COUNCIL AGENDA: 11-20-07
ITEM: 2.22

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: **AIRPORT COMMERCIAL PAPER PROGRAM LETTER OF CREDIT REPLACEMENT**

DATE: November 14, 2007

Approved [signature] Date 11/15/07

COUNCIL DISTRICT: Citywide

REASON FOR ADDENDUM

The recommended actions must be taken by Council at the November 20, 2007, meeting to allow sufficient time for the City to comply with the ten-day notice period specified in the Agreement between the City and Morgan Stanley, Inc., the commercial paper dealer. Notice of the amendments to the Letter of Credit and Reimbursement Agreement, which can only be given after Council takes action, must be provided to Morgan Stanley ten days prior to the expiration of the current letters of credit on December 6, 2007.

RECOMMENDATION

a. Adoption of a resolution of the City Council authorizing the Director of Finance to negotiate and execute the Second Amended and Restated Letter of Credit and Reimbursement Agreement ("Agreement") among the City of San José and JPMorgan Chase Bank National Association, Bank of America, N.A., and Dexia Credit Local (collectively, the "Banks") relating to the Norman Y. Mineta San José International Airport Subordinated Commercial Paper Program reflecting the termination of participation by Citibank, N.A. and a corresponding increase in participation by Dexia Credit Local; and modification of the Agreement to provide the City with increased capacity for the issuance of additional Airport revenue bonds.

b. Adoption of a resolution, amending Resolution No. 69200 to authorize the Director of Finance or the Director's designee to negotiate and execute future substitution and addition of banks under the Agreement; and authorizing the Director of Finance or the Director's designee to negotiate and execute future extensions of the Agreement with respect to the Commitment and Letter of Credit expiration dates and fees paid to the Banks.

OUTCOME

Currently, JPMorgan Chase Bank National Association, Bank of America, N.A., Dexia Credit Local and Citibank, N.A. each provide two letters of credit (LOCs), on a several and not a joint basis, to support the Norman Y. Mineta San José International Airport Subordinated Commercial Paper Program (the Airport CP Program") in the Maximum Stated Amount of $450 million. Approval of the recommended actions will result in a reduction in LOC fees paid by the City for the San José Airport Commercial Paper Program (the "Airport CP Program"), an increase in participation under the LOCs provided by Dexia Credit Local to replace the credit currently provided by Citibank, N.A., and increased capacity for issuance of additional Airport revenue bonds. The credit participation in the LOCs provided by JPMorgan and Bank of America, N.A. will remain at the current levels, and the Maximum Stated Amount of the Airport CP Program will remain at $450 million. The recommended actions will also facilitate administration of the Airport CP Program by authorizing the Director of Finance, within specified parameters, to negotiate and execute future replacement or addition of LOC banks under the Agreement and future extensions of the Agreement.

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 CP Program"), 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 June 20, 2006, the City Council amended Resolution No. 69200 and approved an expansion of the Airport CP Program from $100 million to $200 million to ensure that funding would be available for the award of the design and construction contracts related to the amended Airport Master Plan ("Master Plan") projects and to pay costs related to the Airport's lease of the former FMC property.

On January 9, 2007, the City Council again amended Resolution No. 69200 and approved an additional 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 Phase 1 of the Airport Master Plan; and provide financing for certain future costs not payable from 2007 Bond proceeds. To accommodate the increased program size, three banks (Bank of America, N.A., Citigroup, N.A., and Dexia Credit Local) in addition to JPMorgan were added to provide credit support for the LOCs.

ANALYSIS

City staff, as part of its ongoing market-monitoring responsibilities, determined with the assistance of its financial advisors that the fees paid for the Airport CP Program were higher than other comparable programs. In response to a request from the City, the Banks, with the exception of Citibank, N.A., proposed to lower their fees, with Dexia Credit Local agreeing to increase its share of participation in the Airport CP Program to replace Citibank, N.A. The replacement of Citibank, N.A. by Dexia Credit Local requires amendment of the Agreement. Additionally, staff is recommending that the Agreement be amended to insure that the test used to evaluate the City's capacity to issue additional Airport revenue bonds takes into account any requirement to capitalize interest on commercial paper notes issued during a project construction period. The following sections address these items in more detail.

Reduction of Facility and Commitment Fees

The Maximum Stated Amount of the LOC for the Airport CP Program is $450 million; the amount actually committed by the Banks through the issuance of letters of credit is called the Aggregate Stated Amount. As a way of managing the amount of fees paid by the Airport, the City does not have to use the entire Maximum Stated Amount. The difference between the Maximum Stated Amount and Aggregate Stated Amount is commonly referred to as the "unutilized portion." The fee paid for the Aggregate Stated Amount is called the Facility Fee and the fee paid for the unutilized portion is called the Commitment Fee, with the Commitment Fee typically being a lower fee. The Letter of Credit and Reimbursement Agreement between JPMorgan and the City dated November 1, 1999 initially set the Facility Fee at 0.30% per annum and the Commitment Fee at 0.125% per annum.

