



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson
Larry D. Lisenbee

**SUBJECT: REALLOCATION OF
TRUSTEE-HELD
COMMERCIAL PAPER
PROCEEDS**

DATE: April 27, 2007

Approved

Date

4/30/07

COUNCIL DISTRICT: Citywide

RECOMMENDATION

It is recommended that the City Council take the following actions:

- a. Adopt the following Appropriation Ordinance amendments in the Civic Center Improvement Fund (Fund 473):
 1. Establish a Transfer to the Construction Tax and Property Conveyance Tax Fund: Service Yards Purposes in the amount of \$2,500,000; and
 2. Decrease the Technology, Furniture, and Equipment appropriation in the Public Works Department in the amount of \$2,500,000.

- b. Adopt the following Appropriation Ordinance amendments in the Interim City Facilities Improvement Fund (Fund 460):
 1. Establish a Transfer to the Construction Tax and Property Conveyance Tax Fund: Service Yards Purposes in the amount of \$4,000; and
 2. Decrease the Interim City Facilities Improvements appropriation in the Public Works Department in the amount of \$4,000.

- c. Adopt the following Funding Sources Resolution amendments in the Construction Tax and Property Conveyance Tax Fund: Service Yards Purposes (Fund 395):
 1. Increase the estimate for Transfers in the amount of \$2,504,000; and
 2. Decrease the estimate for Earned Revenue in the amount of \$2,504,000.

OUTCOME

Approval of these recommendations will allow staff to reallocate trustee-held commercial paper proceeds so that the City can meet the 18-month expenditure exception to the IRS requirement to rebate arbitrage interest earnings on the commercial paper notes. By meeting the 18-month expenditure exception, the City will be allowed to keep any interest earned on the commercial paper note proceeds in excess of the interest paid by the City on the commercial paper notes, commonly referred to as arbitrage earnings. Project appropriations will be restored in 2007-2008 to reflect the issuance of additional commercial paper proceeds so as to not impact these projects. The net overall commercial paper issued will remain the same as a result of these actions.

BACKGROUND

On January 13, 2004, the City Council and the City of San José Financing Authority each adopted a resolution authorizing the issuance of City of San José Financing Authority tax-exempt lease revenue commercial paper notes in an amount not to exceed \$98,000,000. This commercial paper program was established as a mechanism for financing public improvements of the City including the offsite parking garage for the new Civic Center, improvements of interim City facilities such as the former Main Library, and non-construction costs for technology, furniture, equipment and relocation services for the new Civic Center.

In subsequent actions, the City Council and the Authority authorized use of the tax-exempt lease revenue commercial paper program to finance procurement costs of the City's consolidated utility billing system, expanded the capacity of the program to \$116,000,000, and authorized use of the program to pay a portion of the costs of the Phase II improvements at the City's Central Service Yard.

The City generally issues commercial paper to reimburse project costs already incurred or in anticipation of imminent project expenditures. Until commercial paper issue proceeds are actually expended, they are held by the City's commercial paper trustee, Wells Fargo Bank, in project accounts. The transactions and balances in those trustee-held project accounts are incorporated into the City's accounting system and are recognized in the City's project funds. As a result, expenditures and transfers of those trustee-held project funds are controlled through the City's budget and appropriation process.

ANALYSIS

The Authority's tax-exempt commercial paper notes are subject to Federal Tax Code requirements necessitating rebate to the IRS of interest earned on tax-exempt borrowings in excess of the interest paid by the City on the commercial paper notes, commonly referred to as arbitrage earnings. The IRS has established certain exceptions to these requirements, including one which provides that interest earned from investing proceeds of a debt issue is exempt from

rebate if the proceeds (including interest earnings) are expended within an 18-month period after issuance of the debt (the "18-Month Expenditure Exception").

The current 18-month period for the Authority's tax-exempt commercial paper notes ends on May 21, 2007, and staff has identified commercial paper proceeds in two trustee-held project accounts that will not be spent by the end of the 18-month period unless they can be reallocated to another trustee-held project account where they can be spent. Reallocating these commercial paper proceeds at this time will not reduce the funds ultimately available for those two projects, as commercial paper can be issued in the future when funds are actually needed. Instead the re-allocation will allow the City to make immediate use of the existing commercial paper proceeds to meet the 18-Month Expenditure Exception.

