COUNCIL/AUTHORITY BOARD AGENDA: 5-25-04
ITEM:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

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

FROM: Paul Krutko

SUBJECT: **ICE CENTRE OF SAN JOSE EXPANSION PROJECT LEASE REVENUE BONDS**

DATE: May 14, 2004

Date

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

1. Conduct a Public Hearing of the City Council concerning the approval of the lease financing by the City and the City of San Jose Financing Authority for certain public capital improvements of the City, consisting of the expansion of the San Jose Ice Centre, and make finding of significant public benefit of such financing by the Authority in accordance with the criteria specified in Section 6586 of the Government Code of the State of California.

2. Adoption of a Resolution of the City Council (a) approving in substantially final form, and authorizing the execution of the Project Lease, Site and Facility Lease, Official Statement, Bond Purchase Agreement, Continuing Disclosure Certificate, Reimbursement Agreement and authorizing the City Manager or his designee to execute and, as appropriate, to negotiate, and deliver these documents and other related financing documents and to take other actions as necessary in connection with the issuance of the Bonds; and (b) establishing Fund 432 as the Ice Centre Revenue Fund, pursuant to the Amended and Restated Lease and Management Agreement with San Jose Arena Management.

3. Adoption of a Resolution of the City of San José Financing Authority:

    a. Authorizing the issuance of City of San José Financing Authority Taxable Lease Revenue Bonds, Series 2004A (Ice Centre of San Jose Expansion Project) (Auction Rate Securities) (the “Bonds”) in the not-to-exceed principal amount of $10,000,000 to be sold through negotiated sale subject to certain limitations.

b. Approving, in substantially final form, the Bonds, Indenture of Trust, Site and Facility Lease, Project Lease, Official Statement, Continuing Disclosure Certificate, Purchase Contract, Auction Agency Agreement, Broker-Dealer Agreement and First Amendment to Project Lease, authorizing the Executive Director or his designee to execute and, as appropriate, to negotiate, and deliver these documents and other related financing documents and to take other actions as necessary in connection with the issuance of the Bonds.

BACKGROUND

The Ice Centre of San Jose opened in April 1994. On June 29, 1999, the City and San Jose Arena Management, ("SJAM") entered into a Lease and Management Agreement for the operation of the Ice Centre, which became effective on December 13, 2000. The City of San Jose Financing Authority (the "Authority") issued its Taxable Lease Revenue Bonds, Series 2000C (Ice Centre of San Jose Refunding and Improvement Project) (the "2000C Bonds") on December 13, 2000, in conjunction with the Agreement. Proceeds of the 2000C Bonds were used to expand the facility and make improvements necessary for the Ice Centre to become the official training facility for the Sharks. These improvements included the addition of approximately 58,000 square feet of new improvements, including a third ice rink, associated dressing rooms, the Sharks training center and a new arcade area.

On March 23, 2004, the City Council adopted a resolution authorizing the City Manager to negotiate and execute an Expansion Agreement with SJAM regarding the construction and financing of the second expansion to the Ice Centre and an Amended and Restated Lease and Management Agreement ("Lease Agreement"). Pursuant to the Expansion Agreement, the City and SJAM have decided to install an approximately 33,000 square foot addition to the Ice Centre consisting of a fourth ice rink with ancillary dressing rooms, restrooms, and the remodeling of the existing mezzanine to add a restaurant facility. The total project budget is estimated to be $8,000,000 and this amount will be funded from the proceeds of the Bonds. Pursuant to the Expansion Agreement, SJAM is responsible for ensuring completion of the improvements and must pay any costs above the $8,000,000 available from the Bonds.

ANALYSIS

The following sections of the report address the items in staff's recommendation to proceed with the issuance of the Bonds. These sections include: establishment of Fund 432 as the Ice Centre Revenue Fund, description of the bond financing structure, bond financing documents, financing team participants and the financing schedule.

Establishment of Fund 432 – Ice Centre Revenue Fund

The provisions of the Amended and Restated Lease Agreement Lease and Management with San Jose Arena Management require the establishment of a separate fund for the purposes of tracking revenue and expenses related to the Ice Centre. Currently the revenues and expenses are accounted for in the Community Facilities Revenue Fund which is also used for several other City projects. The creation of a separate fund will allow for greater financial and management oversight on the part of the City and SJAM related to the City's receipt of base rental payments from SJAM and payment of debt service and related expenses; and capital repair and replacement expenses of the Ice Centre made by the City for the benefit of the facility.

