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FINANCE AND BUDGET COMMITTEE
APRIL 21, 2005

SUBJECT: GRAND CENTRAL SQUARE BONDS

ACTION: APPROVE CHANGE OF INTERNAL FUNDING SOURCE TO PAY THE DEBT SERVICE ON THE OUTSTANDING BONDS

RECOMMENDATION

Approve a change of the internal funding source used to pay the debt service on the outstanding Grand Central Square bonds from Prop A 40% (discretionary) to Prop A 35% (rail).

RATIONALE

With the proposed elimination of the "growth over inflation" cap in the formula allocation procedure ("FAP"), see separate agenda item, approximately $1.5 million more of Prop A 40% will be available to be distributed via the FAP annually. Correspondingly, $1.5 million less Prop A 35% will be available for rail operations or bonding and an equivalent amount of Prop C 40% will required.

In approving the issuance of the Grand Central bonds in 1993 staff indicated that the funding source would be Prop A 40% Discretionary. Although the Grand Central project is eligible for Prop A 35%, in the early 1990's all of this bonding capacity was needed for the Red and Green Lines that were in construction then.

At that time, fees paid by the developer were projected to cover and possibly exceed the debt service on the bonds. Hence, the impact of paying the debt service was not factored into the FAP calculations. However, proceeds from the developer never reached breakeven levels. As a result, the Grand Central agreement has been restructured twice, most recently in December 2002. Under the current arrangement, the amount due from the developer is $0.7 million per year for the next three years while the annual debt service is approximately $2.2 million per year. With the proposal to eliminate the growth over inflation cap, $1.5 million less Prop A 40% will be available for distribution through the FAP unless the recommendation is approved.

In researching the background of Prop A 40%, we found that the debt service on the Grand Central bonds had always been charged to Prop A 35% in error, approximately $18.3 million since inception through the end of FY04. Also in error, the payments actually received from the developer have been credited to the Debt Service Fund, approximately $5.5 million since inception through the end of FY04. During this period, growth over inflation that has been transferred from Prop A 40% to Prop C 40% was $7.4 million pursuant to Prop A 40% guidelines.

This recommendation has no impact on bondholders because it only impacts our internal accounting and budgeting.

FINANCIAL IMPACT

Approval of this recommendation has no impact on the FY05 budget. Recognizing this change reduces the Debt Policy borrowing capacity of Prop A 35% by approximately $30 million to about $350 million at this time.

Had these transactions been correctly recorded, there would have been no significant impact on the fund balances as of June 30, 2004. The amount of Prop A 35% for rail operations would have been $12.9 (18.3 – 5.4) million more. Therefore, Prop C 40% required for rail operations would have been $12.9 million less. The growth over inflation transfers from Prop A 40% to Prop C 40% would have been $7.4 million less. Therefore, the Prop C 40% fund balance is approximately $5.5 (7.4 – 12.9) million less than it would have been. Or, another way to say this is that approximately $500,000 more Prop A 40% per year was allocated via the FAP from FY94 – FY04 and inadvertently funded by Prop C 40%.

ALTERNATIVES CONSIDERED

Alternatives considered included:

Fund the debt service with Prop A 40% as originally planned. This alternative would restore the borrowing capacity to Prop A 35%. However, approximately $1.5 million less per year in the near term would be available to allocate to through the FAP if the elimination of the growth over inflation cap is approved. This alternative is not recommended since increasing bus operating funding in the near term is the highest priority.

Fund the debt service with Prop C 40%. This alternative is not recommended because Grand Central was determined to be a part of the Red Line and the ordinance prohibits the use of Prop C on the downtown portion of the subway.

Terry Matsumoto
Executive Officer, Finance and Treasurer

Roger Snoble
Chief Executive Officer