

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

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

**SUBJECT: EXPANSION OF AIRPORT  
COMMERCIAL PAPER PROGRAM**

**DATE:** May 30, 2006

Approved

Date

4/05/06

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 \$200 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 to authorize issuance of a combination of Series A, Series B, and Series C commercial paper notes under the commercial paper program established for the Norman Y. Mineta San José International Airport through an increase in the aggregate limit from \$100 million to \$200 million in order to fund projects and capitalized interest associated with the Airport Master Plan and the payment of costs related to the Airport's lease of the former FMC property.
3. Adoption of a resolution of the City Council authorizing the Director of Finance to negotiate and execute the First Amendment to the Letter of Credit and Reimbursement Agreement between the City of San José and Morgan Guaranty Trust Company of New York, now JPMorgan Chase Bank, relating to the Norman Y. Mineta San José Airport International Subordinated Commercial Paper Program, increasing the Maximum Stated Amount from \$100 million to \$200 million and increasing the Maximum Series C Letter of Credit Stated Amount from \$15 million to \$35 million.

CEQA: Resolution Nos. 67380 and 71451, PP 06-084

May 30, 2006

**Subject: Expansion of Airport Commercial Paper Program**

Page 2

## **OUTCOME**

This recommendation will expand the existing San José Airport Commercial Paper Program (the "Airport CP Program") from \$100 million to \$200 million to ensure that funding is in place for the award of the design and construction contracts related to the rephased Airport Master Plan projects. Various Airport Master Plan projects are anticipated for award in calendar year 2006, such as the design-build agreement for the Terminal Area Improvement Program and continuation of the North Concourse Building and related projects. Additionally, the Airport CP Program will be used for the payment of costs related to the Airport's lease of the former FMC property.

## **EXECUTIVE SUMMARY**

The actions in this staff report recommend the expansion of the Airport CP Program to provide encumbrance capacity and an interim funding source for projects related to the Airport's Master Plan projects and lease payment obligations on the City lease related to the recently acquired "former FMC property". The Tax Equity and Fiscal Responsibility Act hearing must be conducted to notify the community of the City's intent to issue qualified tax-exempt private activity notes under the Airport CP Program.

## **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.

On October 12, 2004, the City Council approved the extension of the letter of credit expiration date with Morgan Guaranty Trust Company of New York, now JPMorgan Chase Bank ("JPMorgan"), to November 2, 2007 and authorized the Director of Finance to authorize future extensions to the Letter of Credit and Reimbursement Agreement ("LOC Agreement") with respect to the dates and fees paid to JPMorgan.

Since 1999, the commercial paper notes ("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

May 30, 2006

**Subject: Expansion of Airport Commercial Paper Program**

Page 3

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. To date, Notes issued for the runways, the 2002 Refunding, and ATSA-related projects have been repaid.

In June 2004, the City issued \$250.0 million in 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 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.

## **ANALYSIS**

An increase in the aggregate limit of the Airport CP Program requires the amendment of Resolution 69200 and the Letter of Credit and Reimbursement Agreement between the City of San José and JPMorgan relating to the Airport's Subordinated Commercial Paper Program. These documents govern the aggregate limit allowed for the issuance of Notes. The balance of this Analysis section discusses: 1) expansion of the Airport CP Program, 2) TEFRA hearing requirements, and 3) use of taxable Notes to pay lease payment obligations on the former FMC property.

### **Expansion of Airport CP Program for Airport Master Plan Program**

The City is in the process of implementing projects associated with the rephased Airport Master Plan as approved in concept by the City Council on November 15, 2005. Commercial paper is an efficient mechanism for providing interim financing for capital projects, as interest rates are typically lower than rates on long-term bonds. This recommendation proposes an increase in the aggregate size of the Airport CP Program from \$100 million to \$200 million to provide the additional interim funding for projects and capitalized interest associated with the rephased Airport Master Plan. A combination of the three series of Notes may be issued to support the Airport Master Plan's funding needs and the series of Notes to be issued will depend on the nature of the expense.

