COUNCIL AGENDA: 08-14-07
ITEM: 3.9

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

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

SUBJECT: SEE BELOW

DATE: July 23, 2007

Approved [signature] Date 7/27/07

COUNCIL DISTRICT: Citywide

SUBJECT: APPROVAL OF THE SALE AND ISSUANCE OF BONDS AND RELATED BOND DOCUMENTS FOR CITY OF SAN JOSE AIRPORT REVENUE BONDS, SERIES 2007A, 2007B, 2007C AND 2007D

RECOMMENDATION

a. Hold a TEFRA (Tax Equity and Fiscal Responsibility Act) hearing for the issuance of debt pursuant to a plan of finance for Phase I of the Norman Y. Mineta San José International Airport's Master Plan, including Airport Revenue Bonds in an aggregate principal amount not to exceed $825 million, for the purpose of financing and refinancing a portion of the costs of Phase I of the Master Plan, refinancing certain prior bonds, and funding the associated financing costs.

b. Adoption of the Fifteenth Supplemental Resolution of the City Council:

1. Authorizing the issuance of City of San José Airport Revenue Bonds, Series 2007A (the "2007A Bonds"), Series 2007B (the "2007B Bonds"), Series 2007C Refunding (the "2007C Bonds"), and Series 2007D Refunding (the "2007D Bonds") (collectively, the "2007 Bonds") in the not-to-exceed aggregate principal amount of $825 million to be sold through a negotiated sale for the purpose of financing a portion of the costs of Phase I of the Airport Master Plan; funding capitalized interest on the 2007 Bonds and for a portion of the outstanding City of San José Airport Revenue Bonds, Series 2004 (the "2004 Bonds"); funding financing fees associated with the 2004 Bonds; refinancing some or all of the tax-exempt commercial paper notes issued to fund a portion of the Phase I projects; refinancing certain outstanding City of San José Airport Revenue Refunding Bonds, Series 1998A (the "1998A Bonds") and San José Airport Revenue Bonds, Series 2001A (the "2001A Bonds") to the extent such refinancings provide sufficient debt service savings to the City; funding a reserve fund or the cost of a reserve surety policy; funding the bond insurance premium; and paying the costs of issuance of the 2007 Bonds.

2. Authorizing the negotiation and execution of certain financing documents, including the Fifth Supplemental Trust Agreement, one or more Escrow Agreements and other related documents; authorizing the negotiated sale of the 2007 Bonds and the negotiation and execution of the Bond Purchase Agreement with Lehman Brothers, as representative of the underwriters; approving in substantially final form the Preliminary Official Statement for the 2007 Bonds and authorizing the distribution of the Preliminary and Final Official Statements for the 2007 Bonds; declaring the official intent of the City to reimburse certain expenditures from the proceeds of indebtedness; and authorizing certain related actions in connection with the issuance of the 2007 Bonds.

c. Approval of an Agreement by and among the City, Fullerton & Friar, Inc., and Public Resources Advisory Group for financial advisory services in connection with the issuance of the 2007 Bonds in an amount not to exceed $270,000 for the term of February 27, 2007, to December 31, 2007.

d. Adoption of a resolution authorizing the City Attorney to negotiate and execute an Agreement with Orrick, Herrington & Sutcliffe LLP for bond and disclosure counsel services in connection with the issuance of the 2007 Bonds in an amount not to exceed $350,000.

OUTCOME

Approval of these recommendations will allow the issuance of the City of San José Airport Revenue Bonds, Series 2007, for the purpose of financing and refinancing certain Airport capital improvements.

EXECUTIVE SUMMARY

This staff report recommends the issuance of airport revenue bonds to finance and refinance a portion of the costs of the Phase I Airport Master Plan projects, fund related financing costs, and refinance certain outstanding airport revenue bonds to the extent such a refinancing would be economic. The Tax Equity and Fiscal Responsibility Act ("TEFRA") hearing must be conducted to notify the community of the City's intent to issue qualified tax-exempt private activity bonds.

BACKGROUND

The Master Plan for the Airport, originally adopted in 1997, was amended by the City Council on June 13, 2006 (the "Master Plan"), to address changes in passenger demand volume since September 11, 2001, and to re-phase the development program as a means of maintaining competitive airline rates and charges. The most significant changes to the Master Plan were to modify the Master Plan forecast, which moved the horizon year out to fiscal year 2017 (from fiscal year 2010) and extended the associated development program.

The Airport's capital program over the next several years is focused on completing construction of the North Concourse building as well as the implementing a Terminal Area Improvement Program (the "TAIP"). The TAIP consists of a number of projects in the terminal area, many of which are included in the design-build contract awarded to Hensel Phelps Construction on October 17, 2006.

The Phase I projects of the Airport capital program consist of the completion of the North Concourse facility, including nine new gates and approximately 366,000 square feet of new terminal space; design and construction of a portion of the new Terminal B, including two new gates and approximately 116,000 square feet of new terminal space; improvements to Terminal A, including new ticketing facilities, a new in-line baggage system and security checkpoint, lobby concessions and other improvements; temporary improvements to ticketing, baggage claim, and other passenger facilities in the existing Terminal C; the phased demolition of the existing Terminal C; construction of a new consolidated rental car garage and rental car service area to be located directly across from Terminal B; other parking and roadway improvements; airfield projects, including noise mitigation and the reconstruction of Taxiway Y; and other improvements, including construction of a new belly freight facility and the Aircraft Rescue and Fire Fighting Facility. The estimated cost of the Phase I projects is approximately $1.3 billion (excluding costs paid by the City through fiscal year 2004-05).

On January 9, 2007, the City Council approved an expansion of the Airport Commercial Paper Program from $200 million to $450 million to ensure that interim funding would be available for the award of the design and construction contracts; pay capitalized interest related to the amended Master Plan until the 2007 Bonds are sold; and provide financing for certain future costs not payable from proceeds of the 2007 Bonds.

