

## MEMORANDUM

TO: Roger L. Stancil, Town Manager

FROM: Kenneth C. Pennoyer, Business Management Director

SUBJECT: Library Expansion Project Financing

DATE: January 25, 2010

## PURPOSE

The purpose of this report is to provide the Council with updated information on the budgetary impact of debt service and operating costs for the Library Expansion Project. The Library Expansion Project and the issuance of the General Obligation Debt to finance the project were delayed due to the uncertainties associated with the economic downturn. This report provides updates to the following:

- Project Budget and Expenditures to date
- Interest Rates and the Municipal Debt Market
- Impact on the Debt Service Fund of issuing the Library Bonds and remaining authorized General Obligation (G.O.) Bonds in Spring of 2010
- Operating budget impact of the cost of operating the expanded library
- Transition costs during construction
- Cumulative Impacts on the Town Budget

## BACKGROUND

**Estimated Project Budget**

Prior to final execution of a construction contract for the Library project it will be necessary for the Town Council to adopt a budget ordinance establishing specific project accounts. We anticipate returning to the Council in the spring of 2010 to finalize this process. The table below provides information about revenues and expenses we expect will be reflected in the budget ordinance. This information is being provided now to assist with financial planning and to inform the Council of how we anticipate allocating the project funds.

	<u>Estimated Budget</u>
Interest Earnings	\$ 250,000
Proceeds from Bond Sales	16,260,000
Premium Amortization	<u>5,374</u>
<b>Total Revenues</b>	<b>\$ 16,515,374</b>

	<u>Estimated Budget</u>
General Bond Costs	\$ 30,000
Project Management	37,300

Design and Engineering	1,897,400
Construction Management	80,000
Misc. Contract Services	35,000
Construction	12,490,000
Equipment	850,000
Art Acquisition	165,000
Contingencies	932,674
<b>Total Expenses</b>	<b>\$ 16,515,374</b>

### **Expenditures to Date**

A budget for the Design Phase of the Library Expansion Project was established with the proceeds of the 2004-05 (\$500,000) and 2006-07 (\$1,500,000) G.O. Bond Sales. These funds were intended to cover the cost of the design work and other required services such as a Traffic Study, Geotechnical Soil Sampling and a contract for the project Art Work. To date a total of \$1,054,727 has been expended from these funds and an additional \$955,695 encumbered, for a total of \$2,010,422. These expenditures and encumbrances include \$1,947,897 for design services, \$16,632 for traffic studies, \$9,322 for other professional services, including soil boring and surveying, \$15,394 for temporary staff salaries, and \$20,000 for public art.

### **Interest Rates**

Last year when we first contemplated moving forward with the issuance of the Library debt, the interest rate markets were in turmoil because of a credit crisis created by abusive practices in the lending industry. The flight to quality by investors adversely affected the municipal bond market driving rates to historic highs in comparison to treasury securities. Normally 20 year municipal bond rates are about 90% of 20 year Treasury bill rates. During the early period of the credit crisis that ratio spiked to 170%. This created bargains for the investors in Municipal Bonds, but made the cost of debt for municipalities high enough to dry up the market. Recently the municipal bond rates have moved closer to their historical relationship with benchmark Treasury securities and the market is more favorable for municipal debt issuers. This is particularly true for triple A credits who are benefiting from a premium on credit quality.

The return of the municipal credit markets and the premium on credit quality is illustrated by the Town's recent G.O. Bond refunding. Because of the Town's triple A credit rating and the increased demand in the municipal bond market, the Town was able to achieve a savings of 10.2% by issuing refunding bonds at a net interest cost of 2.08% (average bond life of 4.175yrs).

### **Library Project Debt Service Impacts on Town Budget**

Of the original \$16.26 million of Library Bonds approved by voters in November of 2003 there remains a balance of \$14.26 million of unissued bonds. There have been two issues of Library Bonds from the \$16.26 million authorized. The first issue occurred in November of 2004 in the amount of \$500,000 for design. The second issue occurred in January of 2007 in the amount of \$1,500,000 for design, art and miscellaneous costs. If the Council decides to proceed with the project, the remaining debt must be issued prior to November 2010 when the referendum authority lapses. It is possible to extend the authority to issue by making application to, and receiving the approval of, the Local Government Commission. The Council could also request

authority from the voters through the referendum process should the current authority expire without being extended.

