

KETCHIKAN CHARTER COMMISSION

AGENDA STATEMENT

NO. I-1

MEETING OF April 22, 2005

ITEM TITLE

Amend Article XI, Section 11.05: Economic Development Financing

SUBMITTED BY John Harrington

SUMMARY STATEMENT

Currently, the Charter reads:

Section 11.05 Economic Development Financing

The Municipality may enact ordinances authorizing the issuance of non-recourse revenue bonds or other non-recourse revenue obligations and the application of the proceeds thereof for economic development purposes, subject to the following limitations:

- (a) Non-recourse revenue bonds and other non-recourse revenue obligations issued pursuant to this section shall be payable only from money or other property received as a result of projects financed by the non-recourse revenue bonds, or other non-recourse revenue obligations, and from money or other property received from private sources.
- (b) Non-recourse revenue bonds and other non-recourse revenue obligations issued pursuant to this section shall not be payable from, or secured by, any municipal assets, tax funds, or governmental revenue, or by all or part of the faith and credit of the Municipality.
- (c) Non-recourse revenue bonds or other non-recourse revenue obligations may only be used to finance economic development projects, as defined by ordinance.

The restrictions of Articles VIII, X, and XI of this Charter shall not be construed as limitations upon the authority granted by this section. Non-recourse bonds and other non-recourse revenue obligations may be issued pursuant to this section without ratification at an election.

There are two courses of action to be decided upon by the Commission. They are listed below.

- (a) Should the Utility (KPU) be required to gain voter approval prior to issuance of general obligation bonds for improvement or upgrades of the utilities? If the answer is "no," then insert the following as the next to the last sentence in Section 11.01 (c).

"General obligation bonds issued under this section, which are to be used for capital improvement in, and paid for by revenues of Ketchikan Public Utilities may be issued without ratification at an election."

- (b) Should non-recourse revenue bonds be required to gain voter approval prior to issuance? If the answer is "yes," then we need to delete the last sentence in Section 11.05.

Background Information

RE: Sections 11.04 & 11.05 of the Consolidation Charter

Response by Scott Brandt-Erichsen, 3/5/05:

Bob Newell can correct me if I am using the wrong terminology, but the concept is best illustrated by a tangible example. The city of Ketchikan currently has a charter provision which requires a public vote in order to pass revenue bonds. The Borough does not require such a vote for revenue bonds. Generally there are two types of bonds, revenue bonds and general obligation bonds. General obligation bonds pledge the full faith and credit of the municipal entity while revenue bonds only pledge the revenue from the designated project. As such, most revenue bonds are also non-recourse bonds in the sense that the taxpayers are not responsible if there is a default and there is no recourse against the municipal entity involved.

Revenue bonds are often used in connection with major construction projects connected with enterprise activities such as the port, KPU and the Airport. The city has in the recent past been discussing revenue bonds for the port expansion. As revenue bonds of the city these require a public vote. If the new municipality were to issue the bonds as revenue bonds the charter would call for a vote. However, if, rather than calling them port revenue bonds, they are nominally labeled as non-recourse economic development revenue bonds, then section 11.05 would appear to authorize them to be issued without a public vote.

In our experience with economic development, the determination of whether a particular expenditure is within the economic development powers is a factual determination made by the assembly. A court will not reject such a judgment call by the assembly unless it is clearly unreasonable. As such, the range of projects for which an argument could be made that it promotes economic development is very broad. So broad in fact that it is likely that most items for which revenue bonds could be used could be asserted to be economic development projects. As a result, the idea of requiring a public vote for revenue bonds is undercut if you can issue "non-recourse economic development bonds" which are paid by the revenues from the project without a public vote.

You can leave the charter as is, but I wanted to let you know that the public vote requirement for revenue bonds in 11.04 can easily be avoided by the non-recourse bond option in section 11.05. If you want the public vote to clearly apply I would omit 11.05. However, the law does not require that a public vote be used for revenue bonds.

