Overture 2005 Refinancing Fiscal Note

This resolution authorizes the City to enter into loan agreements and modify the current Operation and Cooperation Agreement with the Madison Cultural Arts District (MCAD) to assist in refinancing debt related to the Overture Center. The purpose of the proposed financing plan is to keep in place the possibility of a long-term revenue stream generated by the investment of the W. Jerome Frautschi gift, to be used for the benefit of Overture Center operations. To accomplish this, the City would provide a credit backstop, pledging to pay a portion of the annual debt service in the event that investment earnings and other available Overture Center resources are insufficient to make the required debt payments during the next 7 years.

Current Structure

Under the current financing plan adopted in 2001, the Frautschi gift for the Overture Center was invested to help support future operation of the facility. Overture Development Corporation (ODC), the entity responsible for construction of the facility, borrowed $115,000,000 through a bond issued by the Madison Community Development Authority (CDA). The proceeds of that borrowing have been used toward the construction of the facility.

Payment of principal and interest on the borrowing is secured with a letter of credit issued by a consortium of local banks that is, in turn, backed by the original Frautschi gift and additional temporarily pledged assets (the Pledged Assets) with a total current value of approximately $140,000,000. The gift assets remain invested by the Madison Cultural Arts Support Trust (MCAST).

Reason to Refinance

As Phase II of the Overture Center construction project continues, the temporarily pledged assets will be needed to complete construction. Because the terms of the bank letters of credit require collateral with a greater investment value than the amount of the outstanding debt, the remaining Pledged Assets will eventually be insufficient to support the current letter of credit amount. At that point, the existing financing structure will no longer be viable. If a refinancing structure is not put in place by the end of June 2005, the Pledged Assets would be sold to pay off the outstanding debt and Overture Center construction would be fully completed by ODC as scheduled by early 2006. Under this scenario, the potential for a revenue stream to support Overture Center operations by the continued investment of the remaining Frautschi gift would be lost. The proposed refinancing plan preserves that possibility.

Proposed Refinancing

The proposed refinancing plan would essentially divide the debt into two separate pieces. Of the existing $115,000,000 CDA Bond (Series ‘A’), $27,700,000 would be paid off and replaced with a new loan of the same amount (Series ‘B’).

The underlying conditions of the Series 'A' bonds would essentially remain in place, including the present letter of credit structure. MCAST would continue to hold a portion of the Frautschi gift, presently valued at approximately $101,000,000, which would continue to be invested as a support trust for the Madison Community Foundation to benefit the Overture Center. At that value, this asset would be sufficient to provide collateral support for the remaining $87,300,000 of the original bond issue.

The City would provide the additional collateral support needed for the new Series 'B,' by offering its "moral obligation" promise to include in the City's annual budget an appropriation of up to $2,500,000 for principal and interest payments if the debt service on Series 'B' cannot be paid from the earnings of the MCAST investment or other defined sources. This new Series 'B' would be in the form of a bank loan to ODC, underwritten by a consortium of 2 or 3 local banks. JPMorgan Chase Bank (formerly Bank One) and US Bank have partnered to co-lead this transaction (as well as the letter of credit for the Series 'A' bond). The loan would be for a term of 7 years, with principal repayment amortized over a period of 25 years and a fixed interest rate estimated to be up to 8%. Under the terms of the loan, the bank group would make available an additional line of credit of up to $2,500,000 called a "Debt Service Reserve Line of Credit" to ensure that sufficient funding is available to make scheduled debt payments in a timely manner.

The City's commitment would be to replenish this line of credit in the event that it is ever drawn upon, but only after funds from other sources, as described below, are applied. The loan terms provide for a "cure period" that would allow the City sufficient time to budget for any required payment in the course of the normal annual budget process. This provision would also help the City manage its expenditure responsibly within the limits of the State Expenditure Restraint Program or other similar budgetary limitations that may arise in the future.

Presently, the City holds a property interest in the Overture Center that allows the City to take ownership of the facility for $1.00 if it ceases to be operated as a public performing arts center. As an additional form of security for this loan, the banks will require that the City subordinate this reversionary interest, so that in the event of a default, the banks would have first claim on the property.

The City's promise to replenish the Debt Service Reserve Line of Credit is not a general obligation debt. Rather, it is a contingent liability that, while noted in the City's audited financial statements, would not impact the City's legal debt limit or capacity to borrow.

"Firewalls"

The proposed Overture refinancing has been structured to limit the likelihood that the City would be called upon to replenish the Debt Service Reserve Line of Credit. A number of other potential resources must be drawn upon first, if MCAST investments are insufficient to cover all planned debt payments and operating grants to MCAD and the Overture Center. These protective layers or "firewalls" include (see separate graphic):

- MCAST would be required to direct any available resources to make debt payments before providing annual operating grants.

- MCAD would be required to set aside all but the first $250,000 of operating grants received from MCAST until a funded reserve of $2,500,000 has been accumulated. This reserve will remain in place and available for payment of Series 'B' debt if future MCAST earnings are insufficient to do so.

- The Madison Community Foundation would be asked to permit distribution of portions of the existing Civic Center Endowment Fund if needed for debt service. Currently, approximately $1,400,000 would be available for this purpose, at the discretion of MCF.

