COUNCIL/AUTHORITY AGENDA: 5-22-07
ITEM: 3

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: SEE BELOW

DATE: May 2, 2007

Approved Kay Winer Date 5/4/07

COUNCIL DISTRICT: Citywide

SUBJECT: APPROVAL OF THE SALE AND ISSUANCE OF BONDS AND RELATED BOND DOCUMENTS FOR CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE BONDS, SERIES 2007A (RECREATIONAL FACILITIES REFUNDING PROJECT)

RECOMMENDATION

a. Adoption of a resolution of the City Council approving, authorizing and directing execution of certain financing documents and direct certain related actions in connection with the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2007A (Recreational Facilities Refunding Project) (the "Refunding Bonds") in an aggregate principal amount not to exceed $39,300,000, in connection with the refinancing of certain public capital improvements of the City of San José, to be sold through competitive sale, and authorizing the City Manager or the City Manager's designee to take other actions as necessary in connection with the issuance of the Refunding Bonds.

b. Adoption of a resolution of the City of San José Financing Authority Board:

   1. Authorizing the issuance of the Refunding Bonds, in an aggregate principal amount not to exceed $39,300,000, in connection with the refinancing of certain public capital improvements of the City of San José to be sold through competitive sale; and

   2. Approving, authorizing and directing the execution of various financing documents related to the Refunding Bonds and authorizing the Executive Director or the Executive Director's designee to take other actions as necessary in connection with the issuance of the Refunding Bonds.

OUTCOME

Approval of these recommendations will allow the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2007A for the purpose of refinancing certain capital improvements of the City.

EXECUTIVE SUMMARY

Three series of City of San José Financing Authority bonds in the aggregate amount of $38.1 million are currently outstanding and eligible for refunding/defeasing. The City is able to take advantage of the currently favorable interest rate environment and refund $33.3 million of those bonds to generate an average annual savings of approximately $204,000 over the next 24 years for a net present value savings of approximately $2.4 million. In addition to the savings generated by the refunding, the Center for the Performing Arts will be released from being a leased asset on one of the existing series of bonds and the fee title of the Rancho del Pueblo Golf Course will be transferred from the City of San José Financing Authority to the City. After the City Council and City of San José Financing Authority Board act on the recommendations, the Preliminary Official Statement will be circulated and the bonds will be sold in a competitive bid process on or about June 7, 2007 with bond closing anticipated on June 21, 2007.

BACKGROUND

The refunding includes the following three series of outstanding lease revenue bonds: City of San José Financing Authority Lease Revenue Bonds, Series 1993B ("1993B Bonds"), City of San José Financing Authority Lease Revenue Bonds, Series 1997A ("1997A Bonds"), and City of San José Financing Authority Lease Revenue Bonds, Series 2000B ("2000B Bonds"). A lease revenue transaction is one where either (1) the City leases a City-owned facility to the City of San José Financing Authority (the "Authority") and then the Authority leases it back to the City or (2) the Authority leases an Authority-owned facility to the City. In either case, the lease payments made by the City to the Authority secure the Authority's repayment of bonds issued by the Authority. A brief history of the amount issued, purpose of the financing, and par amount outstanding for each of the series is provided below.

The 1993B Bonds

On April 13, 1993, the City of San José Financing Authority (the "Authority") issued 1993B Bonds in the amount of $18,045,000 for the purpose of financing four City projects including the Ice Centre of San José (the "Ice Centre"), Berryessa Community Center, Murdock Park and the Phase I Renovation of Hayes Mansion ("Hayes Phase I"). On December 13, 2000, the Authority issued the City of San José Financing Authority Lease Revenue Bonds, Series 2000C (the "2000C Bonds"), which refunded the Ice Centre portion of the 1993B Bonds[1], and also financed

[1] The tax-exempt 1993B Bonds were refunded with the taxable 2000C Bonds in order to accommodate the management agreement with San Jose Arena Management.

additional improvement to the Ice Centre. As of May 2, 2007, the outstanding principal and maturity amount of the 1993B Bonds is $10,655,000. The leased assets are the Center for the Performing Arts and the City's Fire Station Number 29.