On March 27, 2007, the City Council authorized the City Manager to negotiate and execute Airport-Airline Lease and Operating Agreements (the "Agreements") with both Signatory and Non-Signatory Airlines, including any such airlines and cargo airlines that commence operations at the Airport following the effective date of the Agreements. The term of the Agreements are from July 1, 2007, to June 30, 2012, with an option to extend for another five years thereafter. Among other things, the new Agreements grant unconditional approval of all Phase I projects. Phase II projects, which are expected to include construction of the remaining portion of the new Terminal B and the South Concourse, apron expansion, a new central plant and other utility improvements, are conditionally approved contingent on the attainment of specific activity levels at the Airport. To date, Delta Air Lines has returned its signed Agreement to the Airport.

On May 17, 2007, staff reviewed the Phase I financing plan with the Public Safety, Finance and Strategic Support Committee. The presentation to the Committee included an overview of the plan of finance, introduction of the financing team, a summary of the proposed bonds, discussion of the sources of debt repayment and a review of the proposed financing schedule.

ANALYSIS

The following sections of the report address the items in staff's recommendation to proceed with the issuance of the 2007 Bonds. These sections include: TEFRA Hearing, Declaration of Intent, Plan of Finance, Bond Financing Documents, Financing Team Participants, and Financing Schedule.

TEFRA Hearing

Section 147(f) of the Internal Revenue Code requires that, before private-activity bonds may be issued, the City must approve the issuance of such obligations after conducting a public hearing. This hearing, known as a Tax Equity and Fiscal Responsibility Act (TEFRA) hearing, is scheduled to be held as part of the action items on the August 14, 2007, Council Agenda, and is intended to provide an opportunity for all interested persons to express their views both orally and in writing on the proposed issuance of the private-activity Airport Revenue Bonds that will provide long-term financing for Phase I of the Master Plan. The City previously held a TEFRA hearing on January 9, 2007, in connection with the expansion of the Airport Commercial Paper Program to $450 million to provide interim financing for the Master Plan projects.

The notice for the public hearing, which is scheduled to be published on July 27, 2007 in the *San Jose Mercury News*, states the City's non-binding intent to issue up to a cumulative total of $825 million of tax-exempt private-activity bonds for Phase I of the Airport Master Plan pursuant to a plan of finance.

Declaration of Intent

Federal tax regulations allow issuers of tax-exempt bonds to use bond proceeds for reimbursement of certain prior expenditures for the project to be financed. However, such reimbursement can only occur if the issuer has adopted an official resolution declaring its intent to reimburse the expenditures with bond proceeds. The City's declaration of intent to reimburse itself from the proceeds of debt obligations will apply to construction expenditures made within 60 days prior to the adoption of the resolution. In general, any such reimbursement of construction expenditures must be made no later than three years after the cost is originally paid. "Soft costs" (such as architectural, engineering, surveying, soil testing, costs of issuance and similar costs) may always be reimbursed whether or not a resolution was adopted and regardless of the timing of the reimbursement.

The holding of the TEFRA hearing, the declaration of official intent and the approval of the plan of finance are intended solely for purposes of complying with the requirements of the Treasury Regulations and the Internal Revenue Code, and do not bind the City to make any expenditure, incur any indebtedness, or proceed with Phase I of the Master Plan or any portion thereof.

Plan of Finance

This section reviews the sources of funding for the Phase I Master Plan projects, provides a description of the 2007 Bonds, to include a summary of the estimated sources and uses of funds, and discusses the additional bonds tests which will apply to the issuance of the Series 2007 Bonds.

Sources of Master Plan Phase I Funding

City staff, working together with Ricondo & Associates, the Airport's feasibility consultant, and co-financial advisor Fullerton & Friar, project that funding of Phase I the Master Plan will require Airport Revenue Bond proceeds of approximately $707.6 million (including $90.5 million from the 2004 Bonds) and Airport Commercial Paper proceeds of approximately $315.9 million, which, together with AIP grants, internally generated funds and other grants, passenger facility charges ("PFCs"), Airport renewal and replacement ("R&R") funds, lease revenue bond proceeds and customer facility charges ("CFCs"), will be sufficient to complete the funding of the Phase I Master Plan projects. Please see the attached Appendix for a brief summary of the Airport feasibility report.

Of the $315.9 million of Airport Commercial Paper Proceeds noted above, approximately $225.5 million is expected to initially fund the proposed consolidated rental car facility, along with CFC revenues collected during the construction period. Each of the eight rental car companies operating at the Airport has signed a letter of intent outlining terms for participation in the planned consolidated rental facility. The letter of intent establishes the commitment of the rental car companies to participate in the design of the facility and agree to the minimum terms and conditions set out in the letter of intent. The rental car companies will be required to make annual contributions (rent payments in addition to concession and space fees) as a source of funding for the facility. The letter of intent does not constitute a binding contract or agreement of any type between the parties. City staff is working on a concession and lease agreement incorporating the terms of the letter of intent and that agreement will be presented to Council for approval at a later date. The City expects to collect rental car CFC revenues and certain rental car payments (that are in addition to current rental car concession and space fees paid to the City) from rental car companies that will be sufficient to repay the debt associated with the consolidated rental car facility over a 25 year period.

If the City does not receive the other sources of funding as shown below in addition to the 2007 Bonds, the City will likely have to issue additional bonds or commercial paper to complete all the projects associated with Phase I of the Master Plan. City staff expects that it will recommend to the Council that the City refinance some or all of the commercial paper issued to fund Phase I projects with long-term bonds on or around the projected completion date of the Phase I projects in 2010; however, this could be subject to change due to market conditions, the Airport's operations and performance, and other factors. No commitment to any such refinancing is being made at this time.