Bond Financing Structure

The Bonds will be issued as taxable variable rate bonds with a final maturity date of December 1, 2024. The estimated par amount of the Bonds is $9,200,000 which includes funding for the $8.0 million project budget with the balance of the Bond proceeds funding a reserve fund, and costs of issuance of the Bonds.

The Series 2004A Bonds to be issued by the Authority will be initially issued as Auction Rate Securities and insured by MBIA. The Bonds will receive triple-A ratings based on the MBIA bond insurance policy. Auction Rate Securities are expected to provide an all-in cost of funds to the Authority that is similar to the all-in cost of the Series 2000C Bonds. This will represent the City's first issuance of Auction Rate Securities; however, the City is expecting to issue Auction Rate Securities on behalf of the Airport in June. The Series 2000C Bonds are also taxable variable rate bonds; however, they are variable rate demand bonds, insured by MBIA with a Standby Bond Purchase Agreement between the Authority and JPMorgan Chase Bank.

It is expected that the initial auction period for the Bonds will be a monthly rate (either 28 or 35 days). The interest rates set at each auction are expected to be similar to the rates that would be carried by variable rate demand bonds. The annual bank and Remarketing Agent costs for the Series 2000C Bonds are currently approximately 0.25%. The annual Broker-Dealer fee and Auction Agent fee for the Bonds will also be approximately 0.25%. By avoiding the need to maintain a bank to provide a Standby Bond Purchase Agreement the issuance of Auction Rate Securities reduces the administrative workload associated with variable rate bonds since the term of such agreements is shorter than the length of the bonds and must be renewed periodically. The primary differences between variable rate demand bonds ("VRDN") and Auction Rate Securities ("ARS") are discussed in Appendix A.

Bond Repayment Plan The Bonds will be repaid through annual lease payments made by the City to the Authority for the use and occupancy of the Ice Centre. In conjunction with the issuance of the Bonds, the Authority will be amending the Project Lease entered into in conjunction with the Series 2000C Bonds to place the lease payments for the Bonds on parity with the lease payments made by the City for the Series 2000C Bonds.

Pursuant to the Lease Agreement, SJAM makes quarterly Base Rental payments to the City for the use of the Ice Centre. These Base Rental payments have been calculated to be sufficient to make the City's lease payments that are due on the Bonds and the Series 2000C Bonds and to fund the City's obligation for necessary capital repair and replacement pursuant to the Lease Agreement. However, the SJAM Base Rental payments are not pledged as a source of repayment of the Bonds or the Series 2000C Bonds, and if the SJAM Base Rental payments are ever insufficient to pay the City's lease payments, the City must make up the difference as long as it has use and occupancy of the Ice Centre.

To provide the Broker Dealer with the best ability to market the ARS and achieve the lowest interest rate possible on the Bonds, the Authority will accelerate the repayment of the Series 2000C Bonds by several years and leave the mandatory redemption of the Bonds to take place in the years after the Series 2000C Bonds have been repaid. This allocation of principal amortization between the two bond series allows the full amount of ARS to remain outstanding longer, making them more attractive to ARS investors.

MBIA was selected as the bond insurer because they insure the Series 2000C Bonds, and their approval would be necessary in order to undertake the financing of any improvements to the existing Ice Centre. Due to the relationship of the improvements to the existing facility, two separate bond insurers would have added significant complexity and additional cost to the financing. Approval of JPMorgan Chase Bank, the provider of the Standby Bond Purchase Agreement for the Series 2000C Bonds, is required in order to undertake the financing of the improvements.

The Auction Agent, Wilmington Trust, was selected following the issuance of a request for proposals for auction agent services distributed to five commercial banks. The Trustee, Wells Fargo Bank, is the Trustee for the existing Series 2000C Bonds.