Scott

Response from Bob Newell, 3/5/05:

Scott is correct. The use of the term "non-recourse" when discussing revenue bonds confuses the issue because revenue bonds are by definition secured only by the revenues of the enterprise or project they are intended to finance. Since there is no full faith and credit pledge by the issuing municipality, the bondholders cannot compel the municipality to raise taxes or use other non-related revenue sources to satisfy debt service on the revenue bonds. A municipality can issue bonds that have recourse. These bonds are called "double-barreled" bonds. These type of bonds are secured by the revenues of the enterprise or the project. They also carry a full faith and credit pledge. They are generally categorized as general obligation debt because of the full faith and credit pledge even if the issuing municipal "intends" to use only the revenues of the enterprise or project to pay for the debt service. Bob

Responses from Scott Brandt-Erichsen and Steve Schweppe on the bonding issue dated 3/21/05

Scott Brandt-Erichsen said:

Concerning the revenue bond issue, I think the discussion by the charter commission brought out a number of relevant considerations. I am not sure what approval procedures the commission is seeking to have 11.04 and 11.05 redrafted to accomplish. They can provide exemptions for only certain revenue bonds, for all revenue bonds, or for no exemptions. Where to draw the lines is a policy issue.

Steve Schweppe said:

Utility Revenue Bonds: There could be a distinction drawn between utility and non-utility revenue bonds. Early on the Borough pointed out that it issues airport revenue bonds which are generally small in size and would have only a remote effect on citizens since they are paid from landing fees and rent. They pointed out that the Borough has had the power to borrow for such purposes without a vote and has not had any problem.

If a distinction is to be made between utility and non-utility revenue bonds perhaps the non-utility bonds should be the ones that do not require a vote. However, that will encourage officials to look for ways to put utility projects into non-utility bonding. Karl's point is well made that KPU Telecommunications needs quick access to financing and that KPU needs quick access to financing in the event of an emergency. Under the present limitation on borrowing, that means that KPU needs to operate with high levels of reserves, which is not a particularly bad thing. It is difficult to change this without opening the door to careless bonding by the Assembly. As we have said, if the Assembly can bond without voter approval it could at some time by a vote of 4 members buy Swan Lake, invest in experimental tidal electric generating facilities or otherwise pursue projects which may have little likelihood of success but a core of political support.

The consequences of a default in a utility revenue bond may be greater than the consequences of a default in a general obligation bond. In the utility revenue bond failure, the bond holders or the bond insurer comes in to force rates up to the point that the bonds are paid and operating expenses are met. In a G.O. bond failure, basic democratic principles may give elected officials more leverage with creditors. I think that the average citizen and business would feel the effects of an unsound revenue bond financing more quickly and more painfully than an unsound G.O. bond. After all, the effects of a G.O. bond can be spread among several income streams such as sales, transient and property taxes, as well as fee increases and cuts can be made from a wide variety of programs, many of which have soft costs. Utilities have only fees for income and have hard costs for materials and supplies to keep the system going.

The charter could set a ceiling on the ability to issue revenue bonds without voter approval, but that ceiling would need to be tied to some inflation measurement and would have to be written in such a way as to bar serial bond issuances at the ceiling. An exception could be made for emergencies but the term emergency is a very loose and broad term for which Courts give legislatures wide room to define. Anyway, most emergencies may be addressed by insurance, reserves, grants or in the case of electric by the fact that Swan Lake and the Intertie will be owned by the 4 Dam Pool, not the Municipality. As for KPU Telecommunications, this may just be one of the drawbacks of public ownership. There are benefits such as freedom from rate regulation, tax exemption, and no need to generate a profit, but some serious disadvantages that cannot be escaped. I noted that there was some comment that economic development bonding could be used in place of revenue bonding. Economic development bonding is limited to projects that will be paid for by non-governmental revenues. KPU's revenues would be governmental. Economic development bonding is meant for private businesses that want to finance a project with tax exempt municipal financing paid out of revenues the private business pledges to the bond holders.

Excerpts from the 3/11/05 meeting minutes:

THOMPSON said that the information provided in the G agenda statement from NEWELL and SBE is very much to the point. He said he'd like to add the State does not require a vote of the people for non-recourse revenue bonds. The City currently does and the Borough currently doesn't for their economic development. He said if there is a non-recourse bond, those bonds are paid back by the user fees. For example, the Airport; if there is a non-recourse bond over there, the only payment on that bond comes from the landing fees or the fees from the airport that stream directly toward that bond. If those are not sufficient to pay back that bond, they do not come back to the taxpayers. The taxpayers have no money at risk, per se, on those types of bonds and that's why the State doesn't require a vote of the people.