Pursuant to the fee proposal received from the Banks, the annual fees payable for the LOC will be reduced from the current level of 0.30% to 0.15% per annum for the Facility Fee and from 0.125% to 0.11% per annum for the Commitment Fee. The LOC expiration date will be extended from November 2, 2010, to December 2, 2010, and the 364-day Commitment expiration date will be extended from December 6, 2007, to December 5, 2008.

The fee proposal represents a total savings in fees over the three-year period of the Agreement ranging from approximately $67,500 to $2.025 million depending on how much of the $450 million authorization is actually utilized. The current Plan of Finance assumes a total utilization of approximately $361.4 million of commercial paper notes by 2010, so the actual savings experienced are likely to fall near the middle of the range.

Replacement of Citibank, N.A. by Dexia Credit Local

The Agreement is an agreement by and among the City and the Banks, and JPMorgan Chase Bank as agent for the Banks under which the Banks agree to provide a Letter of Credit for the tax-exempt Series A and B commercial paper notes and another Letter of Credit for the taxable Series C commercial paper notes. Pursuant to the Letters of Credit, the Banks agree to advance funds to the Issuing and Paying Agent sufficient to pay the interest and maturing amount of commercial paper notes as due, on a several and not a joint basis. This means that each Bank is responsible only for its proportional share of the total commercial paper program. In the event that the commercial paper dealer is unable to issue additional commercial paper notes to repay the advance from the Banks, the City must pay interest to the Banks based on a formula specified in the reimbursement agreement, which formula does not establish a maximum interest rate.

Under the current reimbursement agreement and letters of credit, the proportional shares for each bank are as follows: JPMorgan (44.44.%); Dexia (18.52%); BofA (18.52%) and Citibank (18.52%). As Citibank, N.A. has chosen not to continue its participation in the Agreement at the proposed lower fee level, Dexia Credit Local has agreed to increase its participation to 37.04% and replace Citibank, N.A. Staff does not anticipate that the replacement of Citibank, N.A. by Dexia Credit Local will adversely affect the rating of the Airport CP Program, but will not proceed with the replacement if that would be the case.

Because it is likely that replacements or additions of participating banks will be necessary in the future, staff recommends that Council adopt a resolution to amend Resolution 69200 in order to authorize the Director of Finance or the Director's designee to approve such future replacements or additions, provided they do not adversely affect the rating of the Airport CP Program or otherwise result in modifications to the terms of the Agreement or the Letters of Credit. Further, to clarify authorization provided to the Director of Finance on October 12, 2004 by Resolution No. 72355 related to extensions of the Agreement, staff is recommending that Resolution 69200 also be amended in order to authorize the Director of Finance or the Director's designee to execute future extensions of both the Commitment Expiration Date and the LOC Expiration Date to the extent the total compensation paid to the Banks does not exceed 0.75% per annum of the Maximum Stated Amount. Resolution No. 72355 will be repealed.

Modification of Additional Bonds Test

City staff recommends modification of the Agreement to provide the City with additional flexibility to issue new Airport revenue bonds. Currently, the City must show that General Airport Revenues will be at least 100% of combined senior and subordinated Debt Service in each of the three complete fiscal years immediately following the proposed bond issuance. The additional bonds test currently allows debt service on bonds to be reduced to the extent that interest is being paid from capitalized interest. However, there is no mechanism to adjust for projected debt service associated with commercial paper on which the City is capitalizing interest. Staff is in the process of negotiating revisions to the Agreement to allow for capitalized interest in the projection of debt service on commercial paper in the coverage calculation.

The Agreement, in substantially final form, will be available for review in the City Clerk's Office on or about November 9, 2007. Staff recommends that the Director of Finance or the Director's authorized designees ("Authorized Officers") each be authorized to execute the Agreement. As modifications may be required prior to the closing, staff also recommends that the Authorized Officers each be authorized to execute the final version of the Agreement as may be modified upon consultation with the City Attorney's Office.

EVALUATION AND FOLLOW-UP

These actions will allow the City to benefit from reduced fees on its Airport CP Program and increase its capacity for issuance of additional Airport revenue bonds and requires no follow-up by the City Council.

ALTERNATIVES

Rather than accepting the reduced fee proposal from the Banks, which staff believes is at current market levels, the City could conduct a request for proposals (RFP) process and establish a new group of participating banks. Staff determined that such an RFP process would be cost prohibitive because any savings which might result from lower fees would likely be offset by the costs of negotiating a new letter of credit and reimbursement agreement and preparation of a new Offering Memorandum. Additionally, re-negotiation of the Agreement could result in business terms which would be less advantageous to the City than those contained in the current Agreement.

PUBLIC OUTREACH

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 report has been prepared by the Finance Department in coordination with the Airport Department and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

Expansion of capacity in the Airport CP Program is consistent with the Council approved Guiding Principles for Budget and Financial Management, Mayor's 2006-07 Revised June Budget Message, in that it supports economic recovery and job creation.

COST IMPLICATIONS

Compensation for the City's consultants (bond counsel, bank counsel, financial advisor and dealer) will be paid from either Airport operating funds or commercial paper proceeds. The ongoing costs of the program will be paid from Airport operating funds.

BUDGET REFERENCE

Not applicable.

CEQA

Resolutions No. 67380 and 71451, PP 07-243.

Scott P. Johnson
SCOTT P. JOHNSON
Director, Finance Department

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