The debt service on the remaining projects financed by the 1993B Bonds averages $1.1 million per year, with the debt service on the Murdock Park portion of the 1993B Bonds continuing until November 15, 2013 and the debt service on the Berryessa Community Center and Hayes Phase I portions of the 1993B Bonds continuing until November 15, 2018. The debt service for the Murdock Park, Berryessa Community Center, and Hayes Phase I portions of the bonds are paid from the Council District #1 Construction and Conveyance Tax Fund, Council District #4 Construction and Conveyance Tax Fund, and the Community Facilities Revenue Fund, respectively.

The 1997A Bonds

On July 10, 1997, the Authority issued the 1997A Bonds in the amount of $6,875,000 for the purpose of financing the construction of the Rancho del Pueblo Golf Course. As of May 2, 2007, $5,965,000 of the 1997A Bonds principal remains outstanding. The leased asset is the Rancho del Pueblo Golf Course, which is owned by the Authority. The debt service on the 1997A Bonds averages approximately $480,000 per year through August 15, 2027 and is paid from the Municipal Golf Course Fund.

The 2000B Bonds

On August 8, 2000, the Authority issued the 2000B Bonds in the amount of $22,635,000 for the purposes of financing the construction of the Los Lagos Golf Course and refunding the bonds used to acquire the land for Camden Park (the "Camden Park Refunding"). As of May 2, 2007, $21,500,000 of the 2000B Bonds principal remains outstanding. The leased asset is the Los Lagos Golf Course. The debt service on the 2000B Bonds averages approximately $1.6 million per year through August 15, 2030 and is paid from the Municipal Golf Course Fund and the Council District #9 Construction and Conveyance Tax Fund for the Los Lagos Golf Course and Camden Park Refunding portions of the bonds, respectively.

ANALYSIS

As part of the Finance Department's annual work plan, the Debt Management workgroup reviews all of the City's outstanding debt for opportunities to reduce the annual debt service obligations of the City. Given the currently favorable interest rate environment, staff is recommending a consolidated lease revenue refunding consisting of:

- Partial current refunding of the 1993B Bonds
- Current refunding of the 1997A Bonds
- Advance refunding of the 2000B Bonds

These bonds are collectively referred to as the "Prior Bonds".

A partial refunding is a refunding in which only a portion of the outstanding bonds in a series are refunded. In the case of the 1993B Bonds, staff is recommending refunding $5,795,000 of the $10,655,000 outstanding principal and maturity amount (the "Refundable 1993B Bonds"). The portion of the 1993B Bonds not being refunded consists of non-callable capital appreciation bonds, which are not eligible for refunding.

A current refunding is a refunding in which the refunding bonds are issued not more than ninety (90) days before the redemption date upon which the outstanding bonds become due or are callable. The portion of the proceeds from the Refunding Bonds used to refund the Refundable 1993B Bonds and the 1997A Bonds will be held in trust in an escrow fund with U.S. Bank National Association ("U.S. Bank"), the trustee for the 1993B Bonds and the 1997A Bonds, until the redemption date. The current financing schedule calls for the Refunding Bonds to close on June 21, 2007 with the 1997A Bonds and the Refundable 1993B Bonds to be redeemed on September 17, 2007.

An advance refunding is a refunding in which the refunding bonds are issued more than ninety (90) days before the redemption date upon which the outstanding bonds become due or are callable. The IRS Tax Code allows only one advance refunding of a tax-exempt bond issue, so advance refundings are generally reserved for opportunities to capture unusually high debt service savings or to advantageously restructure a bond issue. The portion of the proceeds from the Refunding Bonds used to advance refund the 2000B Bonds will be held in trust in an escrow fund with Wells Fargo Bank, National Association ("Wells Fargo"), the trustee for the 2000B Bonds. The escrow will be sufficient to pay principal and interest on the bonds through August 15, 2008, and a redemption premium on August 15, 2008, the first date on which the 2000B Bonds can be redeemed.

The refunding will provide two substantial benefits to the City: economic savings and release of a leased asset. Economic savings result because current interest rates are lower than the interest rates paid on the Prior Bonds. In a base case scenario assuming principal amortization to produce approximately equal annual (FY) savings per each issue of Prior Bonds, a cash funded debt service reserve fund, and no bond insurance, the refunding is anticipated to provide net present value savings of approximately $2.4 million, which is equivalent to 7.2% of the $33,260,000 in refunded principal of the Prior Bonds.

