SJFA/COUNCIL AGENDA: 04-25-06
ITEM: 2

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL AND CITY OF SAN JOSE FINANCING AUTHORITY BOARD

FROM: Julia H. Cooper

SUBJECT: **FINANCING PLAN TO RESTRUCTURE AND REFUND PORTIONS OF THE 2002 CIVIC CENTER BONDS**

DATE: April 13, 2006

Approved Kay Winer Date 4/14/06

RECOMMENDATION

Direct staff to proceed with steps to refund the City of San José Financing Authority Lease Revenue Bonds, Series 2002D, and reaffirm the Authority's intent to allow the Series 2002C Bonds to convert to a weekly interest rate mode and remarket as such on June 1, 2006.

OUTCOME

Approval of the financing plan contained in this memo gives staff direction to proceed with preparation of financing documents that will be presented to the City Council and the Authority Board for approval on May 16, 2006.

BACKGROUND

On November 14, 2002, the City of San José Financing Authority issued $292,425,000 of Series 2002B Lease Revenue Bonds; $60,000,000 of Series 2002C Lease Revenue Bonds; and $60,000,000 of Series 2002D Lease Revenue Bonds to fund the construction of the New City Hall. The Series 2002C and Series 2002D Bonds were issued in an initial fixed rate mode through May 31, 2006, and are subject to a mandatory tender on June 1, 2006. Unless the City takes further action, the Series 2002C and Series 2002D Bonds will convert to a weekly interest rate mode on June 1, 2006.

ANALYSIS

Subsequent to the mandatory tender date for the Series 2002C Bonds and Series 2002D Bonds, June 1, 2006, the Authority can refund the 2002D Bonds with fixed rate debt, creating capacity in the Authority's debt portfolio to issue variable rate debt for future projects, such as the permanent financing of the 4th & St. John Garage, aka Civic Center Garage, that may be particularly well suited for this type of financing. A more detailed discussion of this opportunity, as well as activities related to the conversion of the Series 2002C Bonds to weekly variable rate mode, is presented below.

The financing plan outlined in this memorandum requires various notifications to bondholders of the Series 2002 Bonds, the trustee of the 2002 Bonds and potential bond purchasers in advance of the bond sale. Staff must obtain approval of the financing plan from City Council and the Authority Board prior to sending out these notices.

Refunding of Series 2002D Bonds with Fixed Rate Bonds

In November 2002, the City issued the Series 2002C and Series 2002D bonds as variable rate bonds to maximize the City's flexibility to refund or restructure the Civic Center bonds and to provide the lowest overall borrowing cost. The total amount of variable rate bonds issued in 2002 was set at $120 million to limit the variable rate exposure of the City's General Fund to levels deemed consistent with the City's credit ratings on its General Fund indebtedness.

The City currently has approximately 31% of its General Fund supported debt in variable rate mode. This percentage is at the upper end of levels generally considered prudent by rating agencies and, as a result, does not leave capacity to issue additional variable rate debt. However, staff believes such capacity will be needed for the permanent financing plan of the 4th & St. John Garage. The financing plan for the 4th & St. John Garage will be executed following completion of its construction scheduled for fall of 2006. The 4th & St. John Garage is a particularly good candidate for variable rate financing because, if in the future the garage were to produce parking revenues, the City could use those revenues for early redemption of the variable rate bonds.

Long-term fixed interest rates available to the City in the current market are near historic lows. At the same time, interest rates in the short-term market have risen sharply over the past two years due to actions by the Federal Reserve Board designed to control inflationary pressures on the economy. The current weekly variable rate is approximately 3.4% and the current long-term fixed rate obtainable on the municipal bonds is approximately 4.6%. This 1.20% spread between fixed and variable rates is historically low and indicates a good time for the City to consider converting portions of its variable rate debt to fixed rate to the extent it meets overall debt management objectives.

In the proposed plan of finance, the Series 2002D Bonds will be replaced with fixed rate bonds through a competitive sale of refunding bonds (the "Series 2006 Bonds"). Refunding variable rate debt with fixed rate debt often results in increased debt service payment, but in this case the potential costs are mitigated by other debt management objectives. As stated in the City's adopted Debt Management Policy, refundings may be undertaken to achieve various City objectives, which in the case of this plan of finance include changing the overall debt service profile of the City, i.e. providing an increase in future variable rate capacity and increasing operational efficiency.

Consistent with guidance in the Mayor's Amended March Budget Message for Fiscal Year 2006-2007, a portion of the City Hall Construction Surplus may be used to redeem 2002D Bonds, effectively reducing the principal amount of Series 2006 Bonds issued, thereby decreasing debt service costs on the Bonds.

Conversion of Series 2002C Bonds to Weekly Variable Rates

Staff recommends that the Series 2002C Bonds convert to weekly variable rate mode on the mandatory tender date of June 1, 2006, as approved by Council on October 15, 2002. Variable rate bonds in the weekly interest rate mode are expected to provide the lowest cost of borrowing over time.

Bond Insurance

Ambac Assurance Corporation ("Ambac") insures the Authority's Series 2002 Bonds. Staff seeks authorization to obtain bond insurance for the Series 2006 Bonds through negotiations with Ambac rather than select a bond insurer through a competitive selection process. Since Ambac will remain bond insurer on the Series 2002B Bonds and on the remarketed Series 2002C Bonds, staff believes the resulting total insurance cost will be less through negotiation with Ambac than it would be if staff sought proposals. It is expected Ambac will aggressively negotiate lower insurance premiums to remain bond insurer on debt it has already committed to insuring. Conversely, other bond insurers would find the prospect of sharing the leased asset, the New City Hall, with Ambac unattractive and would likely not bid aggressively to insure the Series 2006 Bonds.

Preparation of New Remarketing Memorandum and New Official Statement

The Authority is required to provide the Remarketing Agent for the Series 2002C Bonds a supplement to the current offering statement or a remarketing memorandum (the "Remarketing Statement") in conjunction with the conversion to weekly interest rate mode on June 1, 2006. Orrick Herrington & Sutcliffe LLP has been selected by the City Attorney's Office to prepare the Remarketing Memorandum for the Series 2002C Bonds.

The Authority is also required to prepare an official statement (the "Official Statement") in connection with the offering and sale of the Series 2006 Bonds that will refund the Series 2002D Bonds. Orrick Herrington & Sutcliffe LLP has been selected by the City Attorney's Office to prepare the Official Statement for the Authority's Series 2006 Bonds.

Financing Schedule

Below is a summary of key dates in the financing plan for the Civic Center Bond refinancing:

• Rating agency presentations to Standard & Poor's and Moody's	May 11
• Rating agency presentation to Fitch Ratings • City Council and Authority Board approval of financing documents • Trustee issues rescindable notice of redemption for the Series 2002D Bonds	May 16
• Trustee issues notice of mandatory tender of the Series 2002C and Series 2002D Bonds	May 19
• Competitive sale of the Series 2006 Bonds	May 24
• Remarket Series 2002C Bonds • Close Series 2006 Bond transaction	June 1

PUBLIC OUTREACH

Not applicable.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office.

FISCAL IMPACT

No appropriation of funds is required at this time. Compensation for consultants and other costs associated with issuing the Series 2006 Bonds is contingent on the sale of the Series 2006 Bonds and will be paid from bond proceeds. Work related to conversion of the Series 2002C Bonds is not contingent upon sale of the 2006 Bonds.

CEQA

Resolution No. 68905, File No. PP98-072

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