



Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson
William F. Sherry, A.A.E.

SUBJECT: AIRPORT COMMERCIAL PAPER PROGRAM EXPANSION

DATE: December 4, 2006

Approved

Date

12-10-06

COUNCIL DISTRICT: Citywide

RECOMMENDATION

1. Hold a Tax Equity and Fiscal Responsibility Act hearing for the issuance of Series B (Alternative Minimum Tax (AMT) commercial paper notes under the commercial paper program established for the Norman Y. Mineta San José International Airport with a limit of \$450 million in order to fund projects and capitalized interest associated with the implementation of the Airport Master Plan.
2. Adoption of a resolution of the City Council amending Resolution 69200, as amended, to authorize an increase of \$250 million, for a total authorization of \$450 million, in the aggregate maximum amount of Series A, Series B, and Series C commercial paper notes that can be issued under the commercial paper program established for the Norman Y. Mineta San José International Airport to fund projects and capitalized interest associated with the Airport Master Plan.
3. Adoption of a resolution of the City Council authorizing the Director of Finance to negotiate and execute the Amended and Restated Letter of Credit and Reimbursement Agreement among the City of San José and JPMorgan Chase Bank National Association, Bank of America, N.A., Citibank, N.A., and Dexia Credit Local (collectively, the "Banks") relating to the Norman Y. Mineta San José Airport International Subordinated Commercial Paper Program, increasing the Maximum Stated Amount from \$200 million to \$450 million, to negotiate and execute the agreement amending the Issuing and Paying Agent Agreement between the City of San José and Deutsche Bank (as successor to U.S. Bank) relating to the Norman Y. Mineta San José International Airport Subordinated Commercial Paper Program, to make conforming changes necessitated by the Amended and Restated Letter of Credit and Reimbursement Agreement and to make other technical changes.

CEQA: Resolutions No. 67380 and 71451, PP 06-193

OUTCOME

This recommendation will expand the capacity of the existing San José Airport Commercial Paper Program (the “Airport CP Program”) from \$200 million to \$450 million to ensure that funding is available for the design and construction contracts related to the rephased Airport Master Plan projects. Various Airport Master Plan projects over the next several years are focused on completion of the North Concourse Projects as well as the implementation of a Terminal Area Improvement Program (the “TAIP”). Additionally, the Airport CP Program may be used to pay costs related to the Airport’s lease of the former FMC property and to pay debt service costs related to the City of San José Airport Revenue Bonds, Series 2004.

EXECUTIVE SUMMARY

This staff report recommends the expansion of the Airport CP Program to provide encumbrance capacity and an interim funding source for Airport Master Plan projects. The Tax Equity and Fiscal Responsibility Act (“TEFRA”) hearing must be conducted to notify the community of the City’s intent to issue qualified tax-exempt private activity notes (Series B notes).

BACKGROUND

On November 2, 1999, the City Council adopted Resolution No. 69200 approving the implementation of a commercial paper program for the Norman Y. Mineta San José International Airport (the “Airport”), which authorized the issuance of up to \$100 million through a combination of three series of commercial paper notes: Series A (non-AMT), Series B (AMT), and Series C (taxable). The Airport CP Program was established to provide interim financing for Airport capital needs in anticipation of issuance of Airport revenue bonds that would replace the short-term notes with permanent long-term financing. Airport commercial paper notes are debt obligations backed by Net General Airport Revenues and are subordinate to Airport senior lien debt, also backed by these revenues. Net General Airport Revenues are the Airport’s gross revenues less maintenance and operation expenses and are first pledged to repay Airport revenue bonds and then Airport commercial paper notes.

Since 1999, the commercial paper notes have been used to initially fund the Airport’s runway projects, consolidated rental car garage project design efforts, costs associated with the 2002 Refunding Bonds, the initial costs associated with the implementation of the requirements under the federal Aviation and Transportation Security Act (ATSA), and the Claims Loss Reserve for the Airport’s Owner Controlled Insurance Program (OCIP) for the North Concourse project.

