ALTERNATIVE APPROVAL PROCESS
JOHN ERNST BUILDING LOAN AUTHORIZATION BYLAW

BACKGROUND PAPER

On February 2, 2004, Quesnel City Council gave three readings to the "*John Ernst Building Loan Authorization Bylaw No. 1570, 2004*." The intent of the bylaw is to enable the City to borrow funds not exceeding $8,000,000 for the purpose of purchasing the newly renovated City Hall building at 410 Kinchant Street along with the parking lot/plaza and adjoining land and improvements at 422 Kinchant Street (collectively described as the John Ernst Building Complex). Formal adoption of the bylaw is subject to the approval of City taxpayers and the Inspector of Municipalities.

This Background Paper explains to City taxpayers why the City wishes to proceed with purchasing the John Ernst Building Complex at this time.

Project Origins:

In December 1999, the City of Quesnel proceeded with the acquisition of Place St. Laurent and adjoining four lots. Place St. Laurent is a five-storey building, complete with a full basement, located in the downtown commercial core of Quesnel.

The acquisition of Place St. Laurent was intended to be an important civic development initiative by encouraging economic revitalization within the main business district of the City. The concept plan was to expand the City Hall and library and relocate them into the facility after renovations were completed. The concept also called for leasing the basement and first two levels of the building to an individual company that would be interested in operating it as a fitness/leisure facility.

When the City decided to acquire the land and improvements, the City elected to finance the acquisition through a lease to purchase arrangement with On-Line Finance and Leasing Corporation (On-Line), rather than through an outright purchase. The costs to improve and renovate the facility were also financed through lease financing.

The City's total investment to purchase the land, building and to complete the renovations is summarized below.

JEB Land and Building	$ 4,047,100
Adjoining Lands	742,700
Renovations	3,472,018
Total City Investment	$ 8,261,818

Why Funding is Needed:

In August 2003, a report entitled *New City Hall Financial Sustainability Plan* (available on the City's website) was presented at the regular meeting of Council. Before formally considering the several recommendations contained in the report, Council elected to hold a Town Hall meeting to ensure that the public had an opportunity to provide input and comment on the options and recommendations contained in the report. The Town Hall meeting, which was attended by approximately 70 individuals was held on October 7, 2003. Council went on to consider the recommendations contained in the report on October 20, 2003 and made several decisions, including:

- to retain the building as a civic asset;
- to convert the existing lease financing to conventional debt financing;
- to seek the assent of the electors by way of an "alternative approval process" as provided for under sections 86 and 179 of the *Community Charter*; and
- to make an initial lump sum payment of up to $2.0 million from reserve funds, subject to final approval during the 2004 budget process.

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The City's motivation for converting the existing lease financing and purchasing the building outright is twofold:

1. To remove once and for all the uncertainty surrounding what the City is legally entitled to do and what obligations it may have when the current five year lease agreements expire, and

2. To realize annual cost savings and reduce the level of tax support required. If Council agrees to the initial lump sum payment of $2.0 million, savings of approximately $200,000 per year would be realized.

Removing Uncertainty:

The uncertainty surrounding what the City is entitled to do stems from the legislative provision which prohibits a local government from incurring a liability for a term of more than five years, or with an option to renew that could exceed five years, without the assent of the electors. Because the City acquired the property through lease purchase financing, there was no requirement to seek the assent of electors. Council has now decided that it would be prudent and make economic sense for the City to borrow the money and pay out the leases. In order for the City to borrow the money, the assent of the electors is required.

Some have suggested that the City has no legal or financial obligation to purchase the building at the end of the lease period. Rather, the City could simply walk away from the building and any further financial obligation. This option is entirely unrealistic and simply not available. The City will have ongoing legal and financial obligations at the expiration of the current lease.

Cost Savings Through Ownership:

Real opportunities exist to save money and relieve some strain on the City's operating budget by simply restructuring the financing of the project. The City would receive immediate savings in the form of third party property taxes. Furthermore, by borrowing money to purchase the asset, the City would be able to obtain a stable, fixed interest rate, and thereby guard itself from an unexpected rise in interest rates. Because the lease financing option is tied to a floating interest rate, there is always an element of risk that interest rates will rise, thereby increasing the City's annual cash flow requirements. To avoid this uncertainty, the City wishes to achieve rate stability by locking in a rate for an initial period of 10 years.