THOMPSON continued that the City currently has to go to a vote of the people for a revenue bond. For instance, the Port expansion will have to go back to a vote of the citizens. The question is, as SBE said, this (section of the Charter) can be left as it is, but if it's economic development, a vote of the people is not required for a non-recourse revenue bond. SBE said it was a judgment call. Currently, it is set up that if the Assembly decides they want to build something and they are going to get revenue from the passenger fees to build that and there is non-recourse back to the taxpayers if the bond obligations are forfeited, they don't have to take it to the voters. That's the way the Charter is written right now. The question the Commission needs to ask is that okay? If it's alright as it is, leave it alone, then it needs to be taken back.

OTTE said there are revenue bonds and general obligation bonds. Revenue bonds, by their nature, are non-recourse. THOMPSON said that is correct, but they don't have to be non-recourse. OTTE continued by saying that the bond doesn't have to be labeled non-recourse, it can just be a revenue bond. THOMPSON said that it must be specified either recourse or non-recourse. There are, on occasion, recourse revenue bonds. They are called double-barreled shotgun bonds. If they are non-recourse revenue bonds, then they don't have to go to a vote.

PAINTER said whereas recourse general obligation bonds would be like schools. THOMPSON said that recourse means that the full faith and credit of the municipality is pledged against those bonds and if there is a default, taxes could be changed to pay off the bond.

HARRINGTON wanted to know if the City, in their prior Charter, required a vote on those bonds. THOMPSON said he didn't know and asked AMYLON if that was the case. AMYLON said that in the Charter of three years ago all bonds had to go to the voter regardless of whether they were revenue versus general obligation. He said he could easily fashion an argument on either side for not having to take revenue bonds to the voters. If the full faith and credit of the municipality isn't pledged, some could argue that seems to make sense in terms of non-recourse bonds, there's really not a risk to the user, per se. He said that using the Port as an example; if the City's current charter were currently structured where non-recourse bonds were not taken to the voters, the Council could decide on its own what position to place the new berth. There are some in this community who would be very much outraged that the voters would not have a say in that. AMYLON said the Commission just needs to spin the wheel and take their best shot. The direction he was given three years ago was to maintain the status quo of requiring the bonds be approved by the voters. That's the way it's been done in Ketchikan and that's what was done. He said that speaking for himself, not the council, can understand the desire to not have the non-recourse revenue bonds going to the voters.

AMYLON continued that the one thing he would add is that Telephone is a revenue producing entity and as things get more complex and competition increases, KPU and the Telephone Division are going to be coming under increasing pressure to respond and to respond rapidly. KPU will not have the profit margins that have been traditional. There are going to be times when significant

expenditures are going to have to be made and they're going to have to be made in a very expedited manner. That does not lend itself well to having to go to the voters for non-recourse revenue bonds.

KIFFER said that even though the bonds would be non-recourse, what is the risk to the municipality? THOMPSON said that the risk to the municipality is exactly...the best example is the one just used regarding the Port. It's allowing the new Assembly to make a decision that affects the community for a long period of time with a majority (4 votes) at the table to put a dock north or south, invest in new Telephone equipment, that sort of thing. There is a revenue stream that's outside of the taxpayers, the taxpayers aren't going to pay for it, but it does affect the infrastructure of our town in a large way and the lifestyle would be affected. Whichever way the dock is placed, there's a considerable difference. Does this Commission want to have that in the hands of the Assembly or a vote of the people? If, on the other hand, if there is going to be a utility competing in the open market, they have to have the flexibility to have all the tools to compete.

AMYLON said that it even gets more difficult. It's not only a question of taking it to the voters and getting a ballot proposition passed; then the time to negotiate the sale of the bonds and how they are going to be issued and that tacks on more time. He said one thing that might be considered, and he said he wasn't saying it was a solution, but the Commission may want to talk with the attorneys and get their take on whether there can be a distinction between utility revenue bonds versus other municipal revenue bonds. Perhaps, say, with the exception of utility revenue bonds, all bonds, even if they are non-recourse revenue bonds, would have to go to the voters. AMYLON said he's not sure how that would be received, but it might be something to think about.

