NOTICE AND CALL OF

JOINT SPECIAL MEETING

NOTICE IS HEREBY GIVEN as provided by Government Code of the State of California Section 54956 that Mayor George Huntington called a Special Meeting of the Town Council of the Town of Yucca Valley to meet in joint session with the Board of Directors of the Hi Desert Water District, for Tuesday, November 8, 2011, at 6:00 p.m. at the Yucca Valley Community Center, Yucca Room, 57090 Twentynine Palms Highway, Yucca Valley, California, for the below stated purpose.

AGENDA (REVISED)

(Action may be taken on any of the items listed below)

ROLL CALL: Council Members Abel, Hagerman, Lombardo, Rowe and Mayor Huntington

1. **CALL TO ORDER/PLEDGE OF ALLEGIANCE**

2. **ROLL CALL**

3. **APPROVAL OF AGENDA**

4. **PRESENTATION OF THE INDEPENDENT FISCAL CONSULTANT REPORT ON THE TOWN/DISTRICT SALES TAX PROPOSAL**

   Staff Report

   Recommendation: 1) Receive and file the independent Sales Tax analysis as prepared by Fieldman/Rolapp & Associates; and Discuss the Ad Hoc alternative variation and provide direction to staff.

5. **PUBLIC COMMENTS**
   This is the opportunity for members of the public to address the Council on matters within the Council's jurisdiction that are not listed on the agenda. Please limit comments to three (3) minutes or less. State law prohibits the Board of Directors from discussing or taking action on items not included on the agenda.

6. **BOARD/COUNCIL COMMENTS**

7. **FUTURE AGENDA ITEMS REQUESTED BY THE BOARD/COUNCIL**

8. **ADJOURNMENT**

Copeland

LESLEY R. COPELAND
Deputy Town Clerk

CELEBRATING 20 YEARS — TOWN OF YUCCA VALLEY, CALIFORNIA — INC. NOV. 27, 1991

HI-DESERT WATER DISTRICT

TOWN COUNCIL / DISTRICT BOARD STAFF REPORT

To: Honorable Mayor & Town Council
Honorable President & Board
From: Mark Nuaimi, Town Manager
Ed Muzik, HDWD General Manager
Date: November 3, 2011
For Joint Council Board Meeting: November 8, 2011 6:00PM

Subject: Presentation of the Independent Fiscal Consultant Report on the Town/District Sales Tax Proposal

Recommendation: It is recommended that Town Council and District Board:

- Receive and file the independent Sales Tax analysis as prepared by Fieldman|Rolapp & Associates.
- Discuss the Ad Hoc alternative variation and provide direction to staff.

Order of Procedure:
Request Staff Report
Request Public Comment
Council Discussion / Questions of Staff
Motion/Second
Discussion on Motion
Roll Call Vote (Consent)

Discussion:

At the April 11, 2011 joint meeting of the Yucca Valley Town Council and the Hi Desert Water District, Town and Agency staff presented a conceptual infrastructure financing framework based upon a potential Town 1% transaction and use tax. Upon review and extended discussion by both elected bodies, it was unanimously determined that the concept was an innovative approach to financing some of the critical infrastructure needs in the community, including the $125m regional wastewater treatment facility.

Reviewed By:

Town Manager	Town Attorney	Admin Services	Dept Head

X Department Report	___ Ordinance Action	___ Resolution Action	___ Public Hearing
___ Consent	X Minute Action	___ Receive and File	___ Study Session

Staff was given direction to engage an independent financial consultant who could objectively evaluate and expand on the sales tax framework. This would be a joint review project for both the Town and District, and the cost for the study would be equally shared. The sales tax consultant ultimately chosen for this analysis by both public entities was Fieldman|Rolapp & Associates (FRA).

Over the past four months, FRA worked with the Town and District to understand the scope of the project, the method for analysis, and the information needed from both entities to complete their analysis. This work has now been completed and FRA will be presenting the analysis to the joint meeting.

Sales Tax Analysis and Model

Attached to this report is the final Memorandum from FRA regarding the project. In it, the consultant identifies the facts, description of the model, analysis and conclusion.