City of San José
Plan of Finance – Sources of Funding
Airport Master Plan – Phase I

Series 2004 Airport Revenue Bonds	$ 90,505,000
Series 2007A and Series 2007B Airport Revenue Bonds	617,105,000
Airport Commercial Paper	315,909,000
AIP Grants	54,101,000
Airport Funds(1)	33,652,000
PAYGO Funds (PFCs)	121,238,000
Other(2)	81,032,000
Total	$ 1,313,542,000

(1) Airport Funds include $14.3 million from internally generated cash and $19.3 million of reimbursed grant proceeds (for North Concourse Project).

(2) Other funds include $52.7 million of R&R Funds, $16.3 million of proceeds from the Series 2005 San José Financing Authority bond issue and $12.0 million of rental car CFC collections during the construction period. The proceeds from the Series 2005 San José Financing Authority bond issue are designated for the improvement of the Airport West Property, and may not be expended depending on the outcome of the negotiations with FWSH Partners.

Description of the Series 2007 Bonds

The 2007 Bonds will be issued pursuant to a Fifth Supplemental Trust Agreement to the Master Trust Agreement dated August 1, 2007 (together with prior Supplemental Trust Agreements, the "Trust Agreement"), as described below. The 2007 Bonds are limited obligations of the City secured by a pledge of general airport revenues and certain other funds held or made available under the Master Trust Agreement, after the payment of maintenance and operation costs. In addition to general airport revenues, the City also anticipates applying a portion of its PFC revenues to pay a portion of the debt service on the 2007 Bonds.

The 2007 Bonds will be issued in up to four series as the City of San José Airport Revenue Bonds, Series 2007A (the "2007A Bonds"), Series 2007B (the "2007B Bonds"), Series 2007C Refunding (the "2007C Bonds"), and Series 2007D Refunding (the "2007D Bonds) (collectively, the "2007 Bonds") in the not-to-exceed aggregate principal amount of $825 million. Federal tax law permits the issuance of tax-exempt bonds for either governmental purposes (non-AMT) or for specified private purposes that are "qualified" as tax-exempt subject to the Alternative Minimum Tax (AMT). The 2007A Bonds and 2007D Bonds are subject to the AMT, and the 2007B Bonds and 2007C Bonds are non-AMT bonds. The 2007A Bonds and 2007B Bonds will have a final maximum maturity date of March 1, 2047. The principal amortization of the 2007 Bonds will be structured to result in approximately equal aggregate annual debt service payments.

Bond proceeds will be used to fund construction costs of Phase I of the Master Plan; refinance commercial paper issued to fund such construction costs in advance of the issuance of the 2007 Bonds; fund interest on the 2007 Bonds through June 30, 2010 (the anticipated completion date of the TAIP projects) and interest on a portion of the 2004 Bonds through

June 30, 2010; fund financing fees for a portion of the 2004 Bonds through June 30, 2010 (the anticipated beneficial occupancy date of the North Concourse); refund certain outstanding 1998A Bonds and 2001A Bonds, to the extent such refinancings provide sufficient debt service savings to the City; fund a debt service reserve fund for the 2007 Bonds or provide for the funding of a surety bond to satisfy the reserve requirement; fund the bond insurance premium, and pay the costs of issuing the 2007 Bonds.

The debt service reserve requirement for the 2007 Bonds is estimated to be approximately $46.5 million. The decision to satisfy the debt service reserve requirement with proceeds of the 2007 Bonds or through the purchase of a surety bond will be based upon an economic analysis that will be made closer to the pricing date. This economic analysis will depend upon the premiums proposed during the request for proposal process for bond insurance in July as well as certain factors related to the pricing of the 2007 Bonds, including the available reinvestment rate for a cash-funded reserve at that time.

The estimated sources and uses of funds for the 2007A Bonds and 2007B Bonds (the "New Money Bonds") are shown below:

City of San José
Airport Revenue Bonds, Series 2007A and Series 2007B
Estimated Sources and Uses of Funds[(1)]

	2007A	2007B	Total
Sources of Funds:			
Par Amount of Bonds	$ 568,605,000	$ 184,985,000	$ 753,590,000
Premium	9,688,808	5,909,182	15,597,991
Total Sources of Funds	$ 578,293,808	$ 190,894,182	$ 769,187,991
Uses of Funds[(2)]:			
Project Fund	$ 403,354,677	$ 140,808,833	$ 544,163,510
Refund Commercial Paper	29,153,000	6,586,000	35,739,000
2004 Bonds Capitalized Interest	26,019,372	4,426,542	30,445,914
2004 Bonds Capitalized Fees	2,215,054	0	2,215,054
2007 Bonds Capitalized Interest	69,034,099	23,284,837	92,318,936
Debt Service Reserve Fund	35,116,750	11,425,750	46,542,500
Underwriter's Discount	1,847,966	601,201	2,449,167
Costs of Issuance[(3)]	1,421,513	462,463	1,883,976
Bond Insurance (excluding Surety)	10,127,536	3,294,804	13,422,340
Rounding	3,841	3,752	7,594
Total Uses of Funds	$ 578,293,808	$ 190,894,182	$ 769,187,991

(1) Preliminary; subject to change.
(2) The Project Fund and Capitalized Interest Funds are net funded at an assumed 4% investment rate.
(3) Includes bond counsel fees and expenses, financial advisor fees and expenses, rating agencies fees, trustee fees and expenses, and printing costs.

As stated above, the 2007 Bonds may include up to two refunding components: a current refunding of all or a portion of the outstanding maturities of the 1998A Bonds (to be refunded by the 2007D Bonds) and an advance refunding of a portion of the outstanding 2001A Bonds (to be refunded by the 2007C Bonds). Incorporating a refunding with a "new money" issuance creates certain efficiencies: it reduces costs of issuance, enhances refunding savings through the higher allowable escrow yield, and saves staff time in managing outstanding debt.

