



Memorandum

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

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: November 3, 2005

Approved

Ray Winter

Date

11/8/05

COUNCIL DISTRICT: City-Wide
SNI: N/A

SUBJECT: EXPANSION OF CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE COMMERCIAL PAPER PROGRAM

RECOMMENDATION

- a. Conduct a Public Hearing of the City Council concerning the approval of the City of San Jose Financing Authority's issuance of commercial paper and/or lease revenue bonds in order to finance certain public capital improvements of the City related to the Phase II improvements of the City's Central Service Yard and the demolition of structures and clean up at the City's Main Service Yard.
- b. Adoption of a resolution of the City Council approving and authorizing the execution of financing documents and authorizing other related actions in connection with the City of San José Financing Authority Lease Revenue Commercial Paper Notes Program to increase the not-to-exceed aggregate principal amount from \$98,000,000 to \$116,000,000 and to permit the issuance of commercial paper notes for the Central Service Yard Phase II project and the demolition of structures and clean up at the City's Main Service Yard.
- c. Adoption of a resolution of the City of San Jose Financing Authority approving and authorizing the execution of financing documents and authorizing other related actions in connection with the City of San José Financing Authority Lease Revenue Commercial Paper Notes Program to increase the not-to-exceed aggregate principal amount from \$98,000,000 to \$116,000,000 and to permit the issuance of commercial paper notes for the Central Service Yard Phase II project and the demolition of structures and clean up at the City's Main Service Yard.

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BACKGROUND

On January 13, 2004, the City Council and the City of San José Financing Authority Board (the "Authority") approved a tax-exempt lease revenue commercial paper notes program (the "CP Program") and authorized the Authority to issue up to \$98 million in commercial paper notes ("CP Notes") to finance construction costs of the new City Hall and offsite parking garage and non-construction costs for technology, furniture, equipment and relocation (TFE&R) for the new City Hall.

Subsequently, on November 9, 2004, the City Council and Authority authorized issuance of tax-exempt lease revenue commercial paper notes for the additional purpose of financing computer software, software licensing, hardware and certain other costs related to the City's combined utility billing system project (the "Utility Billing System Project"), formerly known as "CUSP."

Additionally, on June 21, 2005, the City Council and the Authority approved amendments to the CP Program to permit the issuance of taxable CP Notes for any of the authorized purposes in cases where the particular expense may not be paid from tax-exempt debt. These amendments permitted the Authority to issue taxable CP Notes to finance the managed services component of the Nortel Converged Network and Telephony System. As of October 26, 2005, \$34,226,000 of CP Notes was outstanding under these authorizations.

On this same agenda, staff has recommended that the City Council delegate authority to the City Manager to award a construction contract for the Central Service Yard Phase II Project, subject to the successful closing of the expansion of the CP Program as described in this memorandum. As presented in the City's Adopted 2006-10 Capital Improvement Plan, the financing plan for the Central Service Yard Phase II Project, which also incorporates the costs of demolition and clean-up at the Main Service Yard, includes issuance of \$21.5 million of CP Notes to be used as interim financing pending the possible sale of the Main Service Yard. The proceeds of the sale of the Main Service Yard would be used to redeem a portion of the outstanding CP Notes, with the remaining CP Notes to be redeemed with proceeds of a lease revenue bond sale.

ANALYSIS

Overview of Revisions to CP Program

The CP Program is a lease revenue financing structure. As noted above, a number of the financing documents were amended in June, 2005, in order to permit the issuance of taxable CP Notes for the authorized purposes. The City has leased to the Authority various City-owned facilities pursuant to a Site Lease, as amended. The Authority subleased these same facilities back to the City (the "Sublease, as amended") in exchange for the rental payments which support repayment of the CP Notes.

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The Authority issues the CP Notes under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to an Amended and Restated Trust Agreement and an Amended and Restated Issuing and Paying Agent Agreement. The CP Notes are backed by a Letter of Credit issued by State Street Bank and Trust Company and the California State Teachers' Retirement System (the "Banks"). Per the terms of the Letter of Credit, the Banks are not jointly responsible for payments on the draws made on the Letter of Credit. The respective obligations of the Banks are: State Street Bank -- 75% and the California State Teachers' Retirement System -- 25%. Lehman Brothers serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement.

The Phase II improvements to the City's Central Service Yard are estimated to cost \$31.4 million and demolition and clean-up at the Main Service Yard are estimated to cost \$2.1 million for a total of \$33.5 million. Of that total, \$12 million is to be paid from fund balance in the Service Yards Construction and Conveyance Tax Fund, and the remaining \$21.5 million is to be financed through the issuance of CP Notes. The projects previously approved by Council for the CP Program, including the new City Hall, the Civic Center Parking Garage, City Hall TFE&R and the Utility Billing System, are anticipated to use \$94.5 million of the existing \$98 million CP authorization. Therefore, it is necessary to expand the CP Program authorization by \$18 million to accommodate the \$21.5 million needed for the Central Service Yard and Main Service Yard projects.