While FRA will walk through the analysis with the Council and Board members at the joint meeting, the summary statement in the conclusion of the Memorandum states the following:

> *"While complex, the Sales tax Scenario is innovative public-public cooperation between the Town and the District that allows each to achieve both common and individual goals."*

> *"While the evaluation of "fairness" is beyond the scope of any professional evaluation, the Sales tax Scenario does provide a reasonable allocation of resources and a specific application of the resources to meet critical needs consistent with the best practices of governmental jurisdictions."*

Ad Hoc Committee

On October 26, 2011 the Ad Hoc committees of the Town and the District met to receive the draft report and analysis from FRA. After an extensive presentation, members engaged in a thorough discussion with the consultant, Town and District staff. Both Ad Hoc Committees unanimously supported and agreed with the analysis as presented by FRA.

In addition, as part of these discussions, some alternative sales tax variations were discussed, and ultimately, a revised recommendation of a "No-Loan" alternative was identified for further consideration by the full Council and Board. This recommendation will be presented in detail as part of the joint Council and Board meeting.

Alternatives: None recommended.

Fiscal impact: Based upon the direction to staff, supplemental funding may be necessary to analyze alternative variations of the sales tax measure.

Attachments: Fieldman|Rolapp & Associates Memorandum

FIELDMAN ROLAPP
& ASSOCIATES

MEMORANDUM

To: Frank Luckino, CFO, Hi-Desert Water District
Ed Muzik, General Manager, Hi-Desert Water District
Mark Nuaimi, Town Manager, Town of Yucca Valley
Curtis Yakimow, Administrative Services Director, Town of Yucca Valley

From: Daniel L. Wiles, Principal
Paul D. Pender, Vice President
Fieldman, Rolapp & Associates

Re: Sales Tax Financing Model and Analysis

Date: October 12, 2011

Facts

The Hi-Desert Water District (the "District") has been charged by LAFCO to provide a wastewater system to serve the Town of Yucca Valley (the "Town") and some unincorporated portions of San Bernardino County. The overall cost of the necessary wastewater system project (the "Project") has been estimated at $125 million. The District believes that it is eligible for a state revolving fund loan for 90% of that amount with a projected interest rate of 2.6% over a term of 30 years[1] (the "SRF Loan").

The District and the Town have developed a general financial structure (the "Sales Tax Scenario") to enhance the affordability of the costs of financing the Project to the residents of the Town and ratepayers of the District. In the absence of the Sales Tax Scenario, the District likely would fund costs of the Project from imposition of a benefit assessment within an Assessment District that would be approved by the property owners with an assessment over the period from 2016 to 2046 (the "Assessment District Only Scenario").

The Sales Tax Scenario envisions the following:

- **Sales Tax.** The Town would call an election to consider adoption of a 30 year sales and use tax at a rate of 1.00% (the "Sales Tax"). Inland Empire economic consultant John E. Husing, PhD, ("Husing") was engaged to prepare projections of the sales tax revenues generated by the Tax over the next 30 years and to determine the proportion of these taxes that would be paid by non-residents. Included in the projections of the Sales Tax are two scenarios: (i) a Constant scenario that excludes any assumption of inflation; and (ii) a Current scenario that includes a projection of future inflation rates.

  During the 30 year term the Sales Tax would be allocated between the Town and the District under an agreed set of rules:

  - For the first 5 years of collection, the Sales Tax receipts would be provided to the Town.

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[1] Rate and term is based on most recent SRF award to Los Osos Community Services District. Repayment term commences upon completion of the project.

        - Those Sales Tax receipts are divided between road improvements (75%) and park improvements (25%). In sum the Town would derive park improvements (estimated at $3.2 million) and road improvements (estimated at $9.7 million).
        - The road improvement amounts may be loaned by the Town to the District to facilitate the Project's cash flow and better coordinate street improvements with the Project.
    - For the remaining 25 years of the Tax:
        - The first $2,797,439 of receipts (the "Base Payments") is provided to the District for payment of SRF loan related to the Project. Once the Project has been operation for one year (Year 6 of the Tax revenues), the District will begin repaying the SRF Loan.
        - The next receipts up to the level projected for that year in the Husing Constant scenario (the "Residual") are paid to the Town.
        - Additional receipts beyond the Husing Constant scenario (the "Excess Revenues") are to be shared between the Town and the District on an equal (50/50) basis as they are assumed to result from inflation.