City of San José Financing Authority
Lease Revenue Bonds, Series 2007A
(Recreational Facilities Refunding Project)
Summary of Refunding Savings

Series	Final Maturity	Par Amount of Refunded Bonds	Par Amount of Refunding Bonds	Average Annual Savings	Total Savings	NPV Savings*	NPV (% of Refunded Par)*
1993B	2018	$ 5,795,000	$ 5,815,000	$ 62,967	$ 880,454	$ 623,734	10.8%
1997A	2027	5,965,000	5,885,000	61,106	1,283,220	523,079	8.8%
2000B	2030	21,500,000	23,715,000	110,383	4,588,414	1,254,499	5.8%
Total		$ 33,260,000	$ 35,415,000		$ 6,752,088	$ 2,401,312	7.2%

* *Preliminary, subject to change.*

The City's adopted Debt Management Policy specifies a minimum of 3% net present value savings for a refunding to be considered economically feasible. All of the series being refunded substantially exceed this threshold.

The second benefit of the refunding will be the release of the Center for the Performing Arts as one of the leased assets under the 1993B Bonds Project Lease. By refunding a portion of the 1993B Bonds, it will be possible to release the Center for the Performing Arts from that obligation; leaving Fire Station Number 29 as the leased asset for that financing. One of the benefits of releasing the asset is restoring the City's ability use the Center for the Performing Arts as a leased asset for another financing.

Additionally, in order to simplify the legal documentation for the Refunding Bonds, the fee title of the Rancho del Pueblo Golf Course will be transferred from the Authority to the City simultaneously with the issuance of the Refunding Bonds. This transfer will have no financial impact on either the Authority of the City.

Summary of Proposed Refunding Plan

The Refunding Bonds will be issued pursuant to the Trust Agreement (the "Trust Agreement") (described below) and sold on a competitive bid basis. First Southwest Company, the financial advisor for the City and the Authority, will oversee the competitive sale.

The Refunding Bonds will be sold to the underwriter(s) presenting the best bid based on the lowest true interest cost, not to exceed six percent (6%) per year. Currently, the financing schedule calls for the competitive sale of the bonds to occur on June 7, 2007.

A summary of the estimated sources and uses of Bond funds is presented below:

City of San José Financing Authority
Lease Revenue Bonds, Series 2007A
(Recreational Facilities Refunding Project)
Estimated Sources and Uses of Funds*

	Refunding of 1993B Bonds	Refunding of 1997A Bonds	Refunding of 2000B Bonds	Issue Summary
Sources				
Par Amount of Bonds	$ 5,815,000	$ 5,885,000	$ 23,715,000	$ 35,415,000
Reoffering Premium	225,539	14,202	54,468	294,210
Transfer from Prior Issue Debt Service Funds	-	323,384	1,050,061	1,373,444
Transfer from Prior Issue DSR Funds	357,156	490,400	-	847,556
Total Sources	$ 6,397,695	$ 6,712,986	$ 24,819,529	$ 37,930,210
Uses:				
Deposit to Net Cash Escrow Fund	5,836,009	6,143,056	22,532,026	34,511,091
Deposit to Debt Service Reserve Fund (DSRF)	485,141	490,981	1,978,525	2,954,648
Costs of Issuance	41,655	43,639	166,687	251,981
Total Underwriter's Discount	34,890	35,310	142,290	212,490
Total Uses	$ 6,397,695	$ 6,712,986	$ 24,819,528	$ 37,930,210

* *Preliminary, subject to change.*

The City's financial advisor for the Refunding Bonds has determined that it will be cost-effective for either all or a portion of the Refunding Bonds to be qualified for municipal bond insurance, and to purchase a debt service reserve fund ("DSRF") surety bond policy in lieu of funding the DSRF from bond proceeds. The provider of these two credit enhancement products will be rated triple-A by all three credit rating agencies (Moody's Investors Service, Standard & Poor's Ratings Group and Fitch Investors Service). The provider will be selected through a request for proposals process based on the lowest projected all-in cost to the Authority and an assessment of the provider's request, if any, for modifications to the bond financing documents (as described below). This selection process is anticipated to be completed by May 16, 2007, which is prior to the competitive sale of the Refunding Bonds and prior to City Council/Authority approval of the refunding. The supplemental report transmitting the Preliminary Official Statement will provide an update on the bond insurance solicitation and the name of the provider. It is anticipated that the bond insurance providers responding to the City's request for proposals will require that a minimum percentage of the Refunding Bonds be selected for bond insurance (the "Minimum Insured Par Amount") in exchange for providing a DSRF surety policy to the Authority.