Current Refunding of 1998A Bonds 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 proceeds of the 2007D Bonds used to refund the 1998A Bonds, of which $9.35 million are outstanding, will be held in trust in an escrow fund with the Trustee until the redemption date. The current financing schedule calls for the 2007 Bonds to close on September 12, 2007 with the 1998A Bonds to be redeemed on December 10, 2007.

The City's adopted Debt Management Policy specifies a minimum of 3% net present value savings for a refunding to be considered economically viable, although it also provides for consideration of refundings below the 3% threshold on a case-by-case basis. Recent movements in tax-exempt interest rates have rendered a refunding of the 1998A Bonds only marginally economic at present, but staff recommends continuing to monitor these bonds for refunding potential up to the anticipated bond pricing on August 22-23, 2007.

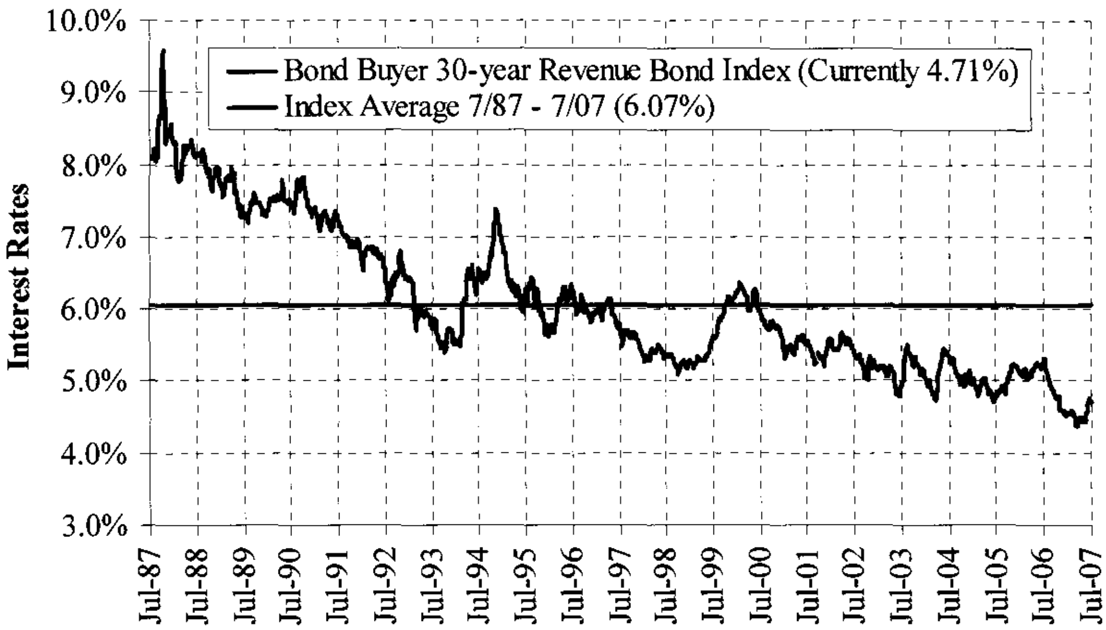
Advance Refunding of 2001A Bonds An advance refunding is a refunding in which the refunding bonds are issued more than ninety (90) days before the redemption date upon which the outstanding bonds become due or are callable. The proceeds of the 2007C Bonds used to refund a portion of the 2001A Bonds will be held in trust in an escrow fund with the Trustee. The escrow will be sufficient to pay principal and interest on the bonds through March 1, 2011, the first date on which the 2001A Bonds can be redeemed.

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. Accordingly, only the portion of the eligible 2001A Bonds providing significant savings above the 3% net present value savings threshold will be considered for refunding. Of the $145.8 million of 2001A Bonds currently outstanding, $131.3 million are eligible for refunding. At present, only approximately $29.6 million of the 2001A Bonds appear to be economic. As with the potential refunding of the 1998A Bonds, staff will continue to monitor the 2001A Bonds for refunding savings through the anticipated bond pricing.

Concurrent with the delivery of the 2007 Bonds, and to the extent conditions at the time of the sale of the 2007 Bonds warrant a refunding of either or both the 1998A Bonds or the 2001A Bonds, the City will enter into Escrow Agreement(s) with the Trustee. The terms of the Escrow Agreement(s) are described more fully below in the Bond Financing Documents section.

The 2007 Bonds will be issued as fixed-rate bonds to take advantage of currently favorable market conditions. As illustrated in the chart below, long-term fixed interest rates (and the interest rate premium for bonds subject to the AMT) are at historically low levels. The Airport currently has approximately $485.5 million of bonds outstanding, of which approximately $140.0 million are in a variable-rate mode. Following the issuance of the 2007 Bonds, approximately 11 percent of the Airport's outstanding debt will be in variable rate mode. Taking into account the estimated issuance of commercial paper to fund a portion of the costs of Phase I of the Master Plan, total variable rate debt is expected to increase to 41 percent by the completion of the Phase I projects in 2010.

Long-Term Fixed Interest Rates are at Historical Lows



Projects that will have significant private use which is not a qualified tax-exempt use must be funded from the proceeds of taxable bonds or taxable commercial paper. The City does not plan to include long-term taxable bonds in the issuance of the 2007 Bonds, but instead will initially fund any taxable projects (primarily the rental car facility included in Phase I of the Master Plan), as well as all projects for which the ultimate federal tax treatment or source of funding is uncertain, from the proceeds of the sale of commercial paper. Use of the Airport Commercial Paper Program for these expenditures will allow the City to retain the ability to refund any eligible project costs with tax-exempt long-term bonds or commercial paper when the appropriate federal tax treatment has been ascertained. Issuance of long-term bonds that may be issued in the future to refinance commercial paper will require City Council approval at the time of issuance of the bonds and will be subject to a number of considerations. Therefore, no commitment is being made at this time to refinance or restructure any commercial paper in the future.