THOMPSON wanted to know what the Commission's desire on this issue would be.

KIFFER said that someone crazy enough to give a bond to expand the Port on a non-recourse basis, he didn't think they would do it anyhow. All said that they would. The revenue stream is there. KIFFER continued that the problem he sees is there is going to be more of a impact to the community than just the payment of that bond. He said that granted the money to repay that bond isn't going to come out of the taxpayers pockets, but there are going to be a whole lot of ancillary things that are going to be changed and moved and upgraded in relationship to any kind of a project of that size. He said he's leaning toward the way the City had it that all bonds go to a vote of the people.

HARRINGTON said that was the reason he'd brought it up. He said his memory of a meeting almost exactly a year ago when the Commission was ready to abandon a vote of the people on those bonds, AMYLON was there at the time saying his group was very firm (in the prior attempt) in the fact that they wanted a vote left in the Charter and HARRINGTON said that certainly changed his mind that we needed to do that. He said that if somehow through this process we have lost that decision and now have made it so we don't require a vote of the people, he would really like to re-visit that and re-visit it with the three options:

1. Excluding the Utility;
2. All bonds require a vote of the people; and
3. The current language.

He suggested that those three options be brought back for a discussion.

FINNEY asked AMYLON if there were a dollar limit on the bonds; would that suffice? He said that he would agree about the Port in that it changes the whole pattern, but it's a huge dollar figure. He wanted to know if the dollar limit would be the way to go.

AMYLON said that a dollar limit in terms of actually incorporating it into the Charter would probably do more to confuse the people than just saying yes or no that either you do or don't go to the voters. He thinks HARRINGTON is right that the decision be made that either all bonds are going

to go to the voters for approval, or non-recourse revenue bonds are not subject to a vote and then under either one of those alternatives, consideration might want to be given for some kind of exemption for utility revenue bonds. He said that is something the Commission needs to wrestle with.

THOMPSON asked AMYLON how much difficulty the City has in terms of bonding for KPU for revenue bonds. He wanted to know if it was a major undertaking or is it...AMYLON asked if THOMPSON meant getting it through the voters. THOMPSON answered, getting it through the voters...from start to finish. When it's decided that there is a project that needs bonding. AMYLON said he'd had this conversation with NEWELL that afternoon on the Port project and assuming that on April 7th the Council were to approve a resolution authorizing a ballot question, it could be well into October or November before he would have proceeds to be able to spend. On the Port, under normal circumstances, that would probably be do-able. Where the City is currently is somewhat unusual. On the Utility, it can get hairy. KPU had generator #2 go down at Bailey a couple of months ago. It was fortunate in that there is surplus generation available right now, but if the Wardcilla unit, for instance, or if the line had gone out between Ketchikan and Swan, any type of catastrophe like that which would require a significant investment of funds and they have to move quickly or, again, going to Telecommunications; it really limits the ability to affectively deal with those type of circumstances, to run it like a business. On the other hand, AMYLON continued, as frustrating as the Port project has been, he said he thinks a project of that magnitude and the implications to the whole community, the voters probably ought to have their say. He said he didn't have a problem with that.

THOMPSON said what it sounded like AMYLON was saying is that if the Assembly were to declare an emergency, which has been addressed in the Charter, and instead of saying they could do it under economic development financing, if they were to do it under emergency financing, substitute the word emergency for economic development, a lot of the problems would be solved. AMYLON said that the question or definition of an emergency is something that the Commission will have to talk to the attorneys about. He said he didn't have an answer for that. He said that he can offer is if two years from now GCI deploys 6th generation technology that puts KPU Telephone at a real competitive disadvantage and the Manager would have to go and borrow \$7 million to keep pace but there isn't 7 or 8 months to go through the typical process, does that constitute an emergency? He said he didn't think so. THOMPSON said that it might if it were going to put the utility under water. AMYLON said that's why the Commission needs to consult with the attorneys. THOMPSON asked OTTE to address that question to the attorneys.