The municipal bond insurance policy will guarantee the payment of principal and interest on all or a portion of the Refunding Bonds in exchange for a premium based on total debt service insured. The underwriter offering the lowest all-in bid for the Refunding Bonds on June 7, 2007 will determine the cost-effective use of bond insurance, subject to the Minimum Insured Par Amount, and will bear responsibility for payment of the premium to the bond insurance provider. Failure of the bond insurance provider to issue its policy shall not justify the failure, or refusal by the successful bidder, to accept delivery of, or purchase, the Refunding Bonds. Should the purchase of a DSRF surety bond be deemed cost-effective, the cost of the surety policy will be funded by the Authority from the proceeds of the Refunding Bonds.

Concurrent with the delivery of the Refunding Bonds, the City and the Authority will issue two separate Irrevocable Refunding Instructions (the "Instructions") to U.S. Bank. Each of the Instructions will direct U. S. Bank to establish a special fund to be known as the "Escrow Fund" and to deposit a portion of the proceeds from the sale of the Refunding Bonds in the Escrow Fund established for the 1993B Bonds and 1997A Bonds. Each Escrow Fund will be used to redeem the corresponding series of outstanding Prior Bonds on their redemption dates. Amounts deposited into each Escrow Fund will be invested either in State and Local Government Securities ("SLGS") issued by the U.S. Treasury or in other eligible federal securities.

Additionally, concurrent with the issuance of the Refunding Bonds, the City, the Authority, and Wells Fargo, as trustee and escrow agent for the 2000B Bonds, will enter into an Escrow Agreement. The Escrow Agreement will provide that Wells Fargo establish a special fund to be known as the "Escrow Fund" and to deposit a portion of the proceeds from the sale of the Refunding Bonds in the Escrow Fund established for the 2000B Bonds. The Escrow Fund will be used to redeem the 2000B Bonds. Amounts deposited in the Escrow Fund will be invested in SLGS or in other eligible federal securities.

Bond Financing Documents

There are a number of bond financing documents which require City Council and/or Authority Board approval to proceed with the issuance of the 2007A Bonds. All of the documents described below, in substantially final form, will be available for review in the City Clerk's Office on or about May 16, 2007. In addition to these documents, the City and/or the Authority will be required to execute documents, such as the Irrevocable Funding Instructions and Escrow Agreement described above, which are necessary or advisable in order to cause the issuance of the Refunding Bonds or to carry out the refunding. As mentioned above, in order to reduce the complexity of the financing documents, it is recommended that title to the Rancho del Pueblo Golf Course be transferred from the Authority to the City and that the City Manager and the Executive Director or their respective designees be authority to execute the appropriate documents to cause this transfer.

Staff recommends that the City Manager or the City Manager's authorized designees and the Authority's Executive Director or the Executive Director's authorized designees ("Designated Officers") be authorized to execute the agreements on behalf of the City and the Authority as described below. As modifications may be required prior to the closing, staff also recommends that the Designated Officers each be authorized to execute the final version of each of these agreements as may be modified upon consultation with the City Attorney's Office.

> ***Official Statement.*** The Official Statement, or prospectus, has been prepared for the City and the Authority by bond counsel/disclosure counsel. Appendix A to the Official Statement describes the City's current financial situation and provides other information useful to investors regarding the City. It has been prepared by Finance staff in close

coordination with the City Attorney's Office, City Manager's Budget Office, financial advisor and bond counsel/disclosure counsel.

The Preliminary Official Statement will be distributed to bidders and investors primarily in electronic form. The Preliminary Official Statement generally discloses material information on the bond issue, such as the projects to be refinanced, the repayment source for the 2007A Bonds, credit enhancement for the 2007A Bonds (if applicable) and credit ratings. Investors may use this information to evaluate the credit quality of the 2007A Bonds. Staff has carefully reviewed the information contained in the Preliminary Official Statement and believes it to be accurate and complete in all material respects. Following the sale of the 2007A Bonds to the underwriters and prior to the closing, bond counsel/disclosure counsel will prepare a final Official Statement for the 2007A Bonds.

Staff recommends that the Designated Officers each be authorized to sign the Preliminary and final Official Statements for the 2007A Bonds on behalf of the City and the Authority and to make such modifications to these documents as may be necessary upon consultation with the City Attorney's Office. Staff also recommends that the Designated Officers each be authorized to execute certificates regarding these documents as required to comply with securities laws and to authorize the underwriters to distribute these documents for the purpose of marketing the 2007A Bonds.