Conditions for Issuance of Additional Airport Revenue Bonds

The City, pursuant to the City Charter and Municipal Code, has the authority to issue Airport Revenue Bonds. Currently, the City has four outstanding issuances of Airport Revenue Bonds. The 1998A Bonds were issued pursuant to Resolution No. 57794, as amended and supplemented, originally adopted by the City Council in 1984 (the "1984 Resolution"). In 2001, the City adopted Supplemental Resolution No. 70532 approving the amendment and restatement of the 1984 Resolution in the form of the Master Trust Agreement dated as of July 1, 2001 (the "Master Trust Agreement") between the City and BNY Western Trust Company, predecessor in interest to The Bank of New York Trust Company, N.A., as Trustee (the "Trustee").

Under the Master Trust Agreement, the City has issued the 2001A Bonds pursuant to the First Supplemental Trust Agreement, the 2002A Bonds and 2002B Refunding Bonds pursuant to the Second Supplemental Trust Agreement, the 2004A and the 2004B Bonds pursuant to the Third Supplemental Trust Agreement, and the 2004C and the 2004D Bonds pursuant to the Fourth Supplemental Trust Agreement.

Under the Master Trust Agreement, the City is authorized to issue additional new money bonds conditioned upon certain tests being met. The 2007A and the 2007B Bonds are proposed to be issued under the prospective additional bonds test, which requires that net general revenues plus other funds available for debt service for the longer of the next five fiscal years, or the three fiscal years following the fiscal year in which the project is expected to be completed, must be at least equal 1.25% of annual debt service on all outstanding bonds after the 2007A Bonds and the 2007B Bonds are issued.

For the purposes of the 2007A Bonds and the 2007B Bonds, this forecast period will be through fiscal year 2013, three full fiscal years following the anticipated completion of Phase I of the Master Plan projects in fiscal year 2010. In conjunction with the issuance of the 2007A Bonds and the 2007B Bonds, the Airport's feasibility consultant, Ricondo & Associates, has prepared a report setting forth a projection of estimated net general airport revenues and other available funds pledged to the payment of the 2007A Bonds and the 2007B Bonds. The City will deliver to the Trustee a certificate setting forth the annual debt service on all bonds subject to the lien of the Master Trust Agreement (including the 2007 Bonds), and the projections of net general airport revenues and other available funds provided by Ricondo & Associates, which demonstrate that these projected revenues equal at least 125% of the annual debt service for each corresponding fiscal year through fiscal year 2013. Based on the Ricondo & Associates report, estimated debt service coverage will range from 175% to 202% within the projection period of 2009 to 2015.

Pursuant the Master Trust Agreement, the City is also authorized to issue additional bonds for the purpose of refunding outstanding Airport Revenue Bonds so long as (i) the proceeds are used solely to pay or defease the refunded Airport Revenue Bonds and to pay the costs of issuance, accrued interest, and reserve costs of the refunding Airport Revenue Bonds and (ii) the annual debt service for the refunding Airport Revenue Bonds in each year is less than or equal to the annual debt service for the refunded Airport Revenue Bonds in each year the refunding bonds are to be outstanding. The 2007C and the 2007D Bonds are proposed to be issued pursuant to this test.

Bond Financing Documents

There are a number of bond financing documents that require City Council approval to proceed with the issuance of the 2007 Bonds. All of these documents in substantially final form will be available for review in the City Clerk's Office on or about August 3, 2007.

Official Statement The Official Statement is the public offering statement for the issuance of the 2007 Bonds. Disclosure Counsel, on behalf of the City, has prepared the Preliminary Official Statement for the 2007 Bonds. This document describes the projects to be funded with the 2007 Bonds, activity information on the Airport, and the financial condition of the Airport. The Official Statement also includes, as an appendix, the full report of the Airport's independent airport consultant, Ricondo & Associates. Investors use this information to evaluate the credit quality of the 2007 Bonds. Following the sale of the 2007 Bonds to the underwriters and prior to the closing, Disclosure Counsel will prepare the final Official Statement for the 2007 Bonds.

Staff recommends that the Director of Finance and the Director of Aviation be authorized to sign the final Official Statement for the 2007 Bonds on behalf of the City 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 Director of Finance and the Director of Aviation 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 purpose of marketing the 2007 Bonds.

A copy of the draft Preliminary Official Statement for the 2007 Bonds, in substantially final form, will be distributed to the City Council under separate cover on or about August 3, 2007. Staff has carefully reviewed the information contained in this offering document and believes it to be accurate and complete in all material respects.

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

City staff, bond counsel, and the financial advisors will be available at the Council meeting on August 14, 2007, to address any questions, issues and/or concerns.

Staff recommends that the Director of Finance or the Director's authorized designees be authorized to execute each of these agreements described below. As modifications may be required prior to the closing, staff also recommends that the Director of Finance be authorized to execute the final version of each of these agreements as may be modified upon consultation with the City Attorney's Office.

Fifth Supplemental Trust Agreement The Fifth Supplemental Trust Agreement contains the responsibilities and duties of the Trustee and the rights of the bondholders in connection with 2007 Bonds. In addition, the Fifth Supplemental Trust Agreement will amend the terms of the Master Trust Agreement in order to (i) change the name of the Safety Net Account to the Rate Stabilization Fund, which is the current name for this fund; (ii) eliminate the $3 million cap on the amount permitted to be deposited in the Airport's Renewal and Replacement Account to give the City additional flexibility with respect to funding the Renewal and Replacement Account; and (iii) revise the requirement for reporting to the Trustee the insurance polices applicable to the Airport in order to conform this report requirement with the City's practices for the procurement of insurance.

