



City of Palo Alto

(ID # 8935)

Palo Alto Public Improvement Corporation Staff Report

Report Type: Action Items

Meeting Date: 2/26/2018

Summary Title: Public Improvement Corporation Board

Title: Approval of 2016-17 Public Improvement Corporation Financial Statement

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff recommends that the Board of Directors of the Public Improvement Corporation (PIC) approve the 2016-17 financial statement for the Public Improvement Corporation.

Background

The Public Improvement Corporation (PIC) is a nonprofit corporation formed by the City in 1983, allowing the City to issue Certificates of Participation (COPs) to fund capital improvements. The PIC, through a lease structure, finances the acquisition, improvement, and construction of City facilities. The PIC uses the lease payments by the City's General Fund to pay the debt service on the COPs.

On July 13, 1998, Council adopted a resolution establishing itself as the Board of Directors of the PIC. In 1983 and 1998, the City of Palo Alto issued COPs to fund improvements to the Civic Center and the Golf Course, respectively. In 2002, the Civic Center bonds were refinanced due to a lower interest rate environment and COPs were issued to finance the construction of commercial space adjacent to the new parking structure on Bryant/Florence Street. The bylaws of the PIC require the Board of Directors of the Corporation to meet at least annually and approve the financial statement for the Corporation. Therefore, the City Council is required to meet annually as the Board of the PIC.

The Downtown Parking Improvement bonds were used to build a two story above-ground structure of approximately 7,638 square feet which was leased to a commercial tenant. This is the only remaining COP. The Golf Course COP principal amount of \$3.7 million was retired by a private placement refinancing. The City realized net present savings of \$239,000 or 6.47 percent on refunded bonds. The Civic Center bonds were issued to undertake various improvements to the City's existing Civic Center and were paid off in 2012.

Discussion

The attached financial statement shows the financial condition of the PIC. The debt service payments have been made on time and all financial requirements, such as the maintenance of a reserve, have been met. At year-end, June 30, 2017, total outstanding debt principal on the COPs equaled \$0.98 million as follows:

COP Description	Principal Outstanding (millions)	Year Debt will be Retired
2002B Downtown Parking Improvements	\$0.98	2022
Total COP	\$0.98	

Staff recommends that the Board of Directors of the Public Improvement Corporation (PIC) approve the 2016-17 financial statement for the Public Improvement Corporation.

Resource Impact

Approval of the Public Improvement Corporation's financial statements will have no resource impact.

Policy Implications

Approval of the Public Improvement Corporation's financial statements is consistent with prior Council policy direction and resolutions.

Environmental Review

This is not a project, as defined in Section 21065 of the California Environmental Quality Act (CEQA).

Attachments:

- Attachment A: Public Improvement Corporation Fiscal Year 2017 Financial Statement

Attachment A

**PALO ALTO PUBLIC IMPROVEMENT
CORPORATION**

(A Component Unit of the City of Palo Alto)

Annual Financial Report
For the Year Ended June 30, 2017



Certified
Public
Accountants

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
For the Year Ended June 30, 2017

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Certified
Public
Accountants

Independent Auditor's Report

The Honorable Mayor and
Members of the City Council of the
City of Palo Alto, California

We have audited the accompanying financial statements of the governmental activities and the major fund of Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto, California (City), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the Corporation as of June 30, 2017, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 14, 2017

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Management's Discussion & Analysis (Unaudited)
For the Year Ended June 30, 2017

The Palo Alto Public Improvement Corporation (Corporation), a component unit of the City of Palo Alto (City), follows the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (GASB 34), *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Corporation is controlled by the City and was organized to assist the City in financing public improvements. The Corporation issues debt and turns the proceeds of the debt over to the City under lease agreements that provide a revenue source for the repayment of this debt. The Corporation has one debt issue outstanding and has turned the proceeds over to the City, which pledged certain lease payments as collateral for this debt as discussed in Note 4 to the financial statements.

FISCAL YEAR 2017 FINANCIAL HIGHLIGHTS

GASB 34 requires the issuance of government-wide financial statements as well as fund financial statements. The government-wide financial statements report the balance of the Corporation's long-term debt while the individual fund statements do not.

In fiscal year 2002, the Corporation issued its 2002B Downtown Parking Improvements Certificates of Participation (COPs) in the amount of \$3.6 million.

As of June 30, 2017, the 2002B Downtown Parking Improvements COPs comprise the Corporation's outstanding debt.