In June 2004, the City issued \$250 million of Airport Revenue Bonds (the “2004 Airport Bonds”) to fund security-related projects mandated by the Transportation Security Administration, including the North Concourse and related projects (collectively, the “North Concourse Projects”). Proceeds of the 2004 Airport Bonds have redeemed commercial paper notes issued to pay initial costs of North Concourse Projects, paid for capital expenses for the

North Concourse Projects incurred since they were issued, and have provided the source of funding for encumbering related contracts for these projects.

On June 20, 2006, the City Council approved an expansion of the Airport commercial paper program from \$100 million to \$200 million to ensure that funding would be available for the award of the design and construction contracts related to the amended Airport Master Plan projects and to pay costs related to the Airport's lease of the former FMC property. It is expected that encumbrances will reach or exceed the combined remaining capacity of the 2004 Airport Bonds and the Airport CP Program during February 2007.

ANALYSIS

This section of the report addresses staff's recommendation to proceed with the expansion of the Airport CP Program. These subsections include discussions of the Airport capital program and plan of finance, TEFRA hearing requirements and the financing documents.

Airport Capital Program and Financing Plan

The Master Plan for the Airport, originally adopted in 1997, was last amended by the City Council on June 13, 2006, to address changes in passenger demand volume since September 11, 2001, and to rephrase the development program as a means of maintaining reasonable airline rates and charges. The Airport's capital program over the next several years is focused on completion of the North Concourse Projects as well as the implementation of the TAIP. These projects combined are considered to be Phase I of the Airport's development program and total approximately \$1.1 billion, of which approximately \$845 million is anticipated to be debt financed. It is staff's intent to return in mid-2007 for approval of long-term bond financing that will repay outstanding commercial paper and finance the balance of the Airport's development program.

North Concourse Projects

The North Concourse Projects include construction of the North Concourse component of the new Terminal B, relocation of Gate A1-C, cargo ramp security and taxiway improvements, expansion of the Airport central plant, improvements to the Airport's utility infrastructure and electrical distribution system, and a variety of other projects necessary to accomplish the Airport Master Plan.

The North Concourse Projects are anticipated to be completed in summer 2008 at an estimated cost of approximately \$330 million, of which approximately \$305 million will ultimately be bond financed. The 2004 Airport Bonds provided funding for approximately \$190 million of the North Concourse Projects, with the remaining \$115 million of costs to be funded on an interim basis through the Airport CP Program. Permanent financing for the remaining costs of the North Concourse Projects will come from the issuance of Airport Revenue Bonds, currently anticipated to be issued in mid-2007.

Terminal Area Improvement Program (TAIP)

The TAIP consists of a number of projects in the terminal area, many of which are included in the design-build contract awarded to Hensel Phelps Construction on October 17, 2006. Major elements of the TAIP include modifications to Terminal A, design and Phase I construction of Terminal B, demolition of the existing Terminal C and construction of a temporary Terminal C, a new public parking garage and a new rental car garage, new roads and bridges, a Terminal A inline baggage system and building, and furniture, fixtures, equipment and signage for the North Concourse building.

The TAIP projects being completed by the design-build contract are anticipated to be completed by summer 2010 at a total cost of \$663 million, of which the majority will ultimately be bond financed. Staff estimates that \$330 million of commercial paper capacity will be needed to meet encumbrance and expenditure needs of the design-build contract as well as other TAIP projects through mid-2007 when Airport Revenue Bonds will be issued to redeem the outstanding commercial paper notes and finance the remaining costs of the first phase of the TAIP.

Capitalized Interest for 2004 Airport Bonds

Staff is also recommending that Council authorize the use of the Airport CP Program to pay debt service costs related to the 2004 Airport Bonds. The 2004 Airport Bonds were issued in June 2004 to fund a portion of the 2004 Security Projects, now referred to as the North Concourse Projects. It was the City's intent at that time to issue additional bonds or subordinate obligations in approximately 2006 to finance the remaining balance of the North Concourse Projects. As costs of facilities which are not available to the airlines can not be included in the Airport's rate structure without the airlines' agreement, interest on the 2004 Airport Bonds was capitalized for a three-year period through June 2007.