Staff has identified four additional City-owned facilities with sufficient rental value to support the incremental \$18 million in CP Program authorization. The Site Lease and the Sublease will be amended to add the four facilities identified below to the seven facilities currently subject to the Site Lease and Sublease. The seven existing facilities are: the former City Hall, the Health Building and "C" lot, the "E" lot, the San José Museum of Art, the Tech Museum, the Mexican Cultural Heritage Plaza and the former Martin Luther King Main Library.

The valuation shown below is the replacement value of the additional facilities to be leased ("Additional Facilities"), exclusive of the land values, as identified by Willis Insurance Services of California, the City's insurance broker, based on Marshall Swift guidelines as of October 2005.

City of San Jose Financing Authority Lease Revenue Commercial Paper Program Additional Leased Assets	
Property	Valuation
Animal Care Center, 2750 Monterey Road	\$10,871,129
Fire Station No. 1, 225 Market Street	3,903,393
Mabury Yard, 1404 Mabury Road	3,189,504
South Yard, 4420 Monterey Road	1,828,234
Total	\$19,792,260

Public Hearing

It is necessary that Council conduct a public hearing, as required by State law, in order to authorize the issuance of commercial paper for the Central Service Yard Phase II Project and the demolition of structures and clean up at the City's Main Service Yard. A notice will be published in the San Jose Post Record on or before November 10, 2005, advertising the City Council's Public Hearing on November 15, 2005.

The Public Hearing will allow the City Council to hear and consider information concerning the approval of the financing by the City of San José Financing Authority (the "Authority") and the City, through the issuance of commercial paper and/or lease revenue bonds, of certain public capital improvements of the City, consisting of the Phase II improvements to the City's Central Service Yard and demolition of the City's Main Service Yard, and the significant public benefit of such financing by the Authority. Under State law, "significant public benefit" includes lower costs of financing.

Repayment of CP Notes Associated with Central Service Yard Phase II Costs

Following completion of the Phase II improvements to the City's Central Service Yard, as indicated in the Adopted 2006-2010 Capital Improvement Program, the City plans to sell the Main Service Yard and use the proceeds from the sale to repay a portion of the CP Notes issued to pay Phase II and Main Yard demolition and clean up costs, with the remaining portion of the CP Notes to be redeemed with proceeds of lease revenue bonds. In the event that Main Service Yard sale proceeds were not available to redeem CP Notes, the CP Notes could be redeemed with proceeds of lease revenue bonds or available City funds on-hand, or amortized over a period of time no longer than the economic life of the financed improvements. The interest cost on the CP Notes during the construction period will be paid from capitalized interest.

Amendments to Financing Documents

City Council and Authority Board approval of the amendments to the CP Program's financing documents are necessary to increase the aggregate principal amount to be issued and to permit the expenditure of the CP Notes for the Central Service Yard Phase II Project and the demolition of the Main Service Yard. All of the documents described below, in substantially final form, will be available for review in the City Clerk's Office on or about November 8, 2005. Staff recommends that the City Manager or the City Manager's authorized designees ("Authorized Officers") on behalf of the City, and the Executive Director or the Executive Director's authorized designees on behalf of the Authority, each be authorized to execute the agreements described below to which the City or the Authority is a party. 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 these agreements as may be modified upon consultation with the City Attorney's Office.

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First Supplement to the Amended and Restated Trust Agreement – The First Supplement to the Amended and Restated Trust Agreement (the “First Supplement”) is between the City of San José Financing Authority and Wells Fargo Bank as the trustee (the “Trustee”). The First Supplement amends the Amended and Restated Trust Agreement in order to permit the Authority to issue up to \$116 million in CP Notes for the authorized purposes. The Amended and Restated Trust Agreement, as amended by the First Supplement, (collectively, the “Trust Agreement”) pledges the lease payments to the repayment of the CP Notes; establishes the funds and accounts to be held by the Trustee; sets forth the requirements for the administration, investment and treatment of investment earnings generated from each fund and account; and contains the responsibilities and duties of the Trustee and rights of the Note Holders. Additionally, proceeds from the issuance of CP Notes are deposited and expended pursuant to the Trust Agreement. The Trust Agreement obligates the Authority to pay compensation to the Trustee for services rendered under the Trust

Second Amendment to Site Lease – The Site Lease is between the City of San José, as lessor, and the City of San José Financing Authority, as lessee. The Site Lease will be amended to add the Additional Facilities and will reflect the other changes consistent with the amendments made to the other financing documents.

Second Amendment to Sublease – The Sublease is between the City of San José Financing Authority, as lessor, and the City of San José, as lessee. The Sublease sets forth the respective terms and conditions of the lease of facilities from the Authority to the City, which provides the source of funds to repay the CP Notes if the expected forms of permanent financing are not available. The Sublease will be amended to add the Additional Facilities and to increase the annual Maximum Base Rental payable by the City for the facilities from \$11,108,958 to \$13,191,614 as a result of the City’s lease of the Additional Facilities.