The Airport CP Program will provide additional funding capacity for the North Concourse Projects when the encumbrance capacity from the 2004 Airport Bond proceeds are exhausted and prior to the issuance of the next series of Airport revenue bonds. It is anticipated that by July 1, 2006, the 2004 Airport Bond proceeds will have been expended or encumbered and the financing capacity of the existing Airport CP Program, on an encumbrance basis, will also be exhausted. It is at this time that additional capacity in the Airport CP Program will be needed to fund a portion of the contract awards consistent with the Airport's rephased Master Plan Program. As has been the City's prior practice, it is anticipated that Notes will be issued as funds are needed to pay program costs.

Initially, it was anticipated that Series B Notes would be used to fund the North Concourse Projects as well as the other projects located on the Airport. Although only approximately \$8 million in Series C Notes are currently outstanding, the Airport CP Program expansion is primarily intended to cover, on an encumbrance basis, expected contract awards between July 1 and December 2006, related to various Master Plan projects, such as the design-build agreement for the Terminal Area Improvement Program and the continuation of the North Concourse Building and related projects.

This recommended action will be the first phase of a multi-phase funding program for the \$1.5 billion rephased Airport Master Plan Program that anticipates the issuance of approximately \$1.2 billion in Airport Revenue Bonds and was approved in concept by City Council on November 15, 2005. It is staff's intent to return to Council in Fall 2006 to recommend additional financing strategies for implementation of the rephased Airport Master Plan.

### **TEFRA Hearing Requirements**

The federal tax law, known as the Tax Equity and Fiscal Responsibility Act of 1984 ("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.

### **Use of Taxable Notes for Lease Payments on Property**

In February 2005, the City purchased 56 acres of property commonly referred to as the "former FMC property" (the "Property") using City of San José Financing Authority bonds issued in 2005 (the "2005 Authority Bonds"). The City currently leases the Property from the City of San José Financing Authority for interim Airport purposes. The lease payments are the debt service payments on the 2005 Authority Bonds. The City's lease payments are paid from the Airport Maintenance and Operation Fund, however, should the lease be terminated then the City is ultimately responsible for making the debt service payments from other available funds, primarily the General Fund.

At the time the 2005 Authority Bonds were issued, the planned interim Airport uses for the Property were rental car operations, Airport employee/tenant parking and construction staging. Because the Property would not be immediately available for rental car use, the financing plan included capitalizing interest for 24 months ("Capitalized Interest") on the taxable series of 2005 Authority Bonds used to finance a portion of the Property. At the time, the City planned to rely upon lease payments from the rental car users of the Property to pay debt service at the end of the Capitalized Interest period. As part of the rephasing of the Airport Master Plan approved in concept by Council on November 15, 2005, the rental car operations previously planned for the Property will remain on Airport premises and not relocate to the Property.

A study that will identify opportunities for the Airport's use of the Property is currently being conducted. It is staff's intent to return to the City Council with any recommendations required. It is anticipated that the Capitalized Interest will be exhausted in February 2007, and that the City will use the Series C Notes (taxable) to fund the portion of the estimated annual lease (debt service) obligation for the Property associated with the taxable series of 2005 Authority Bonds. At this time, the amount of the lease obligation for the Property is budgeted at \$4.7 million for FY 2006-07, approximately \$3.6 million of which is anticipated to be paid from the Series C Notes (taxable). The remainder of the annual lease obligation for the Property will be funded from amounts in the Airport Maintenance and Operation Fund. Staff anticipates using the Series C Notes to fund a portion of the estimated annual lease obligation for the Property until the site is fully utilized for Airport purposes. However, if the study does not identify feasible Airport purposes for the Property and the Airport discontinues its lease of the Property, then lease payments on the 2005 Authority Bonds will then be payable from the City's General Fund.

### **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 June 2, 2006 in the *San José Mercury News*, announcing the time and location of the public hearing.

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 offices of the City Attorney and Economic Development.

**COST IMPLICATIONS**

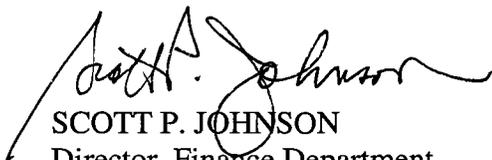
Not applicable.

**BUDGET REFERENCE**

Not applicable.

**CEQA**

Resolution Nos. 67380 and 71451, PP 06-084.

  
SCOTT P. JOHNSON  
Director, Finance Department

  
WILLIAM F. SHERRY, A.A.E.  
Aviation Director

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