The estimated sources and uses of funds for the financing are shown below:

City of San José Financing Authority
Taxable Lease Revenue Bonds, Series 2004A
(Ice Centre of San Jose Expansion Project)
Estimated Sources and Uses of Funds*

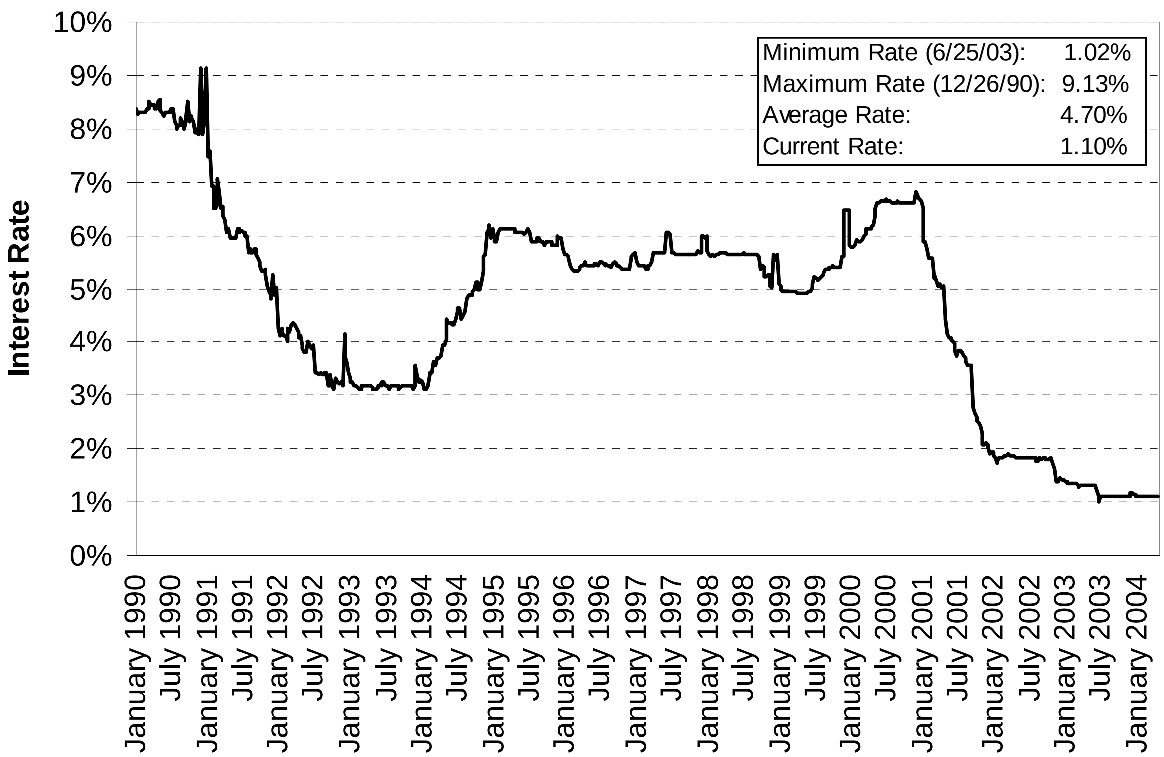
SOURCES OF FUNDS	
Series 2004A Bonds	$9,200,000
Total Sources of Funds	**$9,200,000**
Project Costs	$8,000,000
Debt Service Reserve Fund	750,000
Underwriting Discount	46,000
Costs of Issuance	226,000
Bond Insurance Premium	178,000
Total Uses of Funds	**$9,200,000**

* Preliminary, subject to change.

The interest rate on the Series 2000C Bonds varies weekly. The rate for the week ended April 27, 2004, was 1.07%. This rate is well below the expected interest rate on a long-term fixed rate bond issue in the current market of approximately 5.50%. Although the issuance of variable rate bonds exposes the City to uncertain future debt service payments, staff believes it is reasonable to expect that the average interest rate over the term of the Bonds will be lower than if fixed rate bonds were issued.

To provide some historical perspective, the following graph shows one-month LIBOR, a benchmark taxable interest rate, from January 1990 through April 2004. During this time period, one-month LIBOR averaged 4.70%. More recently, since the delivery of the Series 2000C Bonds in December 2000, one-month LIBOR has averaged 2.27% (slightly below the interest rate on the Series 2000C Bonds, which has averaged 2.31%).

Historical One-Month LIBOR
January 1990-April 2004



Bond Financing Documents

There are a number of bond financing documents that require City Council and/or Authority Board approval to proceed with the issuance of the Bonds. All of these documents will be available for review in the City Clerk's Office on or about May 18, 2004.