Amendment No. 1 to Letter of Credit and Reimbursement Agreement – The Letter of Credit and Reimbursement Agreement is an agreement by and among the City, the City of San José Financing Authority and the Banks, and State Street Bank and Trust Company as agent for the Banks. The Banks agree to advance funds to the Issuing and Paying Agent sufficient to pay the interest and maturing amount of CP Notes as due. In the event that the Dealer is unable to issue additional CP 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.

Amendment No. 1 to Letter of Credit and Reimbursement Agreement will increase the amount of CP Notes that can be issued under the Letter of Credit from \$98 million to \$116 million. In addition, the annual fee payable for the Letter of Credit will be reduced from 0.50% to 0.35% for the utilized portion of the commitment and from 0.30% to 0.20% for the unutilized portion of the commitment. These fee reductions are due to overall lower fees for similar credit facilities in the current market environment. The Banks have also agreed to extend the term of the Letter of Credit and Reimbursement Agreement by three years to January 26, 2010. As approved by Council/Authority Board on January 13, 2004, the

Authorized Officers are each authorized to enter into one or more extensions of the Letter of Credit and Reimbursement Agreement, provided that the annual fees for such extension do not exceed 0.75% of the commitment.

The following financing documents do not require amendment. Instead, the parties will execute certificates at the closing acknowledging the revisions made to the CP Program:

Amended and Restated Issuing and Paying Agent Agreement – The Amended and Restated Issuing and Paying Agent Agreement is between the City of San José Financing Authority and Wells Fargo Bank as the Issuing and Paying Agent. This agreement sets forth the procedures for issuing CP Notes, payment of the matured CP Notes and the application of the funds received from the sale of CP Notes.

Amended and Restated Commercial Paper Dealer Agreement – The Amended and Restated Dealer Agreement is between the City of San José Financing Authority and Lehman Brothers as Dealer for the CP Notes, and describes the procedures and compensation for serving as CP Dealer.

In addition to the documents described above, the City Council and Authority Board are requested to approve distribution of the Revised Offering Memorandum by the Dealer. The Dealer has updated the current version of the Offering Memorandum to reflect the \$116 maximum principal amount of CP Notes which may be issued by the Authority and the additional permitted uses for the issuance of CP Notes. The Revised Offering Memorandum also describes the terms of the CP Notes including the Letter of Credit and the Reimbursement Agreement and provides information regarding the City, the Authority and the Banks. Investors use this information to evaluate the credit quality of the CP Notes.

Revised Offering Memorandum – A copy of the draft Revised Offering Memorandum, in substantially final form, will be distributed under separate cover on or about November 8, 2005. Staff has carefully reviewed the information contained in the Revised Offering Memorandum and believes it to be accurate and complete in all material respects with respect to the information regarding the City, the Authority, and the terms of the CP Notes. The Banks are responsible for the accuracy of the information related to them.

If any councilmember has any personal knowledge that any of the material information in the Revised Offering Memorandum is false or misleading, the 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 Council meeting on November 15, 2005, to address any questions, issues and/or concerns.

As modifications may be required prior to the closing, staff also recommends that the Authorized Officers each be authorized to approve the final version of the Revised Offering Memorandum upon consultation with the City Attorney's Office.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: Public Resources Advisory Group
- Bond Counsel: Jones Hall
- CP Dealer: Lehman Brothers
- Letter of Credit Banks: State Street Bank and Trust Company
California State Teachers' Retirement System
- Trustee/Issuing and Paying Agent: Wells Fargo Bank

Financing Schedule

The current proposed schedule is as follows:

Council approval of amendments to financing documents: November 15, 2005
Document closing: November 17, 2005

OUTCOME

Approval of the recommendations will provide the funds necessary to award the contract for construction of Phase II improvements to the City's Central Service Yard.

PUBLIC OUTREACH

The City Council will hold a public hearing on November 15, 2005, as required by Section 6586.5 of the Government Code of the State of California to consider information concerning the approval of issuance of the CP Notes. The Notice of Public Hearing to be held in conjunction with the approval of the issuance of the CP Notes will be published in the San Jose Post Record on or before November 10, 2005, announcing the time and location of the public hearing.

COORDINATION

This report was prepared by the Finance Department in coordination with the Department of General Services, the Department of Public Works, the City Manager's Budget Office, and the City Attorney's Office.

COST IMPLICATIONS

Compensation for all the City's consultants (financial advisor, bond counsel and dealer) and the costs of the financing are contingent on the successful sale and close of the CP Notes and will be paid from CP Note proceeds.

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CEQA

Not a Project.

A handwritten signature in cursive script that reads "Julia H. Cooper".

JULIA H. COOPER

Deputy Director, Finance Department