If the project proceeds, it is anticipated that the balance of Library bonds will be issued in spring of 2010 with the remaining authority for Street and Sidewalk bonds and Parks & Recreation bonds in the amounts shown below:

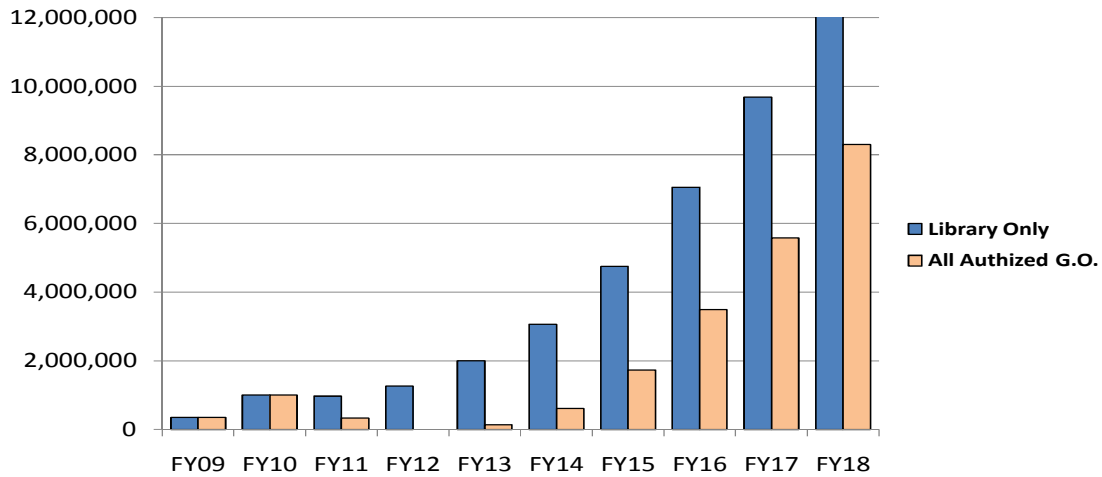
Library	\$14,260,000
Parks and Recreation	3,700,000
Streets/Sidewalks	<u>2,450,000</u>
Total	\$20,410,000

The estimated debt service costs for the Library Project and all planned new G.O. debt is shown below for the first three fiscal years of debt service payments:

	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>
Annual Debt Service (Library only)	\$ 1,499,300	\$ 1,459,975	\$ 1,420,650
Annual Debt Service (All new debt)	\$ 2,142,550	\$ 2,086,450	\$ 2,030,350

Assuming that the Debt Service Fund continues to receive the current equivalent of 9.3 cents on the property tax rate, the fund can absorb the additional debt service from issuing all of the \$20.41 million of authorized G.O. debt. The following graph illustrates the balance in the Debt Service Fund with the issuance of only the Library Debt (dark bars) and the issuance of all of the authorized G.O. Bonds (light bars).

## Debt Fund Balance



### Anticipated Operating Cost Impacts on Town Budget

Operating and maintaining the new Library building will result in increases to the Library's current \$2,373,932 annual operating budget. The anticipated increased costs of providing Library services are the result of increased costs for both staff resources and for general facility use and maintenance of a larger building. The costs associated with fully staffing the new facility are expected to be approximately \$626,227. This increase of 35.2% in the personnel budget is based on the costs for the following staffing changes:

- three additional service desks included in the proposed design (downstairs exit/circulation desk and computer lab support desk; teen room desk),
- in-house janitorial support,
- staff to coordinate increased use of expanded meeting room space and additional children's/teen programming efforts.

Increased personnel costs also include additional hours to maintain library operations at the current level of service in a larger facility with an expanded collection. These personnel costs include additional hours to supervise the circulation desk, to process collection materials (selecting, purchasing, cataloging, mending and weeding of materials), to support increased use of the expanded Youth Services area, and to re-shelve materials. Proposed personnel costs reflect an anticipated 40% reduction in Library Assistant I circulation desk staff hours, due to the patron self-checkout option provided by planned installation of a radio frequency identification system (RFID). Personnel costs also reflect redistribution of some circulation desk clerical tasks and reclassifying two positions from a Library Assistant III to a Library Assistant I to perform these tasks at a reduced hourly rate.