The bulk of the commercial paper proceeds to be re-allocated, \$2,500,000, were issued in anticipation of expenditures related to the Civic Center Technology, Furniture and Equipment projects that were budgeted to occur during the current fiscal year but which have been delayed to next fiscal year. A small portion of the amount to be re-allocated, \$4,000, is the unused remainder of a larger commercial paper issuance used to reimburse expenditures in the Interim City Facilities Improvements Fund.

Staff recommends re-allocating these \$2,504,000 of commercial paper proceeds to reimburse expenditures for the Central Service Yard Phase II project. The re-allocation of existing commercial paper proceeds will reduce the amount of new commercial paper issuance for the Central Service Yard Phase II project. The Technology, Furniture, and Equipment and the Interim City Facilities Improvements appropriations will be restored in 2007-2008, offset by additional commercial paper proceeds to ensure that the overall funding for these allocations are not impacted. A corresponding decrease to commercial paper issuance related to the Central Service Yard Phase II project is recommended to reflect commercial paper proceeds that will no longer be needed as a result of the reallocations recommended in this memo. As a result, the net overall commercial paper issued among the Civic Center Improvement Fund, the Interim City Facilities Improvement Fund, and the Construction Tax and Property Conveyance Tax Fund: Service Yards Purposes will remain the same.

Staff estimates that arbitrage interest earnings at the end of the current 18-month period will be in the range of \$45,000-\$90,000. Because the interest earnings on the commercial paper proceeds and the interest cost of the outstanding commercial paper notes can not be determined until after the 18-month period has ended, a complete arbitrage rebate analysis is not possible at this time. If the City meets the 18-Month Expenditure Exception, the arbitrage earnings will be available to pay commercial paper project costs and reduce the amount of future commercial paper issuance.

ALTERNATIVES

Not applicable.

PUBLIC OUTREACH/INTEREST

Not Applicable; funds are being reallocated, but existing project budgets remain unchanged.

- 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)**

COORDINATION

This staff report has been coordinated with the Public Works Department and City Attorney's Office.

COST SUMMARY/IMPLICATIONS

If the City takes the recommended reallocation actions to meet the 18-Month Expenditure Exception, the arbitrage earnings on the commercial paper proceeds will be available to pay commercial paper project costs and reduce the amount of future commercial paper issuance. If the City is unable to meet the 18-Month Expenditure Exception, the City's arbitrage rebate consultant will calculate the arbitrage liability owed to the IRS, and the City will be required to make a rebate payment, currently estimated in the range of \$45,000-\$90,000, by July 20, 2007.

BUDGET REFERENCE

Fund #	Appn. #	Appn. Name	Total Appn.	Amt. For Contract	2006-2007 Adopted Capital Budget (Page)	Last Budget Action (Date, Ord. No.)
460	4851	Interim City Facilities Improvements	1,463,469	N/A	V-1217	10/17/2006, Ord. No. 27888
473	5190	Technology, Furniture, and Equipment	9,971,939	N/A	V-1193	10/17/2006, Ord. No. 27888

HONORABLE MAYOR AND CITY COUNCIL

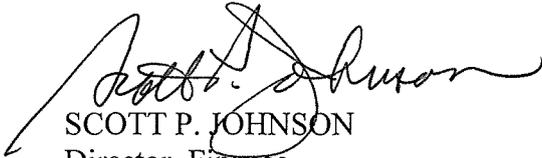
April 27, 2007

Subject: Reallocation of Trustee-held Commercial Paper Proceeds

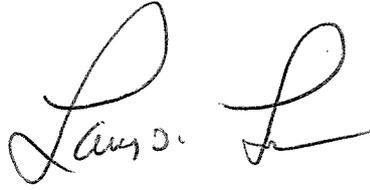
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CEQA

Not a project.

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SCOTT P. JOHNSON
Director, Finance

A handwritten signature in black ink, appearing to read "Larry D. Lisenbee". The signature is cursive and stylized, with a large initial "L".

LARRY D. LISENBEE
Budget Director

For questions, please contact David Persselin, Debt Administrator, at (408) 535-7012.