Escrow Agreements To the extent either or both of the 1998A Bonds and 2001A Bonds are refunded, the City will enter into an Escrow Agreement with the Trustee (The Bank of New York Trust Company, N.A.) for each refunded series. The Escrow Agreement(s) sets forth the responsibilities of the Trustee, as Escrow Agent, with respect to the investment and application of funds in the Escrow Fund with respect to each series of refunded bonds. Each Escrow Agreement will direct Trustee 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 2007 Bonds in separate Escrow Funds established for the 1998A Bonds and the 2001A Bonds, respectively. Each Escrow Fund will be used to redeem the corresponding series of outstanding Bonds on their redemption dates. Any 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 U.S. securities.

Bond Purchase Agreement. The Bond Purchase Agreement is a contract between the City and the underwriters as the purchasers of the 2007 Bonds. The Bond Purchase Agreement specifies the representations and warranties of the City, the documents to be executed at closing, and the conditions that allow the purchaser to cancel the purchase of the 2007 Bonds. The City will be entering into Bond Purchase Agreement with Lehman Brothers Inc. as the Senior Manager and representative of the underwriting team, which includes Citigroup and Merrill Lynch as Co-Senior Managers, and a Co-Manager team that includes E.J. De la Rosa & Co., Goldman Sachs, Loop Capital, Morgan Stanley and RBC Dain Rauscher. The underwriters will be paid a takedown for the 2007 Bonds of $3.00/$1,000 of the par amount issued. The City will reimburse the senior managing underwriter for its expenses, including underwriters' counsel.

Continuing Disclosure Agreement This Agreement 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 Co-Financial Advisors:	Fullerton & Friar, Inc. Public Resources Advisory Group
• Bond and Disclosure Counsel:	Orrick Herrington & Sutcliffe LLP
• Independent Airport Consultant	Ricondo & Associates, Inc.
• Underwriting Team:	Senior Manager - Lehman Brothers Co-Senior Managers – Citigroup and Merrill Lynch Co-Managers – E.J. De la Rosa Goldman Sachs Loop Capital Morgan Stanley RBC Dain Rauscher
• Underwriters' Counsel:	Kutak Rock LLP
• Bond Insurer:	To be determined
• Trustee/Escrow Agent:	The Bank of New York Trust Company, N.A.

Financing Team Agreements

The Finance and Airport Departments are recommending approval of an agreement with the City's co-financial advisors for financial advisory services related to the 2007 Bonds. Their current agreement (the "Current Agreement") with the City (approved February 27, 2007) provides general financial advisory services related to the Master Plan on a time and materials basis. The Current Agreement specifies that financial advisory services specific to a bond issuance will be provided pursuant to a separate agreement by and among the City and the co-financial advisors.

The Current Agreement sets forth a fee schedule for additional services related to specific bond issues to be provided with compensation to be contingent on the sale of bonds. Total compensation for this recommended contract will not exceed $270,000 including expenses. Professional fees and expenses will be split 50/50 between each firm. The term of the agreement will be retroactive from February 27, 2007, and will expire on December 31, 2007. Staff estimates that all services under the proposed agreement will be completed in October 2007. The firms' compensation is contingent on the sale of Bonds and is to be paid from bond proceeds.

The City Attorney's Office is recommending that the City Attorney be authorized to negotiate and execute an agreement with Orrick, Herrington & Sutcliffe LLP for bond and disclosure counsel services related to the 2007 Bonds in an amount not to exceed $350,000. Orrick, Herrington & Sutcliffe LLP has previously provided bond and disclosure counsel services related to the City's issuance of Airport debt. Accordingly, they are familiar with the structure of the

City's Airport debt portfolio as well as other issues related to the City's issuance of Airport revenue bonds. The term of the agreement with Orrick, Herrington & Sutcliffe LLP will be retroactive from March 15, 2007, and will expire following issuance of the proposed bonds. The firm's compensation is contingent on the sale of the 2007 Bonds and is to be paid from bond proceeds.

Financing Schedule

The current proposed schedule is as follows:

City Council approval of bond documents:	August 14, 2007
Distribute Preliminary Official Statement to investors:	August 15, 2007
Price Bonds:	August 22 - 23, 2007
Bond closing:	September 12, 2007

EVALUATION AND FOLLOW-UP

On May 17, 2007, the Finance and Airport Departments made a presentation to the Public Safety, Finance and Strategic Support Committee. The presentation to the Committee included an overview of the plan of finance, introduction of the financing team, a summary of the proposed bonds, discussion of the sources of debt repayment and a review of the proposed financing schedule. At that time it was anticipated Council approval of the bond sale would occur in June 2007. Additional work on the feasibility study necessitated modification of the schedule.

This memorandum presents the set of recommendations related to the City Council's approval of the issuance of the 2007 Bonds. Subsequent to the bond sale and closing, an informational memorandum will be prepared for the City Council which will provide the results of the bond sale, including any potential refunding savings.

PUBLIC OUTREACH/INTEREST

A public hearing will be held on August 14, 2007, as a method of notifying the community of the City's intent to issue qualified tax-exempt private-activity bonds requiring that the City provide notice in a newspaper of general circulation of the City Council meeting at which the Council will consider approval of the financing. The public hearing notice is scheduled to be published in the *San Jose Mercury News* on July 27, 2007, announcing the time and location of the public hearing.

☑ **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 report was prepared by the Finance and Airport Departments in coordination with the City Attorney's Office and financing team participants.

COST SUMMARY/IMPLICATIONS

Based on current interest rates, the annual debt service for the New Money Bonds will be approximately $46.5 million per fiscal year beginning in fiscal year 2013-14 when principal amortization is expected to commence, bringing aggregate debt service on all outstanding Airport Revenue Bonds to approximately $80.6 million per year.