The costs for other operating expenses, notably utility use and building maintenance are also expected to rise to reflect the 123% increase in the Library's physical size. In total, the additional non-personnel cost increase associated with the expanded facility is estimated to be approximately \$148,572.

Taken together, these anticipated annual operating cost increases total \$774,799 or approximately 32.6% of the Library's current annual operating budget, and result in an anticipated total annual Library operating budget of approximately \$3,219,948 during the first full year of operations. The resulting Library project related operating budget cost increases, along with their cumulative tax rate equivalents based on existing valuations, are shown in the following table:

	2011-12*	2012-13
Annual Operating Cost Increase	\$581,099	\$774,799
Tax Rate Equivalent	0.84 cents	1.31 cents

\* Assumes 15 month construction schedule and July 2010 start date.

### **Transition Costs During Construction**

In addition to ongoing operating costs, during the fifteen months estimated for construction there will also be supplemental costs associated with operating Library services from a leased building. We are currently exploring options for leased space and believe there are several options including single spaces of approximately 15,000 square feet and combinations of smaller spaces that total a similar size. Annual lease rates for appropriate spaces are generally between \$15 and \$20 a square foot or about \$18,700 to \$25,000 a month for the space needs identified. Depending upon the specific space selected there will also be a cost for upfitting the building that will need to be done prior to occupancy. Based on the proposed construction schedule these upfit costs, and possibly a short period of lease payments will need to be accommodated in the Town's current year operating budget and we are studying options to address this need as potential lease spaces are identified. Based on a monthly lease cost of \$25,000 the costs of transition services along with their cumulative tax rate equivalents based on existing valuations, are shown in the following table:

	2010-11	2011-12*	2012-13
Annual Transition Service Cost	\$300,000	\$75,000	NA
Tax Rate Equivalent	0.44 cents	0.11 cents	NA

\* Assumes 15 month construction schedule and July 2010 start date.

### **Cumulative Impacts on Town Budget**

Based on the preceding estimates, the combined operating, transition services and debt service costs for completing the library expansion project will add approximately 0.44 cents to the tax rate in FY 1010-11, 0.95 cents to the tax rate in FY2011-12 and 1.31 cents in FY2012-13. The impact on a taxpayer with a \$200,000 assessed value would be about \$26.20 per year beginning in FY2012-13. The preceding calculation does not take into account the tax rate equivalent of

the debt service payments for the Library Expansion because the Debt Fund can sustain the additional debt service from without increasing the current tax rate. If you were to add the tax rate equivalent for the debt service it would be approximately 2.13 cents. The total peak tax burden for the project with debt service would be 3.44 cents or \$68.80 per year for a taxpayer with a \$200,000 assessment.

Although the amount of the annual debt service for this project is almost twice the cost of the additional operating expenses, the Debt Service Fund can absorb the additional debt service without a tax increase. The operating costs increases in the General Fund are more difficult to absorb due to the various competing costs and the uncertainty of revenue that are dependent on the economy.

Based on current trends it appears that we are slowly coming out of the recession. However, with consumer credit markets still constricted and jobless rates still at historically high levels it is likely to be a slow recovery, which suggests that our revenue growth will continue to be flat while our costs continue to increase.

Financial results for FY2008-09 were better than expected due to the effect of the budget savings plan and revenues remaining flat rather than decreasing as expected. This created additional "one-time" funds that increased our fund balance and will provide additional protection from future financial set-backs and funding for "one-time" expenses such as capital outlays. The challenge to the operating budget as we move forward is to balance current revenues with current expenditures. In each of the past three years the Town has used about \$3 million in fund balance (non current revenues) to balance the General Fund Budget. This is an indication that our revenues are not in balance with our planned expenditures. Adding 32.9% to the Library's annual operating budget could increase this imbalance unless additional revenues are identified or significant cost cuts can be made in the General Fund Budget before the full impact of Library expansion is felt in FY2011-12.