- **Loan of Sales Tax Proceeds to District from Town.** The Base Payments received by the District consist of Sales Tax paid by both residents and nonresidents who purchase goods and services in the Town. Husing has projected that 50.3% of the Sales Tax is paid by residents of the Town, while the remainder is paid by nonresidents. The portion of the Base Payments provided to the District for the Project that is allocable to residents is received at no cost to the District.[2] The portion allocable to non-residents is loaned to the District by the Town (the "Loan"). The Sales Tax Scenario also includes the loan of the road improvement funds to the District from the Town. The terms of the Loan are:
    - Repayment of the Loan is on an annual basis from 2023 to 2071 with interest accruing at 0.50% per year. The payments start in 2023 at $618,998 per year and increase by 1% each year, reaching $986,679 in 2071.
    - The road improvement fund portion of the loan is treated as repaid upon completion of the road improvements (Year 6).
- **State Revolving Fund Loan.** The District will enter into the SRF Loan for the financeable portion of the Project, estimated to be $112,500,000, for a term of 30 years from operation of the Project (first year estimated at FY 2016-17), bearing interest at 2.6% per year. The SRF Loan will be secured by an assessment on all properties within the three phases of the Project and imposed by an election of the property owners (the "Assessments"). The Assessments will be sufficient to pay the full amount of debt service on the SRF Loan and the Loan. However, receipts of the Sales Tax by the District, both from the Base Payments and from additional Sales Tax, are modeled to reduce the Assessments.

[2] This is on the expectation that residents have already paid those funds for the funding of the Project so no Loan obligation springs from their receipt.

Issue

You have engaged us to develop a quantitative model of the Sales Tax, the Loan, the SRF Loan and the Assessments. The primary purpose of the model is to provide a basis to compare the Sales Tax structure as outlined above with a structure that relies solely on Assessments for the entire SRF Loan debt service.

The model will also provide the Town and the District with an ongoing tool to monitor the sales tax as received, allocate the tax between the Town and the District and track the outstanding obligation of the District to the Town under the Loan.

Conclusions

The use of the Sales Tax enables both the Town and the District to fund infrastructure improvements with revenues provided, in part, by nonresidents of the Town. Since Sales Tax receipts paid by nonresidents are treated as the Loan to the District, up to the Base Amount, the District benefits less than the Town from this nonresident portion of the Taxes. However, the District does benefit from being able to repay the Loan over a long period of time at a very favorable interest rate, and benefits equally with the Town on the Excess Revenues it receives, since no portion of Excess Revenues are added to the Loan amount.

In addition, the use of the Loan structure works to provide interconnected benefits to the District and the Town. First, the effective term of the SRF Loan is stretched beyond the original 30 year Tax term, ending in 2046, through the Loan from the Town. This serves to refinance a portion of the SRF Loan debt service over a term ending in 2071. The refinancing is at well below market interest of 0.50%. The amortization of the obligation itself is structured to provide for an annual payment that increases by 1.0% each year. On a present value basis, on virtually any reasonable discount factor, the use of the Loan provides benefit to those paying the Assessments by reducing the present value costs associated with the Project.

For the Town, the Loan provides an ongoing stream of income through 2071. If the Town implemented a sales tax without cooperating with the District, it is unlikely the term of the tax would remain at 30 years. Moreover, the proposed allocation of the Sales Tax provides the Town the opportunity to fund some of its most needed civic improvements in 2012-2016.

In comparing the value received by the Town and the District, we note that if the actual receipt of Sales Taxes is consistent with the Husing Current projection (which includes the effects of projected inflation), the total economic value is split very evenly between the two. The Town receives 49.2% of the net present value and the District receives 50.8% of the net present value. The division of Sales Taxes alone is more in favor of the District (as we would expect), with a split of 33.6% for the Town and 66.4% for the District.

From the perspective of a customer of the District (an EDU for purposes of this memo), the use of the Sales Tax Scenario outlined above results in a net present value savings The present value per EDU of the burden imposed by an Assessment District Only financing structure exceeds the burden imposed per EDU by the Sales Tax Scenario, including a prorata share of Sales Taxes paid, by $1,062. On a per capita basis, the net present value savings is $593.

