costs of issuance assumed at \$175,000, Underwriter's Discount assumed at \$7.00 per bond, Capitalized Interest and Project Funds invested at assumed interest rate of 4.00%.

² Surety bond cost assumed at 2% of reserve fund requirement.

³ Bond insurance based upon 80 basis points of total principal and interest.

⁴ 2% of the 12% Transient Occupancy Tax. \$550,000 for FY 08 and \$669,000 for FY 09 and on after an additional 62 rooms become available.

In order to maximize the amount of funds available for project construction, we structured the financing scenarios assuming use of a surety bond in lieu of a debt service reserve fund. A surety bond is a commitment from a third party credit enhancer, such as a bond insurer, to fund the debt service reserve fund at a future date in the event of a payment default by the Town. By paying a relatively small upfront fee to the surety bond provider (typically 2% - 3% of the reserve fund requirement) rather than funding a full reserve fund (typically 10% of total bond par amount) from bond proceeds, the Town can maximize the amount of bond proceeds available for project cost. Surety bonds are commonly used to help maximize funds available for projects in instances where the source of repayment is a fixed-revenue stream.

Town Cash Contribution

We have assumed that the Town will pledge the Community Center to the bond transaction, which necessitates deferring principal and interest payments until the Town has use and occupancy of the facility (i.e. after completion of construction). Therefore, the full \$669,000 of TOT revenues that are collected during the 2008-09 fiscal year are available for project related costs. KNN analyzed the potential use of accumulated Town TOT funds to either (i) directly offset the construction cost of the project, or (ii) pay costs of issuance directly, such as fees for a surety bond and/or bond insurance. If we assume that accumulated TOT funds are used for project costs throughout the one-year construction period and invested at approximately the bond rate, our analysis shows that the two options above produce about the same amount of total funds for project construction.

Under either approach, TOTs collected during construction add approximately \$670,000 to total project costs. To quantify this impact, the table below assumes that the Town will pay the cost of the Surety Bond and Bond Insurance directly at closing from accumulated funds on hand. The results add approximately \$770,000 to the total funds available for project cost.

Table 3: Bond Sizing Assumptions with Varying Coverage Factors and Town-Funded Bond Insurance and Surety Bond Fees

	30-Year COP Structure with Coverage (General-Fund Backed Transaction)			
	Scenario 5	Scenario 6	Scenario 7	Scenario 8
	TOT as Max Debt Service 1.0x Coverage	TOT as Max Debt Service 1.1x Coverage	TOT as Max Debt Service 1.25x Coverage	TOT as Max Debt Service 1.5x Coverage
Par Amount ¹	\$10,610,000	\$9,640,000	\$8,475,000	\$7,055,000
Dated Date	7/1/2008	7/1/2008	7/1/2008	7/1/2008
Final Maturity	7/1/2037	7/1/2037	7/1/2037	7/1/2037
All-In-T.I.C.	4.54%	4.54%	4.54%	4.54%
Total Project Draws	\$9,900,972	\$8,979,459	\$7,872,773	\$6,523,759
Net Project Fund Deposit	\$9,710,936	\$8,807,088	\$7,721,619	\$6,398,466
Capitalized Interest Fund Deposit	\$649,794	\$590,432	\$519,056	\$432,149
Surety Bond Cost ²	\$0	\$0	\$0	\$0
Bond Insurance ²	\$0	\$0	\$0	\$0
Accumulated TOT Revenues ³	\$669,000	\$669,000	\$669,000	\$669,000
Total Funds Available for Project	\$10,569,972	\$9,648,459	\$8,541,773	\$7,192,759
Average Annual Net Debt Service	\$666,516	\$605,670	\$532,461	\$443,383
Available Annual TOT Revenues ⁴	\$669,000	\$669,000	\$669,000	\$669,000
Annual Excess TOT Revenues	\$2,484	\$63,330	\$136,539	\$225,617
Total Net Debt Service	\$18,688,438	\$16,982,383	\$14,929,657	\$12,432,003

¹ Based upon insured COP market conditions as of November 30, 2007, numbers are subject to change based on market conditions and investment returns of various bond funds. Costs of issuance assumed at \$175,000, Underwriter's Discount assumed at \$7.00 per bond, Capitalized Interest and Project Funds invested at assumed interest rate of 4.00%.