THOMPSON continued that as he reads in 11.04 and 11.05, 11.04 says it must be taken to the voters. 11.05 states that if it's economic development, it doesn't need to go to the voters. He said he didn't know why that was separated out, but he said he thinks maybe that was a combination of the current Borough and City, but he said if 11.05 were eliminated or made 11.05 stating that it has to be an emergency or exempting the utilities. AMYLON said that in the case of the utilities or the Port, he could fashion an argument why either one of those would be an economic development project. He said some of the language needs to be cleared up with the legal counsel.

KIFFER said his concern is that at some point technology is going to clean our clock in relationship to KPU. He said that at some point as we go along, it may very well be best for the community to say we're out of the business. We can't keep up and we're not going to pour money into this any more. He said that KPU could come in, in trying to keep ahead of technology, and put a \$7 or \$10 million bond in there so that we could all have video telephones in our house, when, is that really what the people want. An emergency is a generator going out or a line going down or something that would prevent KPU from operating as it is at that time, that would be considered an emergency. Something to keep pace with the Jones', he said he didn't know.

PAINTER said that to his recollection, KPU, in the past several years since the dissolution of the KPU Advisory Board and the Council's decision to operate KPU as a business, and their decision to go with the TV, and prior to that, a vote of the people whether or not to sell the Telecommunications business (the voters didn't want to do that), but Telecommunications is a rapidly changing, technological deal and the City's choice up to this point in time to run KPU as an enterprise and a profitable deal is to keep up with the technology and do what needs to be done, because that's what the voters said to do several years ago. Trying to keep with status quo, he said he'd be in favor of excluding the utility from going to the voters for revenue bonds because there are times when there is a short window to catch up that's going to cost in the millions and it being a revenue bond, they've got to demonstrate to the bonding company the revenue stream is there to do so and on the other hand, any of the other community projects should go before the voters, even though like AMYLON said on the Port deal, it's virtually a revenue bond situation, the revenue stream is there, the bonding company would jump at doing that, but it's a very controversial community issue that would have long-lasting effects on other commerce in the community. He said the only case that he could see that really shouldn't go to the voters is probably the utility and that's what he'd be in favor of.

OTTE said she'd forward the excerpt from the minutes to the attorneys and ask them for some suggested language for the alternate sections and bring it back for work session, not as an agenda item, for next time.

FINNEY said that his concern would be that good money would be thrown after bad trying to stay up with technology and then find out that like a dot-com, you crash, and the \$50 million that KPU just spent wasn't worth anything because of new technology. He said that PAINTER had a good point in that regard in that the bonding companies would really serve as the filters for that. If they think it would be a good investment, it's their money they're putting out there, it may not be a bad way to go.

THOMPSON asked AMYLON on a non-recourse revenue bond for KPU, say (to give a wild example) a \$50 million piece of equipment and it was bonded for with the revenue stream and somebody came in and brought in their \$100 million machine and put KPU out of business, would a bonding company at that point, have any recourse to KPU and the assets of KPU? AMYLON said he wished NEWELL were there. If the bonds were insured, which is what getting non-recourse revenue bonds is all about, he said he thinks it would be unlikely, but the Commission might want to pose that question to the Finance Directors. He said he thought PAINTER hit the nail on the head; if KPU wanted to go out and sell \$50 million worth of bonds to keep up with GCI or ACS or whoever, if there isn't a credible plan in place, it wouldn't be possible to get the bonds rated and they wouldn't be sold. He said he didn't think that is of a particular concern.

OTTE said that before the expansion into the television product a business plan had to be produced and it had to be examined by bond counsel? AMYLON said the process hasn't gotten that far.

PAINTER said he sees no difference in anyone doing a start-up business and needing financing and going to the bank. The bank has to see a business plan and if it doesn't pencil out on paper, there won't be a loan.

THOMPSON said his question was if they do lend the money, if those bonds were insured and there was a default...AMYLON said he'd rather have NEWELL address that question. That would be the risk. The question should be asked as to what would be the risk if something were allowed and a management group makes a decision in all good faith and good conscience with their best business sense. Things happen out there that are beyond control and he said he goes back to the early days of the Washington Public Power supply. Five nuclear plants were considered to be

enough power forever and it was the largest municipal bond default in the history of man. Things happen, so what's the recourse from the bonding companies back to KPU if that were to happen? If they're insured bonds and the insurance company picks up the default on that, we don't have to worry about them coming in and taking over KPU. No harm/no foul.