The Transaction:

The City is seeking authority to borrow up to $8.0 million, for a period not to exceed twenty-five years from the date of issue of the debenture. The total sum, which represents 21% of the City's borrowing capacity, would be obtained through the Municipal Finance Authority. The MFA's Triple A credit rating guarantees that interest rates on the City's loan will be very competitive.

Although the City is seeking authority to borrow up to $8.0 million, it should be noted that Council has agreed in principle to make an initial lump sum payment from City reserves. The reason for making a lump sum payment at the outset is to reduce the City's level of indebtedness. This, in turn, will reduce the City's annual cash flow requirement for debt servicing purposes.

At this time, Council has not confirmed the planned $2.0 million contribution from reserve funds. Instead, Council has elected to wait until the 2004 budget process is well underway before committing these funds in the event that all or some of these funds may be required to address other spending priorities. Rather than delay the loan authorization bylaw and the public approval process, the City has simply elected to seek authority to borrow the entire amount necessary to purchase the building, without any contribution from reserves. If Council ultimately approves a contribution from reserves of up to $2.0 million, the amount of money that will need to be borrowed will be reduced accordingly.

Financial Impact:

Two financing impact scenarios are outlined below. The first scenario assumes a borrowed amount of $8,000,000, while the second scenario assumes a $2.0 million contribution from reserves and is based on a borrowed amount of $6,000,000. The calculations are based on an interest rate of 4.87% amortized over 25 years. Please note that the annual payments do not include any current or future rental income that would be applied against these totals. The current or future rental income would actually improve the financial picture if added.

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Financial Impact Summary

	Scenario 1	Scenario 2
Borrowing Amount	$ 8,000,000	$6,000,000
Annual Principal	167,619	125,715
Annual Interest	389,600	292,200
Total Annual Payments	557,219	417,915
Estimated tax rate per $1,000	.286	.214
Estimated Annual Cost for $100,000 home	$28.60	$21.40
Estimated Monthly Cost for $100,000 home	$2.38	$1.78

What Happens If Debt Financing is Not Approved?:

As noted previously the City has legal and financial obligations at the expiration of the current leases, and, therefore, the option of simply walking away is not realistic. If the assent of the electors is not received via the alternative approval process, then Council has the option of putting the matter to a city-wide referendum. In the alternative, if electors do not give their assent to borrow the money to purchase the building, Council has the option to negotiate a new lease based on the residual value. This is not the preferred option insofar as it is more costly for taxpayers and does not resolve the issue of longterm tenure. Nevertheless, the option of entering a new five-year lease might be considered as the City's fallback position in the event the option of borrowing the funds to buy the building is not acceptable to the electors of the City.

Expert Review:

The municipal solicitor and municipal auditor were both asked to review the City's *Financial Sustainability Plan* and the options and recommendations contained therein. Our solicitor concurred with options set out in the report while, in the auditor's opinion, "City Council has been provided with a plan for the financial aspect of the New City Hall that is reasonable, achievable, and financially sound."

How Does Voting Process Work?:

Before Council can decide to formally proceed with purchasing the building, approval of the City's electors is required. Council has elected to use an "alternative voter approval process" (formerly known as a counter-petition opportunity) to determine elector approval.

Simply put, alternative voter approval (AVA) is a process designed to gauge the level of public support for a proposed course of action – in this case, the borrowing of up to $8.0 million to purchase the JEB complex outright. The process requires the City to make available a special elector response form. Electors who oppose the proposed transaction must:

- obtain a copy of the form from the Office of the Deputy Clerk (4th floor City Hall);
- sign the form to register their opposition; and
- submit the form by 1:00 p.m. on April 15, 2004 (at least 30 days after notice publication).

Electors who do <u>not</u> oppose the borrowing and purchase proposal need do nothing.

If fewer than 10% (583) of Quesnel's electors submit signed elector response forms by the deadline, then Council would be authorized to proceed with the proposed transaction. If 10% or more of Quesnel's electors register their opposition, Council has two choices: abandon the proposed transaction and continue with the leasing arrangement, or hold a referendum on the matter.

Conclusion:

The City recommends the purchase option to municipal taxpayers. The proposed transaction will result in cost savings to the City and its taxpayers and remove any uncertainty as to the City's ownership of this civic asset. The City and its advisors have spent considerable energy and resources reviewing this matter. They feel confident that the purchase option as proposed represents the best option for City of Quesnel taxpayers.

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