² Assumed that cost of surety bond (estimated at 2% of reserve fund requirement) and bond insurance premium (estimated at 80 basis points of total principal and interest) is paid directly by the Town and not from bond proceeds.

³ TOT revenues in the amount of \$669,000 are available for construction during the first year of the bonds since principal is deferred and interest is capitalized.

⁴ 2% of the 12% Transient Occupancy Tax. \$550,000 for FY 08 and \$669,000 for FY 09 and on after an additional 62 rooms become available.

Appropriate Levels of Debt Service Coverage

To assist the Town in establishing a coverage ratio that balances the competing goals of maximizing bond proceeds and providing adequate cushion against revenue volatility, we examined the history of the Town's TOT revenues. We note that the stream of revenues has experienced strong growth, averaging about 13.6% annually over a 15-year period. This growth however is not smooth, with large annual increases occurring when new hotels are constructed and only modest growth in other years resulting from increases in room rates. In all cases, however, we note that TOT revenues experienced a year-over-year decline only once, in the 2002 fiscal year.

Table 4: History of TOT Revenues¹

Fiscal Year Ending	Total TOT Revenues	Share Available for Debt Service (2%)	Percentage Growth
2007	3,216,573	536,096	5.33%
2006	3,053,759	508,960	7.43%
2005	2,842,489	473,748	17.89%
2004	2,411,097	401,850	15.36%
2003	2,090,041	348,340	5.07%
2002	1,989,132	331,522	-6.05%
2001	2,117,313	352,886	8.25%
2000	1,955,884	325,981	38.19%
1999	1,415,353	235,892	61.51%
1998	876,304	146,051	11.75%
1997	784,189	130,698	12.57%
1996	696,610	116,102	15.21%
1995	604,646	100,774	7.35%
1994	563,225	93,871	1.80%
1993	553,286	92,214	1.64%
1992	544,354	90,726	-

¹ Figures reflect zero increase in the number of rooms since the 1999 fiscal year.

Given the strong history of TOT revenues, the Town may consider an internal coverage ratio as low as 1.0x or 1.1x available debt service. To the extent that the Town enjoys future TOT revenue growth, this coverage factor would increase over time as illustrated in the table below. The table below shows potential coverage scenarios for both 1.0x and 1.1x coverage, and assumes a 3.0% annual growth in available TOT revenues. The 2009 fiscal year only contains a partial payment, so the 2010 fiscal year is the first year in which the Town is close to the 1.0x and 1.1x coverage ratios.

Table 5: Growth in TOT Creates Future Coverage

Fiscal Year Ending	Estimated Debt Service with 1.0x Coverage	Estimated Debt Service with 1.1x Coverage	Town Share of TOT Revenues ¹	Coverage Factor for 1.0x Coverage	Coverage Factor for 1.1x Coverage
2009	453,504	412,190	669,000	1.48 x	1.62 x
2010	668,504	607,190	689,070	1.03 x	1.13 x
2011	666,560	605,892	709,742	1.06 x	1.17 x
2012	664,388	604,372	731,034	1.10 x	1.21 x
2013	666,940	607,586	752,965	1.13 x	1.24 x
2014	663,974	605,298	775,554	1.17 x	1.28 x
2015	665,670	607,686	798,821	1.20 x	1.31 x
2016	666,820	604,544	822,786	1.23 x	1.36 x
2017	667,434	606,060	847,469	1.27 x	1.40 x
2018	667,417	606,971	872,893	1.31 x	1.44 x
2019	666,749	607,255	899,080	1.35 x	1.48 x
2020	665,410	606,894	926,052	1.39 x	1.53 x
2021	668,449	605,930	953,834	1.43 x	1.57 x
2022	665,471	604,188	982,449	1.48 x	1.63 x
2023	666,756	606,739	1,011,923	1.52 x	1.67 x
2024	667,115	603,390	1,042,280	1.56 x	1.73 x
2025	666,556	604,364	1,073,549	1.61 x	1.78 x
2026	665,109	604,474	1,105,755	1.66 x	1.83 x
2027	667,784	603,724	1,138,928	1.71 x	1.89 x
2028	664,377	607,134	1,173,096	1.77 x	1.93 x
2029	665,120	604,482	1,208,288	1.82 x	2.00 x
2030	664,810	606,018	1,244,537	1.87 x	2.05 x
2031	668,470	606,534	1,281,873	1.92 x	2.11 x
2032	665,869	606,030	1,320,329	1.98 x	2.18 x
2033	667,235	604,502	1,359,939	2.04 x	2.25 x
2034	667,362	606,976	1,400,737	2.10 x	2.31 x
2035	666,255	603,221	1,442,760	2.17 x	2.39 x
2036	668,902	603,462	1,486,042	2.22 x	2.46 x
2037	665,074	607,469	1,530,624	2.30 x	2.52 x