Compensation, including reimbursable expenses, for the co-financial advisors, bond/disclosure counsel and underwriters is contingent on the successful sale and close of the 2007 Bonds and will be paid from bond proceeds. Compensation for the independent airport consultant is not contingent on the sale of the 2007 Bonds and has been paid from the Airport Operating Fund. It is anticipated that the Airport Operating Fund will be reimbursed from bond proceeds for this cost. In the event that the 2007 Bonds do not close, the City would be responsible for reimbursing bond/disclosure counsel for the cost of publication of the TEFRA notice, in which case this cost would be paid from the Airport Operating Fund.

CEQA

Resolutions No. 67380 and 71451, PP 07-149.

Scott P. Johnson

SCOTT P. JOHNSON
Director, Finance Department

WILLIAM F. SHERRY, A.A.E.
Director, Airport Department

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

RICONDO
& ASSOCIATES

July 19, 2007

Mr. William F. Sherry
Director of Aviation
City of San José
1732 N. First Street, Suite 600
San José, CA 95112-4508

Re: ***City of San José***
Airport Revenue Bonds, Series 2007A (AMT)
Airport Revenue Bonds, Series 2007B (Non-AMT)

Appendix B: Report of the Independent Airport Consultant

Dear Mr. Sherry:

This report sets forth findings, assumptions, and projections of the air traffic and financial analyses developed by Ricondo & Associates, Inc. (R&A), in conjunction with the planned issuance by the City of San José (the City) of its Airport Revenue Bonds, Series 2007A (AMT) (Series 2007A Bonds) and its Airport Revenue Bonds, Series 2007B (Non-AMT) (Series 2007B Bonds) (collectively the Series 2007 Bonds), for improvements at Norman Y. Mineta San José International Airport (the Airport). The Airport is owned by the City, operated as a department of the City, and accounted for as a self-supporting enterprise fund in the basic financial statements of the City. This report is intended for inclusion in the Official Statement for the Series 2007 Bonds as Appendix B: Report of the Independent Airport Consultant.

Proceeds of the Series 2007 Bonds, along with certain other available funds, will pay for the costs of Phase 1 of the Airport's Development Program. Major Phase 1 elements that will receive funding from the proceeds of the Series 2007 Bonds include completion of the new nine-gate North Concourse, construction of the first phase of the new Terminal B, improvements to the existing Terminal A, the phased removal of the existing Terminal C, and various terminal area roadway improvements, all as more fully described in this report.

Proceeds of the Series 2007 Bonds will also be used to fund capitalized interest, the required debt service reserve fund, and costs of issuance associated with the Series 2007 Bonds. Proceeds of the Series 2007 Bonds will also be used to fund additional capitalized interest associated with Outstanding Series 2004 Bonds and also refund outstanding commercial paper.

The City is considering the possibility of issuing certain refunding bonds in conjunction with the issuance of the Series 2007 Bonds. The City is considering refunding all or a portion of its Outstanding Series 1998A (AMT) and Series 2001 (Non-AMT) Bonds and expects that debt service savings would result from these potential refundings. These potential refundings (and any associated debt service savings) have not been assumed in this report or the accompanying financial tables.

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& ASSOCIATES

Mr. William F. Sherry, A.A.E.
Director of Aviation
City of San José
July 19, 2007

This report includes examinations of the underlying economic base of the Air Service Area (as defined in this Report) for the Airport (Chapter 1); the historical and projected air traffic activity at the Airport (Chapter 2); a description of existing Airport facilities, including a summary of Phase 1 of the Airport's Development Program (Chapter 3); and projected debt service, expenses, and revenues, with consideration of the anticipated impacts of Phase 1 improvements through fiscal year (FY) 2015 (Chapter 4).[1]

The Master Trust Agreement governing the City's Airport Revenue Bonds requires that certain covenants be met while any such bonds are outstanding and that certain financial tests be met before future Airport Revenue Bonds can be issued—including an additional bonds test requiring that projected Airport Net Revenues and Other Available Funds, as defined in the Master Trust Agreement, provide sufficient coverage for future debt service associated with outstanding Airport Revenue Bonds (including the Series 2007 Bonds). This report presents estimates of future debt service coverage incorporating debt service requirements associated with outstanding Airport Revenue Bonds, the Series 2007 Bonds, and commercial paper expected to be issued in connection with Phase 1 improvements. A separate analysis and certificate will be provided at the bond closing incorporating requirements of the additional bonds test contained in the Master Trust Agreement.

On the basis of the assumptions and analyses described in this report, R&A is of the opinion that Airport Net Revenues and Other Available Funds will be sufficient to meet the rate covenant requirement, as set forth in Section 7.13 of the Master Trust Agreement, during the projection period FY 2008 through FY 2015. Additional findings of these analyses include the following:

Economic Base

- While the economy of the Air Service Area and the Bay Area suffered through the downturn of the dot-com industry in 2001 and 2002, the regional economy is showing signs of improvement in recent years with continued population growth, reduced unemployment rates, and growth in the services, information and trade industries.
- Population growth in the Air Service Area between 1990 and 2006 was comparable to that of the Bay Area, the State of California, and the United States--providing for a stable population base for future economic growth. Population in the Air Service Area (as well as the Bay Area and the State of California) is projected to increase at a compounded annual growth rate of approximately 1.2 percent between 2006 and 2015, while population for the United States is projected to increase at a compounded annual growth rate of approximately 0.5 percent for the same period.

[1] The City's fiscal year is the 12-month period ending June 30.