While complex, the Sales Tax Scenario is an innovative public-public cooperation between the Town and the District that allows each to achieve both common and individual goals. While the evaluation of "fairness" is beyond the scope of any professional evaluation, the Sales Tax Scenario does provide a reasonable allocation of resources and a specific application of those resources to meet critical needs consistent with the best practices of governmental jurisdictions.

Description of the Model

The attached model contains a quantitative analysis of the Sales Tax Scenario in a Microsoft Excel format. The model is constructed to allow the user to alter many of the variables to produce results for comparison of different scenarios. The model is constructed with the following primary worksheets:

- **Assumptions.** The model has been designed to allow a large variation in assumptions and has a wide set of variable entries:
  - Sales Tax revenues: can be set for Husing's projections (both Constant or Current) or to reflect a specified first year revenues and annual escalation[3]
  - Sales Tax term: can be set to a year up to 30
  - Period in which Town receives 100% of Sales Tax
  - Amount of Base Payment
  - Proportionate share for Town and District of Sales Tax revenues over Husing Constant projection (reflecting alternate terms of the Sales Tax Scenario)
  - Discount rate for NPV (can be set differently for the Town and the District)
  - Loan assumptions including possible use of RDA funds and loan of funds for road improvements related to utility improvements by District (these can be set to $0, if desired)
  - % of Sales Tax paid by non-residents – currently set at 49.7% per Husing projection
  - Loan terms: Level of initial Loan repayment by District, annual escalation and interest rate
  - # of EDU's, growth and maximum level
  - Cost of Project
  - SRF Loan terms: Loan amount, interest rate and term

- **Scenario Cash Flows**. This worksheet provides the cash flow of Sales Tax revenues, reflecting the assumptions used for the Sales Tax and demonstrates the split between the District (Base Payments), the Town (Residual) and the split between the Town and the District of Excess Revenues.
- **Town.** This worksheet provides the cash flow from the perspective of the Town and demonstrates the allocation of Sales Tax to the Town, including the road and park projects, the Residual amounts, the Town share of Excess Revenues, the District payment of the Loan and the total revenues to the Town, both from Sales Tax and the Loan repayments.
- **HDWD**. This worksheet provides the cash flows from the perspective of the District and demonstrates the allocation of the Sales Tax to the District, including the Base Payments, the District share of Excess Revenues, the repayment of the Loan. This worksheet contains the outstanding balance on the Loan by year and shows the annual amortization of that amount over the term through 2071.
- **Agency Split Analysis**. This worksheet provides a comparison between the Town and the District of: (i) the economic value received by each and (ii) the Sales Taxes received by each. At the top of the worksheet, there are direct comparison statistics of the net present value of total economic value and the Sales Tax.
- **Sewer Cost Analysis.** This worksheet contains the comparison of the Assessment District Only cost of funding the Project and the Sales Tax Scenario cost. The

[3] Note that the estimates in this memo are based on the Husing Current projection, which reflects inflation at Husing's assumed rates. The model can be set to provide results based on different levels of actual Sales Tax receipts.

Assessment is calculated on an EDU basis providing the net present value and annual cost. In addition, the net present value cost is reallocated on a per capita basis. For the Sales Tax Scenario, the worksheet calculates on an EDU basis the total net annual cost including the necessary Assessment, the portion of Sales Tax allocable to each EDU (on a pro rata basis) to provide a net present value and annual costs. As with the Assessment District Only calculation, the NPV cost is also allocated on a per capita basis. The top of the page includes summary statistics for comparison.

- **Constant and Residual.** This worksheet provides a comparison of the Husing Constant and Current projections.