¹ Assumes 3.00% annual growth.

Public Offering vs. Private Placement

We have considered the potential benefits of a private placement as compared to a public sale of bonds and determined that a public offering would provide the Town with a lower cost of funds.

Interest rates for private placements are generally far higher than for public offerings due to the restrictions imposed on the transferability of privately placed bonds. In fact, we solicited private placement rates for a Stanislaus County COP refunding earlier this year and the rate indications were at least 67 basis points higher for a private placement than for an insured public offering.

For very small financings, this added interest cost is offset by reduced costs of issuance. This was the case for the Town's floodwall financing which was sold by way of private placement. However, it is rare for local governments to utilize a private placement for financings over \$3-5 million in par unless the credit is troubled or there are other unique circumstances. Other than for very small issuances, the private placement alternative is traditionally reserved for debt issuances that cannot be sold via a public sale. For instance, issuers with poor or no financial history frequently choose the private placement option because the risk is too high for a public investor to purchase the debt. Issuers which do not have current financial statements or which cannot obtain an investment-grade bond rating are also good candidates for private placements. We do not think this is the case for the Town and thus we recommend that the Town pursue a public offering.

Recommendation and Next Steps

KNN recommends a public offering of General Fund backed Certificates of Participation to finance the Community Center. We recommend further that the Town utilize a competitive method of sale to achieve the lowest cost of funds and provide the greatest pricing transparency and accountability.

The bonds would be sized to provide the General Fund with a cushion against a downturn in TOT revenues and we look forward to discussing with staff an appropriate debt service coverage level based on the Town's historical collections as well as the desired final maturity for the bonds. Please note that a COP structure requires the pledge of an asset to serve as the subject of the lease for the life of the borrowing. The leased asset can either be the Community Center that will be built with the funds, or another facility with comparable market value and useful life. We assume that the Town will pledge the Community Center, necessitating capitalized interest for a period of 6 months past expected completion of construction.

Next steps in the financing process would be to procure the services of a bond and/or disclosure counsel to assist the Town in the drafting of bond and disclosure documents. KNN has worked with a variety of leading firms and would recommend obtaining bids from a minimum of three leading firms for the Town's financing. We will assist the Town in the identification of such firms and coordinate the actual bid process. Bond and Disclosure counsel fees are typically paid from bond proceeds and are contingent upon the successful sale of bonds. The same applies to Financial Advisory, underwriting and other bond related expenses. The only non-contingent fees would be that of the rating agency and such fees would not be incurred until the Town formally requests a rating. To the extent that the Town pursues a competitive method of sale, no advance underwriter selection is required.