Official Statement This document is the public offering statement for the issuance of the Bonds, and has been prepared on behalf of the City and the Authority by the Disclosure Counsel. The Official Statement describes the financing program, the Ice Centre Expansion Project and the financial condition of the City. Investors use this information to evaluate the credit quality of the bonds.

A copy of the draft Official Statement, in substantially final form, will be distributed to the City Council/ Authority Board under separate cover on or about May 18, 2004. Staff has carefully reviewed the information contained in the Official Statement and believes it to be accurate and complete in all material respects.

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

City staff, bond counsel, and the financial advisor will be available at the City Council/ Authority Board meeting on May 25, 2004, to address any questions, issues and/or concerns.

Indenture of Trust The Indenture of Trust (the "Indenture") is between the City of San José Financing Authority and Wells Fargo Bank as the trustee (the "Trustee"). Proceeds of the Bonds will be deposited and expended (including Project costs) pursuant to the Indenture. The Indenture pledges the lease payments received from the City to the repayment of the bonds, sets forth terms of the Bonds (including the mechanism for setting the variable rates on the 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 Indenture obligates the Authority to pay compensation to the Trustee for services rendered under the Indenture.

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 Lease sets forth the respective terms and conditions of the lease of the Ice Centre from the City to the Authority.

First Amendment to Project Lease The First Amendment to Project Lease is between the City of San José Financing Authority and the City of San José. This document amends the Project Lease entered into in conjunction with the issuance of the Series 2000C Bonds in order to permit lease payments on the Series 2004A Bonds to be placed on parity with lease payments for the Series 2000C Bonds.

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 Ice Centre from the Authority to the City, which provides the source of funds to repay the Bonds.

Reimbursement Agreement The Reimbursement Agreement is an agreement by and between the City, the Authority and MBIA as bond insurer for the Bonds. The City agrees to repay MBIA for any amounts advanced on its behalf as payments of principal and interest under the municipal bond insurance policy.

Purchase Contract The Purchase Contract is a contract by and among the City of San José Financing Authority as the Issuer, the City, and Bear Stearns as the purchaser of the Bonds. The Purchase Contract specifies the representations and warranties of the Authority and the City, the documents to be executed at closing, and the conditions that allow the purchaser to cancel the purchase of the Bonds.

Auction Agency Agreement The Auction Agency Agreement is among the City of San José Financing Authority, the Trustee, and Wilmington Trust as Auction Agent. This Agreement describes the procedures to be followed by the Auction Agent and compensation to be paid the Auction Agent.

Broker-Dealer Agreement The Broker-Dealer Agreement is among the City of San José Financing Authority, the Auction Agent, and the Broker-Dealer. This Agreement describes the procedures to be followed by the Broker-Dealer and compensation to be paid the Broker-Dealer. Initially, Bear Stearns & Co., Inc., will be the only Broker-Dealer. The Authority has the ability to replace the Broker-Dealer or to add additional Broker-Dealers at any time.

Continuing Disclosure Certificate This Certificate is executed by the City for the benefit of the bondholders and in order to assist the participating underwriters to comply with Securities and Exchange Commission Rule 15c2-12(b)(5). In executing this document, the City commits to notify certain parties if certain listed events occur and to file annually an update to certain information contained in the Official Statement.

Financing Team Participants

The financing team participants consist of:

• City's Financial Advisor:	Public Resources Advisory Group
• Bond Counsel:	Jones Hall
• Disclosure Counsel:	Jones Hall
• Underwriter and Broker-Dealer:	Bear Stearns & Co., Inc.
• Auction Agent:	Wilmington Trust
• Trustee/Paying Agent:	Wells Fargo Bank

Financing Schedule

The current proposed schedule is as follows:

Council approval of bond documents:	May 25, 2004
Distribute Preliminary Official Statement to Investors:	May 26, 2004
Pricing:	June 2, 2004
Bond Closing:	June 3, 2004

PUBLIC OUTREACH

The City Council will hold a public hearing on May 25, 2004, as required by Section 6586 of the Government Code of the State of California to consider information concerning the approval of issuance of the Bonds. The Notice of Public Hearing to be held in conjunction with the approval of the issuance of the Bonds will be published in the San Jose Post Record on or about May 17, 2004.