At the government-wide level, interest and fiscal agent charges were \$70 thousand for fiscal year 2017, a decrease of \$10 thousand from the prior year. The interest on leases on the assets securing this COP issue was \$74 thousand, a decrease of \$10 thousand from the prior year. The interest on leases from the City exceeded interest and fiscal agent charges by \$4 thousand, thereby resulting in an increase in net position of \$4 thousand over the prior year.

The Corporation ended fiscal year 2017 with total assets of \$1.2 million, a decrease of \$0.2 million from the prior year. Total assets consist of \$251 thousand in cash and investments and \$1.0 million of leases receivable from the City of Palo Alto. Total liabilities were \$1.0 million, a decrease of \$0.2 million from the prior year, and included \$975 thousand of long-term debt.

At the fund level, the Corporation's revenues nearly equaled the expenditures. As of June 30, 2017, the Corporation had one fund, the Debt Service Fund, which reported a \$252 thousand restricted fund balance.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Management's Discussion & Analysis (Unaudited)
For the Year Ended June 30, 2017

OVERVIEW OF THE CORPORATION'S BASIC FINANCIAL STATEMENTS

The Basic Financial Statements are in two parts:

- 1) Management's discussion and analysis (this part),
- 2) The basic financial statements, which include the government-wide and the fund financial statements, along with the notes to these financial statements.

The basic financial statements comprise the government-wide financial statements and the fund financial statements. These two sets of financial statements provide two different views of the Corporation's financial activities and financial positions, both short-term and long-term.

The government-wide financial statements provide a long-term view of the Corporation's activities as a whole, and comprise the statement of net position and the statement of activities. The statement of net position provides information about the financial position of the Corporation as a whole, including all its long-term liabilities on the full accrual basis, similar to that used by corporations. The statement of activities provides information about all the Corporation's revenues and expenses on the full accrual basis, with the emphasis on measuring net revenues or expenses of the Corporation's program. The statement of activities explains in detail the change in net position for the year.

The fund financial statements report the Corporation's operations in more detail than the corporate-wide statements and focus primarily on the short-term activities of the debt service fund. Fund financial statements measure only current revenues and expenditures; current assets, liabilities and fund balances; and they exclude capital assets and long-term debt.

Together, these statements along with the notes to the financial statements are called the basic financial statements.

DEBT ADMINISTRATION

The Corporation issues debt in the form of COPs for future lease receipts from the City of Palo Alto. Legally, these COPs issues are the Corporation's debt only; the City is liable only for the payment of the amounts set forth in the lease securing each COPs issue.

As of June 30, 2017, the Corporation has one outstanding debt related to the 2002B Downtown Parking Improvement projects with an outstanding balance of \$975 thousand.

ECONOMIC OUTLOOK AND MAJOR INITIATIVES

The economy of the City and its major initiatives for the coming year are discussed in detail in the City's Comprehensive Annual Financial Report.

CONTACTING THE CORPORATION'S FINANCIAL MANAGEMENT

These Basic Financial Statements are intended to provide citizens, taxpayers, investors, and creditors with a general overview of the Corporation's finances. Questions about these financial statements should be directed to the Finance Department of the City of Palo Alto, 250 Hamilton Avenue, Palo Alto, CA 94301.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Statement of Net Position
June 30, 2017

Assets

Cash and investments held for operations	\$ 14,018
Cash and investments held by trustee	237,441
Interest receivable	66
Investment in leases to the City of Palo Alto	<u>975,000</u>
Total assets	<u>1,226,525</u>

Liabilities

Interest payable	21,125
Long-term debt:	
Due in one year	170,000
Due in more than one year	<u>805,000</u>
Total liabilities	<u>996,125</u>

Net Position

Restricted for debt service	<u><u>\$ 230,400</u></u>
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See accompanying notes to financial statements.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Statement of Activities
For the Year Ended June 30, 2017

Expenses

Interest and fiscal agent charges	\$	70,308
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Program revenues

Interest on leases from the City of Palo Alto		73,775
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Net program revenues		3,467
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General revenues

Investment earnings		559
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Change in net position		4,026
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Net position, beginning of the year		226,374
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Net position, end of the year	\$	230,400
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See accompanying notes to financial statements.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Balance Sheet
Debt Service Fund
June 30, 2017

Assets

Cash and investments held for operations	\$ 14,018
Cash and investments held by trustee	237,441
Interest receivable	66
Investment in leases to City of Palo Alto	975,000
Total assets	<u>\$ 1,226,525</u>