The rephased Airport Master Plan, approved by the City Council on June 13, 2006, extends the construction period of the North Concourse Projects to summer 2008. As a result, the capitalized interest funded as part of the 2004 Airport Bonds issuance will not be sufficient to pay debt service through project completion and the subsequent commencement of receipt of airline rents for utilization of the gates. The 2007 Airport revenue bond issuance, described above, would include funding for 2004 Airport Bonds debt service through the anticipated commencement of receipt of airline rents. However, a rapid increase in variable interest rates or a delay in the 2007 bond issuance would necessitate use of the Airport CP Program to pay interest on the 2004 Airport Bonds until Airport revenue bonds could be issued. Accordingly, staff is recommending that Council authorize use of the Airport CP Program, as needed, to pay debt service costs related to the 2004 Airport Bonds. IRS regulations place limitations on the expenditure of tax-exempt debt (whether commercial paper or bonds) for the payment of debt service. As a result, the City will need to issue taxable debt to fund the 2004 Airport Bonds debt service.

Financing Plan

Commercial paper is an efficient mechanism for providing interim financing for capital projects, particularly when large amounts must be encumbered well in advance of actual expenditures. Staff recommends an increase in the aggregate size of the Airport CP Program from \$200 million to \$450 million to provide encumbrance capacity and an interim funding source for the North Concourse Projects and the TAIP, pay costs related to the Airport's lease of the former FMC property, and fund capitalized interest for the 2004 Airport Bonds. A combination of the three series of commercial paper notes may be issued to support the Airport Master Plan's funding needs and the series of commercial paper notes to be issued will depend on the nature of the expense. As has been the City's prior practice, it is anticipated that commercial paper notes will be issued only as funds are needed to pay program costs.

As noted above, staff anticipates an Airport revenue bond issuance in mid-2007 to redeem outstanding commercial paper and to fund design and construction costs of the Airport Master Plan. IRS regulations restrict issuance of tax-exempt bonds to amounts which the City reasonably expects to be spent (not encumbered) within a three-year period. Accordingly, with an expected project completion date of mid-2010, the City anticipates issuing its next series of Airport revenue bonds in mid-2007.

TEFRA Hearing Requirements

The federal tax law, known as the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") requires that projects funded with qualified tax-exempt private activity bond proceeds (the Series B proceeds) be approved by the City Council after a noticed public hearing, called a "TEFRA hearing." These hearings provide interested individuals or parties the opportunity to comment on any matters related to such potential bond issues, including the nature and location of the project.

Financing Documents

City Council approval of the amendments to Resolution 69200, as previously amended, the Letter of Credit and Reimbursement Agreement, and the Issuing and Paying Agent Agreement is necessary to increase the aggregate principal amount to be issued. All of the documents described below, in substantially final form, will be available for review in the City Clerk's Office on or about January 3, 2007. Staff recommends that the Director of Finance or the Director's authorized designees ("Authorized Officers") each be authorized to execute the agreements described below to which the City is a party. As modifications may be required prior to the closing, staff also recommends that the Authorized Officers each be authorized to execute the final version of these agreements as may be modified upon consultation with the City Attorney's Office.

Amended and Restated Letter of Credit and Reimbursement Agreement – The Letter of Credit and Reimbursement Agreement is an agreement by and among the City and the Banks, and JPMorgan Chase Bank as agent for the Banks. The Banks agree to advance funds to the Issuing and Paying Agent sufficient to pay the interest and maturing amount of commercial paper notes as due, on a several and not a joint basis. This means that each Bank

is responsible only for its proportional share of the total CP program. In the event that the commercial paper dealer is unable to issue additional commercial paper notes to repay the advance from the Banks, the City must pay interest to the Banks based on a formula specified in the Reimbursement Agreement, which formula does not establish a maximum interest rate.

The Amended and Restated Letter of Credit and Reimbursement Agreement will increase the amount of commercial paper notes that can be issued under the Letter of Credit from \$200 million to \$450 million. The Reimbursement Agreement will also be amended to eliminate the current issuance cap on the taxable series of commercial paper notes, providing more flexibility for the City.