COORDINATION

This report was prepared by the Finance Department in coordination with the Office of Economic Development, City Attorney's Office and the financing team participants.

COST IMPLICATIONS

No appropriation of funds is required at this time. Compensation for all of the consultants (financial advisor, bond counsel and underwriter) is contingent on the successful sale and closing of the Bonds and will be paid from Bond proceeds.

CEQA

CEQA: Negative Declaration, File No. H-93-06-038 and add addenda thereto, File No. HO3-035.

PAUL KRUTKO
Director, Economic Development

APPENDIX A

TECHNICAL ASPECTS OF MULTI-MODAL VARIABLE RATE DEMAND BONDS AND AUCTION RATE SECURITIES

The Series 2004 A Bonds will carry variable interest rates until their maturity or earlier redemption. The Indenture permits the Authority to issue the Bonds as either multi-modal variable rate demand bonds ("VRDB Bonds") or as Auction Rate Securities ("ARS Bonds") and to switch between these two options from time to time. Both structures provide the Authority with an interest cost that varies depending on market interest rates over time. There is a significant difference between the methodologies used to establish the interest rates under the two options. The purpose of this Appendix is to briefly describe the options available to the City/Authority.

AUCTION RATE SECURITIES

Auction Rate Securities ("ARS") differ from VRDBs in the methodology used to establish the periodic interest rate to be paid by the Authority. The interest rate on the ARS is established through a periodic auction wherein investors place bids through authorized Broker Dealers to the Auction Agent. The Auction Agent establishes the interest rate to be paid for the given auction period at the market-clearing rate based on the auction bids received. The Authority determines which firms will serve as authorized Broker Dealers and appoints a commercial bank to serve as Auction Agent. The Authority will pay periodic fees to the firms serving in these capacities.

Auction Rate Securities do not provide the investor with the ability to "put" the bond back to a Tender Agent therefore it is not necessary for the Authority to have a liquidity facility in place. The only way an investor holding an ARS can sell its bonds is to submit a sell order at the next occurring auction. If there are sufficient bidders with buy orders at the auction, then the investor's ARS is redeemed by the proceeds received from the new investor. Thus, the investor in an ARS takes the liquidity risk rather than a bank.

If there are insufficient bids from investors at an auction to fill any sell orders, the interest rate on the ARS is determined based on a formula.

MULTI-MODAL VARIABLE RATE DEMAND BONDS

The interest rate on a multi-modal variable rate demand bond ("VRDB") is established by a Remarketing Agent appointed by the Authority. The rate can be reset as often as daily or can be fixed for longer periods. The most common reset frequency is weekly. Interest reset periods are also referred to as "modes", thus the characterization of the VRDBs as "multi-modal". The Remarketing Agent is required to set the rate based on its impression of current market interest rates. If an investor no longer wishes to hold the VRDB, they are permitted to notify the Tender Agent and "put" the bond back to the Authority and "demand" repayment - hence the term "demand bond".

In such an event, the Remarketing Agent will attempt to place the bonds so “put” to another investor. If the Remarketing Agent is unable to find a substitute investor, for any reason, the Tender Agent is authorized to draw on a liquidity facility established by the Authority for this purpose. The liquidity facility is in essence a line of credit that provides immediate funding to the Tender Agent to repay the bonds that have been “put” by an investor and the Remarketing Agent has not remarketed. The “put” feature associated with VRDBs is essential to the ability and willingness of investors to purchase the bonds and a liquidity facility is required in order to provide substance to the “put” ability. The Authority pays a quarterly fee to the bank providing the liquidity facility.

Under the Indenture, the Authority can choose to have the interest on the VRDBs reset with different frequencies. The choices are: (1) daily; (2) weekly; (3) monthly; (4) semiannual; (5) any other period less than one year (“flexible rate”); and (6) any period greater than one year (“long rate”). The Authority can also choose to convert the VRDBs to a fixed interest rate to their maturity. Each Series of VRDBs can bear interest at a different mode. In order to switch between interest modes the Authority must give notices to bond investors and others. The ability to change interest rate modes provides the Authority with the ability to manage its interest rate risk during the term of the bonds.

The Indenture permits the Authority to switch between ARS and VRDBs by providing sufficient notice to various parties.