Deferred Inflows of Resources

Unavailable lease receipts from the City of Palo Alto	\$ 975,000
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Fund balance

Restricted for debt service	251,525
Total deferred inflows of resources and fund balance	<u>\$ 1,226,525</u>

Reconciliation of fund balance to net position

Fund balance restricted for debt service	\$ 251,525
Adjustment to remove deferred inflows of resources from the balance sheet	975,000
Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the Fund:	
Interest payable	(21,125)
Long-term debt due within one year	(170,000)
Long-term debt due in more than one year	(805,000)
Net position of governmental activities	<u>\$ 230,400</u>

See accompanying notes to financial statements.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Statement of Revenues, Expenditures and Changes in Fund Balance
Debt Service Fund
For the Year Ended June 30, 2017

Revenues:

Lease receipts from the City of Palo Alto:

Principal	\$ 160,000
Interest	73,775
Investment earnings	559
Total revenues	<u>234,334</u>

Expenditures:

Debt service:

Principal repayment	160,000
Interest and fiscal agent charges	73,775
Total expenditures	<u>233,775</u>
Net change in fund balance	559
Fund balance, beginning of the year	<u>250,966</u>
Fund balance, end of the year	<u><u>\$ 251,525</u></u>

Reconciliation of net change in fund balance to change in net position

Net change in fund balance - debt service fund	\$ 559
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Amounts reported for governmental activities in the statement of activities are different because:

Repayment of bond principal is an expenditure in the governmental funds, but in the statement of net position the repayment reduces long-term liabilities.	160,000
Some amounts reported in the statement of revenues, expenditures and changes in fund balances reflect the collection of an asset which are not includable as revenues and expenses on the statement of activities.	
Change in deferred inflows of resources	(160,000)
Change in interest payable	<u>3,467</u>
Change in net position of governmental activities	<u><u>\$ 4,026</u></u>

See accompanying notes to financial statements.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2017

NOTE 1 – DESCRIPTION OF REPORTING ENTITY

The Palo Alto Public Improvement Corporation (the Corporation) was incorporated in September 1983 under the General Nonprofit Corporation Law of the State of California to acquire, construct and lease capital improvement projects. The Corporation is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. The Corporation provides financing of public capital improvements for the City through the issuance of Certificates of Participation (COPs), a form of debt which allows investors to participate in a stream of future lease payments. Proceeds from the COPs are used to construct projects which are leased to the City for lease payments which are sufficient in timing and amount to meet the debt service requirements of the COPs.

The Corporation is an integral part of the City of Palo Alto (City). It primarily services the City and its governing body is composed of the City Council. Therefore, the financial data of the Corporation has also been included as a blended component unit within the City's comprehensive annual financial report for the year ended June 30, 2017.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

Government-wide Statements: The statement of net position and the statement of activities include the financial activities of the Corporation. Eliminations have been made to minimize the double counting of internal activities.

The statement of activities presents a comparison between direct expenses and program revenues for each function of the Corporation's activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including investment earnings, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the Corporation's funds. The emphasis of fund financial statements is on major individual funds, of which the Corporation only reports one debt service fund.

(b) Major Fund

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures equal to ten percent of their fund-type total and five percent of the grand total. The Corporation has one fund which is reported as a major governmental fund in the accompanying financial statements:

Debt Service Fund – This fund accounts for debt service payments on the Corporation's long-term debt.

(c) Investment in Leases

Improvements financed by the Corporation are leased to the City for their entire estimated useful life and will become the City property at the conclusion of the lease during the year ended June 30, 2022. The Corporation therefore records the present value of the lease and considers the leased improvement to have been sold for this amount when leased.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2017

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Net Position

The government-wide financial statements utilize a net position presentation. Net position is further categorized as net investment in capital assets, restricted and/or unrestricted. As of June 30, 2017, the entire net position was considered restricted.

Restricted Net Position – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

(e) Deferred Inflows of Resources

A deferred inflow of resources is defined as an acquisition of net position or fund balances applicable to a future reporting period and will not be recognized as an inflow of resources (revenue) until that time. On the governmental fund balance sheet, the lease receipts from the City corresponding to the debt are recorded as deferred inflows of resources since the balances are not current financial resources. The City considers revenues susceptible to accrual to be available if the revenues are collected within ninety days after year-end, except for property taxes, which are available if collected within sixty days after year-end.