- MCF would be asked to reduce annual holding and administrative fees it retains as a result of its role in investment of the MCAST funds. The value of any potential fee reduction has not been determined.

- The $2,500,000 Debt Service Reserve Line of Credit made available by the bank under the terms of the Series 'B' loan agreement would be drawn upon, allowing the City to delay any required payment until it can appropriate the necessary funds in its next annual budget cycle.

Revisions to Operating Agreement

As a condition of the refinancing, certain provisions of the existing Operation and Cooperation Agreement between the City and MCAD would be modified as defined in the resolution. These changes generally ensure that all available MCAD resources would be committed to repay the City for any required Debt Service Reserve Line of Credit replenishment it has made.

Financial Risks

Under the financial structure that is in place today, the City has no responsibility for the repayment of debt related to Overture Center construction. Overture Development Corporation, the developer of the facility, is solely obligated to pay debt service and the existing bonds do not constitute an indebtedness of the City or the CDA. This would continue to be true for the $87,300,000 of existing debt that would remain in place as Series 'A' after refinancing.

As a result of refinancing, the City would assume the maximum risk of making an annual debt service payment on the $27,700,000 Series 'B' bank loan of up to $2,500,000 per year for the 7-year term of the loan. This obligation would arise only if the earnings from the MCAST investment are insufficient to make these payments and only if the other identified sources have been exhausted. The City's pledge would be a "moral obligation" and subject to appropriation. Thus, a future Common Council could avoid payment by failing to budget the necessary funds. Such an action, however, would be viewed by the bond market as a default similar to a default on a general obligation debt. Not only would the City lose its exceptional bond rating, it would lose the ability to borrow altogether.

As with the original Overture financing, the future success of the proposed refinancing structure will be dependent on the return generated by the invested Frautschi gift. That asset will be invested in a mix of stocks, bonds and other investment vehicles selected to achieve a high enough return to pay all fees, debt service for both Series 'A' and Series 'B', and an annual operating contribution to MCAD. Investment decisions will be made by MCAST, which will determine the availability of annual distributions, subject to terms specified in the bond and loan agreements.

Today, the fair market value of the assets that will be invested to support this structure is approximately $101,000,000. Under the terms of the refinancing as negotiated with the bank group:

- If the fair market value of this portfolio grows to more than $105,000,000, then MCAST will be allowed to make distributions to cover debt service on Series 'A' bonds, the Series 'B' loan and, in addition, operating grants to MCAD of up to $1,400,000 per year.

- If the fair market value grows to between $100,000,000 and $105,000,000, MCAST will be allowed to make distributions to cover debt service on both Series 'A' bonds and the Series 'B' loan.

- If the fair market value of the investment falls below the current value of $100,000,000 but not below $97,000,000, funds from the account may only be released to make debt payments on Series 'A'. If this condition occurs, the bank group would next look to the identified "firewalls" and the City to pay Series 'B' debt service.

- A reduction in the fair market value to less than $97,000,000 would be deemed to be a default under the Series 'A' bond, requiring that all investments be converted to short-term US Government securities until such time that alternative arrangements can be made.

For the first several months following closing of the refinancing transaction, interest on both Series 'A' and Series 'B' debt would be paid from approximately $2,700,000 of capitalized interest reserves remaining from the original bond sale. This continued draw on capitalized interest would delay implementation of the value tests outlined above.

It is difficult to predict the likelihood that the City would be called upon to make a payment under the proposed structure. The most recent financial model of the proposed structure prepared for ODC indicates that an annual investment return of approximately 8.3% would be needed to pay all planned costs and a $1,400,000 annual operating contribution to MCAD. A return of about 7% would be sufficient to cover required fees and debt service only. If investment returns remain positive but fall below that level for an extended period of time, the long-term viability of this financing arrangement would be jeopardized, and the City could be called upon to make an annual appropriation to replenish the Debt Service Reserve Line of Credit after any accumulated "firewall" protections have been exhausted.

Another circumstance where the City could be called upon to make payments, however, would occur if the value of the investment portfolio would fall abruptly. At some point it would be determined by the participating lending institutions that the value of the investment portfolio has fallen below the level required to "collateralize" the Series 'A' bonds. Based on the current investment portfolio, any drop below the current value of $101,000,000 would cause this condition. The financing structure could then begin to unwind and the City could be called upon to continue making annual appropriations of up to $2,500,000 during the remaining term of the bank loan.

Conclusion

The proposed refinancing structure has been designed to minimize the City's financial risk while providing needed credit support to maintain the long-term investment of a substantial portion of the Frautschi gift. The City's risk is limited to an annual payment of up to $2,500,000 for 7 years. Those payments would only be made if a series of other potential resources were first depleted, and the "cure period" built into the structure would allow the City to plan for any required expenditure as part of the normal budget process. There is little margin, however, between the current $101,000,000 value of the investment portfolio and the minimum needed to support the proposed financing.

While the $87,300,000 Series 'A' bond is structured to remain in place for an additional 30 years, the City's contingent liability would only remain in place for the 7-year life of the $27,700,000 Series 'B' loan. All parties will be able to re-evaluate and modify the financing structure at that time. The risk inherent in this proposal should be weighed against the possibility of a significant future revenue stream to support Overture Center operations.