The annual fee payable for the Letter of Credit will remain at its current level of 0.30% for the utilized portion of the commitment and 0.125% for the unutilized portion of the commitment. The current Letter of Credit expiration date is November 2, 2010, and the current 364-day commitment expires on October 16, 2007. As approved by Council on October 12, 2004, the Director of Finance is authorized to negotiate and execute future extensions to the Letter of Credit and Reimbursement Agreement with respect to the expiration dates and fees.

First Amendment to Issuing and Paying Agent Agreement – The Issuing and Paying Agent Agreement is between the City of San José and Deutsche Bank as the Issuing and Paying Agent. This agreement sets forth the procedures for issuing commercial paper notes, payment of the matured commercial paper notes and the application of the funds received from the sale of commercial paper notes.

The amendments to the Issuing and Paying Agent Agreement will make conforming changes necessitated by the changes to the Amended and Restated Letter of Credit and Reimbursement Agreement and technical changes such as updating the defined terms to recognize the Master Trust Agreement as the governing document with respect to the issuance of debt backed by Airport revenues. As of the date of this memorandum, it is anticipated that the amendment will be in the form of a First Amendment to the Issuing and Paying Agent Agreement. If instead the amendments are in the form of an amended and restated agreement, City staff will update this discussion in a supplemental memorandum.

The following financing document does not require amendment. Instead, the parties will execute certificates at the closing acknowledging the revisions made to the Airport CP Program:

Commercial Paper Dealer Agreement – The Commercial Paper Dealer Agreement is between the City of San José and Morgan Stanley as Dealer for the commercial paper notes, and describes the procedures and compensation for serving as commercial paper Dealer.

ALTERNATIVES

Not applicable.

PUBLIC OUTREACH

The TEFRA hearing to be held as part of the action herein is a method of notifying the community of the City's intent to issue qualified tax-exempt private activity bonds (Series B notes). The public hearing notice will be published on or about December 21, 2006, in the San José Mercury News, announcing the time and location of the public hearing.

- Criteria 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

The Chair of the Airport Airline Affairs Committee ("AAAC") conveyed conceptual approval for the rephased Airport Master Plan in November 2005. Additionally, the Airlines were consulted on the Airport's Proposed 2007-2011 Capital Improvement Program ("CIP") on May 10, 2006 at the AAAC meeting and no significant issues were raised. The Airport continues to collaborate with the Airlines on the implementation of the program.

The re-phasing of the Airport Master Plan was developed with extensive Airline participation. The revisions were also presented to the San José Convention and Visitors Bureau on October 28, 2005, to the Silicon Valley Leadership Group and the San José Silicon Valley Chamber of Commerce on October 30, November 7 and November 8, 2005, to the AAAC on November 9, 2005, and to the Airport Commission on November 14, 2005. All of these stakeholder groups indicated support for proceeding with the proposed changes.

COORDINATION

This report has been prepared by the Airport and Finance Departments, in coordination with the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

Expansion of capacity in the Airport CP Program is consistent with the Council approved Guiding Principles for Budget and Financial Management, Mayor's 2006-07 Revised June Budget Message, in that it supports economic recovery and job creation.

The North Concourse Projects and the TAIP are consistent with several initiatives identified in the Economic Development Strategy adopted by Council in November 2003, and aligns most significantly with:

- Strategic Initiative #1: Build a World-Class Airport and Air Services, and
- Strategic Initiative #5: Support the Growth (and Start-up) of Local Businesses – Small and Large (5.12 – increase access to City contracting and purchasing opportunities through improvements to communication and the procurement process).

COST IMPLICATIONS

Compensation for the City’s consultants (bond counsel, bank counsel and dealer) and the costs of the financing will be paid from Airport operating funds or commercial paper note proceeds.

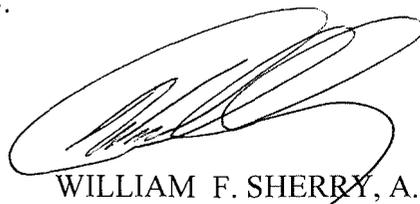
BUDGET REFERENCE

Not applicable.

CEQA

Resolutions No. 67380 and 71451, PP 06-193.


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For questions, please contact Scott Johnson, Director of Finance, at 535-7000, or William Sherry, Director of Aviation, 501-7669.