Town of Yountville
Community Center Bonding Analysis
December 21, 2007

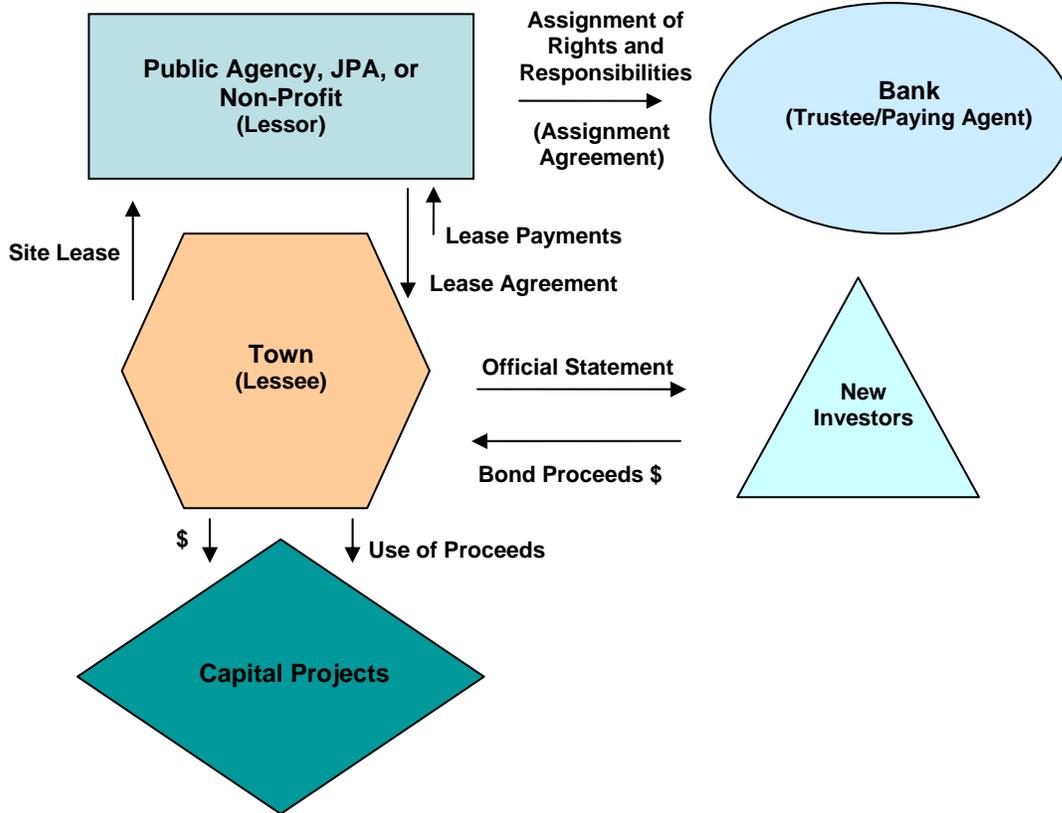
From the date of the formal “kick-off” of the financing, the bonds can be structured, priced and closed within approximately 3-4 months typically. During this time, we would develop a credit presentation for the Town based on its economy and financial performance and accompany Town officials to meetings with a selected rating agency and possibly with bond insurers as well. We have included an estimated costs of issuance breakdown in Appendix B which shows the costs of various professional services involved in a bond transaction. We would be happy to provide a sample Financing Schedule at the appropriate time.

We look forward to meeting to discuss the results of our analysis. Please contact either David Leifer or Bobby Cheung at 510-839-8200 with any questions.

Appendix A
Key Features of Certificates of Participation

- COPs are contingent obligations and not “Debt” under the State Constitutional debt limit
- Investors receive stream of lease payments on pledged assets (building or equipment)
- “Essentiality” and “useful life” of pledged assets are key security considerations
- Covenants to “budget and appropriate” annual lease payments distinguish California COPs
- “Abatement” occurs if leased asset is not usable by lessee (Town) due to fire, earthquakes, etc., issuer cannot be obligated to make lease payments if it does not have use and occupancy of pledged assets
- Rental interruption insurance (typically covering 24 months of debt service) enables issuer to make lease payments during abatement while property and casualty insurance proceeds are used to re-construct pledged asset

COP – Legal Structure



Appendix B
Estimated Costs of Issuance

Below is an estimated cost of issuance schedule for a \$10.0 million COP issuance.

Role	Contingent Upon Closing of Bonds	Ongoing Cost	Estimated Cost*
Bond Counsel/Disclosure Counsel	Yes	No	50,000
Financial Advisor	Yes	No	90,000
Printing and Trustee Fees	Yes	Yes (Trustee)	10,000
Rating Agency	No	No	12,500
Title Insurance	No	No	10,000
Contingency	-	-	2,500
Estimated Total			\$175,000

* All costs are estimated and subject to change; does not represent formal fee quote.