Analysis

We have focused our analysis on an evaluation of the following attributes of the Sales Tax Scenario:

- Benefits
- Equity or "fairness" of split between Town and District
- Value to citizen or ratepayer of the Town and District

Benefits

Use of Sales Tax Structure. Sales taxes are paid by any person or entity in the jurisdiction, regardless of residency. One value of a sales tax based funding structure is the ability to shift costs from ratepayers and residents of Yucca Valley to non-residents. In this case, the Town and the District both receive that benefit of payment by third parties, although in different degrees. The Town receives the primary benefit of the contributions by non-residents. For the District, the portion of Sales Tax receipts provided by non-residents (set at 49.7%) included in the Base Payments are added to the Loan, providing that benefit to the Town through the Loan payments. For the District, the value of non-resident payments isolated to the District's share of Excess Revenues which are not included in the Loan obligation.

The interconnection between the Sales Tax and repayment of the Loan serves to provide a benefit to the Town by effectively extending the term over which the Town realizes revenues. While the revenues received are smaller than the overall Sales Tax receipts, the term is extended by an additional 25 years. The structure of the repayment of the Loan serves to provide the Town with a significant level of revenue and provides some buffer to ongoing inflation.

The District benefits from the Sales Tax Scenario in two ways: 1) the direct contribution of Taxes paid by residents to reduce SRF loan repayment and 2) through the Loan (of the non-resident taxes), which effectively restructures the obligation to repay the debt funding the Project over a much longer time at a very low interest rate. The original terms of the SRF Loan are estimated to be 30 years at 2.6% interest. Because the Town is providing $2,797,439 per year from the Sales Tax and only 49.7% of that amount is added to the Loan obligation, the District gains benefit. Moreover, the terms of the Loan provide for a very long repayment term, extending the final term to 2071, an additional 30 years. Added to this benefit is the very low rate of interest on the Loan, 0.50% as compared to 2.6% on the SRF Loan.

In our net present value analysis, we have selected a rate of 4.0%, which represents an estimate of the Town's cost of long term capital as a governmental agency. Moreover, this is essentially consistent with the Husing estimate of 4.312%. That discount rate was based on then current rates, while an estimate of 4.0% is more closely aligned with current rates. With the discount rate exceeding the rate of interest on the Loan, the net present cost of the Project for the District decreases due to the Loan.

Equity or "Fairness"

The concept of equity or the determination of what is "fair" is beyond the professional competence of any consultant. However, we can provide analysis on the relative financial benefits provided by the Sales Tax Scenario and make observations on whether that division appears reasonable and consistent with industry practice.

As noted above, the worksheet "Agency Split Analysis" provides a computation of the total economic value generated directly through the Sales Tax and the Loan. If the actual Sales Tax collections reflect the Husing Current projection and the discount rate is at 4.0%, the net present value of the total economic value of the Sales Tax and the Loan is split $42,759,893 (49.2%) to the Town and $44,121,804 (50.8%) to the District. A small change of the discount rate to 3.5% makes the split virtually identical at 50% each. That appears to be an even sharing of the economic benefit.

Value to Citizen or Ratepayer

The Sales Tax Scenario provides benefit to citizens or ratepayers by applying the Sales Tax revenues to decrease the Assessments being used to repay the SRF Loan. A direct comparison of the Assessments before and after application of the Sales Tax clearly demonstrates significant savings. However, a more complete evaluation of the impact on the individual citizen or ratepayer needs to include the amount of Sales Tax paid by or allocable to that party as a cost.

For the purposes of this analysis, we have adopted a simplistic method of allocating Sales Tax. We have taken the total Sales Tax projection under the model for any given year and simply allocated it to each EDU on a pro rata basis. For per capita estimates, we have divided the Sales Tax by the population. This results in a general comparison, but is not specific to any individual citizen or ratepayer.

Applying this method, we have produced the following comparison of the Net Present Value of the two alternatives, assuming that Husing Current projection:

	Per EDU Total Project Cost (NPV)	**Per Capita Total Project Cost (NPV)**
Assessment District Only	$5,748	$3,084
Sales Tax Scenario	$4,686	$2,491
Benefit from Sales Tax	$1,062 (18.5%)	$593 (19.2%)

This comparison indicates that the Sales Tax Scenario provides a general level of net present benefit on both an EDU and a per capita basis. While a significant level of the benefits stems from the extension of the repayment to the Town and the low interest rate on the Loan, there is benefit on an undiscounted basis as well. This stems from the impact of the payment of Sales Tax by nonresidents that benefits the District through the Excess Revenues.