(f) Fund Balances

At June 30, 2017, the Corporation's governmental fund's fund balances include the following classification:

Restricted Fund Balance – includes amounts that can be spent only for the specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted only with the consent of resource providers.

(g) Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE

Under the provisions of the Corporation's COPs issues, a trustee holds and invests the Corporation's cash held for purposes of bond reserves.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2017

NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE (Continued)

(a) Interest Rate Risk

Interest rate risk is the risk that a change in market interest rates will adversely affect the fair value of an investment. Normally, the longer it takes an investment to reach maturity, the greater will be that investment's sensitivity to changes in market rates. Information about the sensitivity of the fair values of the Corporation's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Corporation's investments by maturity:

<u>Investment Type</u>	<u>Amount</u>	<u>Maturity Date</u>
Money Market Mutual Fund	\$ 237,441	34 days

(b) Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As of June 30, 2017, the Fund's investments in money market mutual funds are rated AAAM by Standard & Poor's.

(c) Fair Value Hierarchy

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. The Corporation's investments in money market mutual funds are not subject to the fair value hierarchy.

(d) Investment Policy

The Corporation must maintain required amounts of cash and investments with trustees under the terms of certain debt issues. These funds are unexpended bond proceeds or are pledged as reserves to be used if the Corporation fails to meet its obligation under these debt issues. The California Government Code (Code) requires these funds to be invested in accordance with bond indentures or State statutes. All these funds have been invested as permitted under the Code. The Investment Policy is described in detail in the City's Comprehensive Annual Financial Report.

The table below identifies the investment types that are authorized by the City's Investment Policy. The table also identifies certain provisions of the City's Investment Policy that address interest rate risk, credit risk and concentration of credit risk.

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2017

NOTE 3 – CASH AND INVESTMENTS HELD BY TRUSTEE (continued)

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Government Securities	10 years (*)	N/A	No Limit	No Limit
U.S. Government Agency Securities	10 years (*)	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years (*)	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days	N/A	30%	\$5 million
Commercial Paper	270 days	P-1/A-1+	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$50 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Deposit Accounts	N/A	N/A	No Limit	No Limit
Mutual Funds	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years (*)	N/A	10%	\$5 million
Medium-Term Corporate Notes	5 years	AA	10%	\$5 million
Bonds of State of California Municipal Agencies	10 years (*)	AA/AA2	20%	No Limit

(A) Callable and multi-step securities are limited to no more than 25% of the par value of the portfolio, provided that: 1) the potential call dates are known at the time of purchase, 2) the interest rates at which they "step-up" are known at the time of purchase, 3) the entire face value of the security is redeemed at the call date.

(B) The lesser of \$3 million or 10% of outstanding commercial paper of any one institution.

(*) The maximum maturity is based on the Investment Policy that is approved by the City Council and is less restrictive than the California Governmental Code.

NOTE 4 – CERTIFICATES OF PARTICIPATION

The Corporation's changes in long-term debt are presented below:

	Balance June 30, 2016	Retirements	Balance June 30, 2017	Amount due in one year
Certificates of Participation				
2002B Downtown Parking				
6.50%; due 03/01/2022	\$ 1,135,000	\$ 160,000	\$ 975,000	\$ 170,000

PALO ALTO PUBLIC IMPROVEMENT CORPORATION
(A Component Unit of the City of Palo Alto)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2017

NOTE 4 – CERTIFICATES OF PARTICIPATION (Continued)

On January 16, 2002, the Corporation issued the 2002B Downtown Parking Improvements Certificates of Participation (2002B COPs) in the amount of \$3.6 million to finance the construction of certain improvements to the non-parking area contained in the City's Bryant/Florence Garage complex. Principal payments are due annually on March 1 and interest payments are due semi-annually on March 1 and September 1 and are payable from lease revenues received from the City. In fiscal year 2005, a partial redemption was completed by placing excess construction and debt service reserve funds into an escrow account to defease \$900 thousand of the 2002B Downtown Parking Improvements COPs.

The 2002B COPs are secured by lease revenues received by the Corporation from any City of Palo Alto General Fund revenue source.

Future annual debt service on the 2002B COPs is shown below:

For the Year Ending June 30,	Principal	Interest Payment	Total Payment
2018	\$ 170,000	\$ 63,376	\$ 233,376
2019	185,000	52,326	237,326
2020	195,000	40,300	235,300
2021	205,000	27,626	232,626
2022	220,000	14,300	234,300
	<u>\$ 975,000</u>	<u>\$ 197,928</u>	<u>\$ 1,172,928</u>