Copies of the draft Preliminary Official Statement along with Appendix A, which generally describes the City's demographic, economic and financial information, in substantially final form will be distributed to the City Council under separate cover on or about May 16, 2007. Staff has carefully reviewed the information contained in the draft Preliminary Official Statement and believes it to be accurate and complete in all material aspects.

If any councilmember or Authority Board member has any personal knowledge that any of the material information in the Official Statement is false or misleading, the councilmember/Authority Board member must raise these issues prior to approval of the distribution of the document.

City staff, bond counsel/disclosure counsel, and the financial advisor will be available at the City Council/Authority Board meeting on May 22, 2007, to address any questions, issues and/or concerns.

Trust Agreement. The Trust Agreement is between the City of San José Financing Authority and a commercial bank to be selected through a request for proposals process, as the trustee (the "Trustee"). The Council and the Authority will be informed of the selected trustee bank in the supplemental memorandum used to transmit the draft Preliminary Official Statement. Proceeds of the Refunding Bonds will be deposited and expended pursuant to the Trust Agreement. The Trust Agreement pledges the lease payments received from the City to the repayment of the bonds, sets forth terms of the

Refunding Bonds, establishes the funds and accounts to be held by the Trustee, sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account and contains the responsibilities and duties of the Trustee and the rights of the bondholders. The Trust Agreement obligates the Authority to pay compensation to the Trustee for services rendered under the Trust Agreement.

Site and Facility Lease. The Site and Facility Lease is between the City of San José, as lessor, and the City of San José Financing Authority, as lessee. The Site and Facility Lease sets forth the respective terms and conditions of the lease of the facilities from the City to the Authority.

Project Lease. The Project Lease is between the City of San José Financing Authority, as lessor, and the City of San José, as lessee. The Project Lease sets forth the respective terms and conditions of the lease of the facilities from the Authority to the City. The Project Lease obligates the City to pay the Authority rental payments sufficient to cover debt service on the Refunding Bonds.

Amendments to Project and Site Leases Related to the 1993 Bonds. Both the Project Lease and the Site Lease related to the 1993 Bonds need to be amended in order to release the Center for Performing Arts as a pledged asset.

Official Notice Inviting Bids/Notice of Intention to Sell Bonds. The Official Notice Inviting Bids describes the competitive bidding process, the bidding parameters governing the submission of bids by potential underwriters for the Refunding Bonds, and the basis for awarding the Bonds to an underwriter. This document is provided to potential bidders with the Preliminary Official Statement. The City's bond counsel will publish a notice of intention to sell the Bonds, in the form on file with the City Clerk, in "The Bond Buyer," a financial publication generally circulated throughout the State of California, at least five (5) days prior to the date for submission of bids.

Continuing Disclosure Certificate. This document is executed for the benefit of the bondholders and obligates the City to immediately disclose to the marketplace the occurrence of any material events that are required to be disclosed by federal Securities Laws. It also requires the City to prepare an annual report to the marketplace, the contents of which are outlined in the Continuing Disclosure Certificate. These actions are taken in accordance with Rule 15c2-12(b)(d) adopted by the Securities and Exchange Commission.

Financing Team Participants
The financing team participants consist of:

Financial Advisor:	First Southwest Company
Bond Counsel/Disclosure Counsel:	Jones Hall, A Professional Law Corporation
Trustee:	To be selected

Financing Schedule
The Finance Department, together with the City Attorney's Office, is proceeding on an aggressive schedule to take advantage of the currently favorable interest rate environment. The key dates to meet this schedule are highlighted below:

Council approval of the financing and related documents	May 22, 2007
Electronically distribute Preliminary Official Statement	May 24, 2007
Competitive sale	June 7, 2007
Bond Closing	June 21, 2007

PUBLIC OUTREACH/INTEREST

Not applicable.

☐ **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 prepared by the Finance Department in coordination with the City Attorney's Office.

COST SUMMARY/IMPLICATIONS

Costs associated with the refunding will be paid from bond proceeds. The financial advisor and bond counsel/disclosure counsel work on a contingency basis and are only paid upon the successful sale and close of the Refunding Bonds.

BUDGET REFERENCE

Not applicable.

CEQA

Not a project.

Julia H Cooper
JULIA H. COOPER
Deputy Director, Finance

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