- Per capita effective buying income (EBI) for the Air Service Area grew at a compounded annual growth rate of 0.4 percent between 2000 and 2005. In addition, the Air Service Area's EBI is significantly higher than that of the State of California and the United States with approximately $6,000 per capita of additional EBI available in 2005 to the Air Service Area's residents compared to California and U.S. residents.
- Unemployment rates in the Air Service Area have improved in recent years, decreasing from 7.6 percent in 2003 to 4.7 percent in 2006.
- Employment in the Air Service Area is led by the sectors of services, manufacturing, trade and information. These sectors are projected to grow at compounded annual growth rates of 1.6 percent, 1.0 percent, 1.4 percent and 1.7 percent respectively over the period of 2005 to 2015.
- The Air Service Area is characterized by its highly trained and specialized workforce in the high-technology and bio-technology sectors and their respective research and development functions. New ventures in the areas of green and clean enterprises, solar technologies as well as environmental and energy research projects complement the high-technology sector and the Air Service Area's dynamic and innovative workplace.

Air Traffic

- The Airport is classified as a Medium Hub airport by the Federal Aviation Administration and ranked as the 30th largest U.S. origin and destination (O&D) market for the year ended June 2006 and 41st in North America for Calendar Year 2006 in terms of all passengers (i.e., including connecting passengers).[2] [3]
- The Bay Area is served by three commercial service airports: the Airport, San Francisco International Airport (SFO), and Oakland International Airport (OAK).
- As of May 2007, 16 carriers provided scheduled passenger service at the Airport, including six legacy carriers, five low-cost carriers, four regional/commuter carriers, and one international carrier. In addition, four all-cargo carriers provided scheduled cargo service at the Airport.
- The Airport's strong O&D passenger base is supported by the presence of five low-cost carriers, including Southwest, Alaska, America West/USAirways, Frontier, and jetBlue. In FY 2006, low-cost carriers accounted for approximately 58 percent of the Airport's enplaned passengers. In addition to service by low-cost carriers, the

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2 As defined by the FAA, a medium hub airport enplanes between 0.25 percent and 0.999 percent of nationwide enplanements during a calendar year.

3 U.S. DOT, O&D Survey of Airline Passenger Traffic and Airports Council International-North America.

Airport is served by traditional legacy carriers such as American, Continental, Delta, Northwest, and United.

- As of May 2007, 29 airports were served with a total of 185 daily nonstop flights. Eighteen of the Airport's top 20 O&D markets were provided with daily nonstop service in FY 2006, reflecting the Airport's diverse range of airlines and choices in air service. Los Angeles, the largest O&D market for the Airport, was provided 63 daily nonstop flights by American, American Eagle, Southwest, and United Express to the four airports serving the Los Angeles market, including Los Angeles International, Burbank, LA/Ontario International, and Orange County (John Wayne).
- After peaking in FY 2001, American has eliminated or reduced service to a number of markets served from the Airport, which has further contributed to reduce demand at the Airport. Combined, American and American Eagle accounted for approximately 19 percent of the Airport's total enplanements in FY 2006, which is down from 32.8 percent in FY 2002. American Airlines' flight reductions at the Airport are assumed to have ended and no further flight reductions are anticipated.
- Overall, total passenger activity at the Airport increased from 5,086,442 enplanements in FY 1997 to 5,414,831 in FY 2006, representing a compounded annual growth rate of 0.7 percent during this period, compared to 1.6 percent compounded annual growth rate nationwide. Following decreases in the Airport's enplanements in FY 2002 and FY 2003 as a result of the September 11th terrorist attacks and the downturn in the local economy, total enplanements have continued to increase modestly, from 5,204,987 in FY 2003 to 5,414,831 in FY 2006, representing a compounded annual growth rate of 1.3 percent. As discussed in greater detail in this report, excluding decreases in activity resulting from American's downsizing of operations at the Airport in recent years, enplanements by all other airlines operating at the Airport have increased by a compounded annual growth rate of 4.7 percent since 2003, with much of this growth coming from the low-cost carriers serving the Airport.
- Total Airport enplanements are projected to increase from 5,414,831 in FY 2006 to 6.7 million in FY 2015, representing a compounded annual growth rate of 2.5 percent during this period, compared to the 3.4 percent growth projected nationwide by the FAA. This compounded annual growth rate in enplanements is consistent with long-term historical growth at the Airport when enplanements are correlated with local socioeconomic factors.

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Financial Analysis

- Phase 1 of the Airport's Development Program is expected to provide facilities necessary to satisfy future airline and air passenger needs at a cost that will produce reasonable levels of rates and charges to the users of the Airport facilities.
- The Signatory Airline terminal rental rate per square foot is projected to increase from $131.12 in FY 2008 to $259.62 in FY 2015. The Signatory Airline landing fee rate per 1,000-pound unit of landed weight is projected to increase from $2.00 in FY 2008 to $2.55 in FY 2015. Additionally, cost per enplanement (future dollars) is projected to increase from $6.89 in FY 2008 to $14.33 in FY 2015.
- Airline rates and charges, together with other General Airport Revenues and Other Available Funds, are projected to be sufficient to pay operating and maintenance expenses, debt service, and required fund deposit requirements in each year of the projection period (FY 2008 to FY 2015).
- In FY 2008, debt service coverage for senior debt is estimated to be 2.01x. In subsequent years, senior debt service coverage is estimated to range from a low of 1.75x in FY 2011 to a high of 2.02x in FY 2010, exceeding the rate covenant requirement in each year of the projection period.

Except as defined otherwise, the capitalized terms used in this report are as defined in the Master Trust Agreement. The techniques used in this report are consistent with industry practices for similar studies in connection with airport revenue bond sales. While R&A believes the approach and assumptions utilized are reasonable, some assumptions regarding future trends and events may not materialize. Achievement of projections described in this report, therefore, is dependent upon the occurrence of future events, and variations may be material.

Sincerely,

Ricondo & Associates, Inc.

RICONDO & ASSOCIATES, INC.