



# SUPPLEMENTAL

COUNCIL AGENDA: 01-13-09  
ITEM: 7.1

## Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Scott P. Johnson  
John Stufflebean  
Jennifer A. Maguire

**SUBJECT:** SEE BELOW

**DATE:** January 7, 2009

Approved

Date

1/7/09

**SUBJECT: APPROVAL OF THE SALE AND ISSUANCE OF BONDS AND RELATED BOND DOCUMENTS FOR SAN JOSE-SANTA CLARA CLEAN WATER FINANCING AUTHORITY SEWER REVENUE REFUNDING BONDS, SERIES 2009A**

### SUPPLEMENTAL #2

#### REASON FOR SUPPLEMENTAL MEMORANDUM

The reasons for this supplemental memorandum are to provide revised recommendations, notify the City Council of the 2009A Bonds ratings, provide additional information related to the debt service reserve funds for the 2005A Bonds and the 2009A Bonds, provide additional information related to the Third Amendment to the Improvement Agreement, provide an update on the status of debt payoff discussions with tributary agencies, and provide budgetary impact information.

#### REVISED RECOMMENDATION

- a. Adopt the following 2008-2009 Appropriation Ordinance amendments in the San Jose-Santa Clara Treatment Plant Capital Fund (512):
  1. Increase the appropriation for Transfer to the Clean Water Financing Authority for Series 2005A/B Bond by \$3,700,000;
  2. Establish an appropriation for 2005A Bonds Reserve Fund in the amount of \$5,402,000;
  3. Establish an appropriation for 2009A Bonds Reserve Fund in the amount of \$1,700,000; and
  4. Decrease the Ending Fund Balance by \$10,802,000.

b. Adopt a resolution:

1. Authorizing the Governing Board of the San José-Santa Clara Clean Water Financing Authority (the "Authority") to issue its Sewer Revenue Refunding Bonds, Series 2009A (the "2009A Bonds") in an aggregate principal amount not to exceed \$35,000,000, in connection with the refinancing of certain public capital improvements to the San José-Santa Clara Water Pollution Control Plant, to be sold through negotiated sale, and authorizing the execution of certain financing documents and other actions as necessary in connection with the issuance of the 2009A Bonds; and
2. Authorizing the City Manager to negotiate and execute amendments to the Master Agreements with Treatment Plant tributary agencies for the payment of their respective debt service obligations related to the Treatment Plant.

**2009A BONDS RATINGS**

The 2009A Bonds have been rated AAA/AA+ from Standard & Poor's and Fitch Ratings, respectively. The rating from Moody's Investors Service is pending and staff anticipates that the rating will be available prior to the City Council meeting on January 13, 2009. These excellent credit ratings place the Authority among an elite group in the California municipal credit market. The Authority remains among the highest rated waste water enterprises within the State of California and successfully upgraded its credit ratings from Standard & Poor's and Fitch Ratings from the previous AA/AA ratings to AAA/AA+. This positive change came despite the adverse conditions affecting the local economy. The very strong ratings reflect the City's and the Authority's proven track record of sound operations and fiscal management.

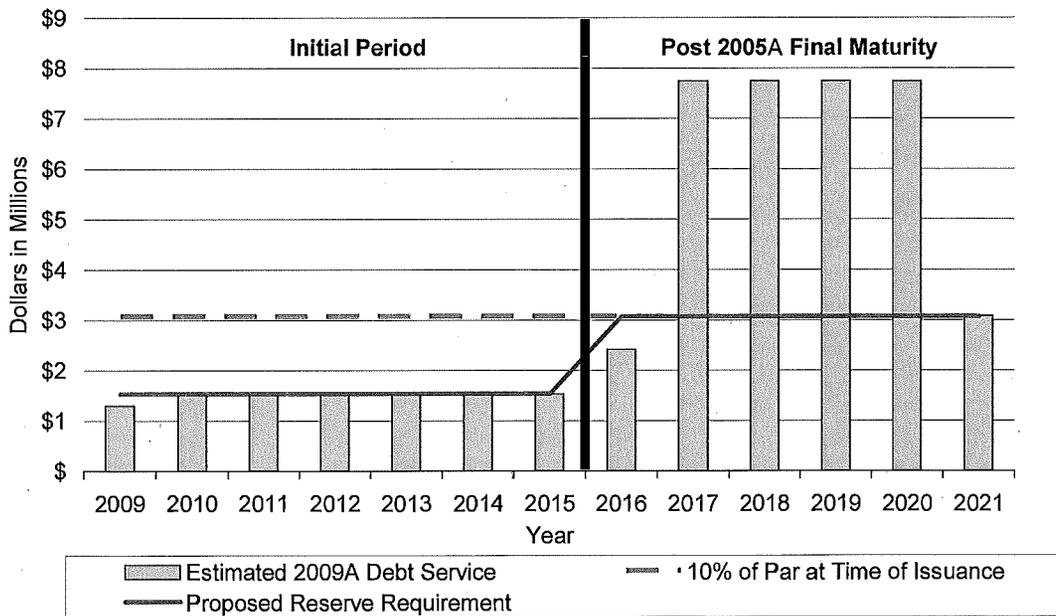
**DEBT SERVICE RESERVE FUNDS**

***2005A Bonds Reserve Fund*** In the memorandum dated December 8, 2008, staff recommended that the 2005A Bonds reserve requirement be met by making the 2009A Bonds Reserve Fund available to the holders of the 2005A Bonds in conjunction with a cash contribution of approximately \$2,400,000. This particular strategy has been determined to be infeasible due to restrictions on the use of bond proceeds in the Internal Revenue Code. Staff now recommends that the 2005A Bonds reserve requirement be met by transferring \$5,402,000 from the enterprise to the bond trustee. The amounts transferred from the enterprise and deposited in the 2005A Bonds Reserve Fund may be returned to the enterprise if at some point in the future the 2005A Bonds reserve requirement is met through the deposit of a reserve financial guaranty or, once no 2005A Bonds remain outstanding. Additionally, the 2005A Bonds Reserve Fund may be used to redeem the final maturity of the 2005A Bonds a year early in 2015.

**2009A Bonds Reserve Requirement and Reserve Fund** The reserve requirement for a municipal bond issue is typically determined using a three-pronged test with the reserve requirement set at the lowest of the three amounts determined by the test. Using the three-prong test, the 2009A Bonds reserve requirement would be set at 10% of the initial par of the issuance, which is anticipated to be approximately \$3,000,000.

In lieu of using the three-prong test to determine the 2009A Bonds reserve requirement, staff recommends using a “step-up” reserve requirement whereby the reserve requirement is initially equal to the maximum annual debt service for the 2009A Bonds for the period from the date of issuance through November 15, 2016, approximately \$1,700,000, and then increases to 10% of the initial par amount of the 2009A Bonds after the 2005A Bonds mature, approximately \$3,000,000. The initial reserve requirement provides sufficient funding in the 2009A Bonds Reserve Fund during the initial period to pay debt service for any year in that period in the event that the enterprise is unable to make debt service payments. The higher step-up reserve requirement is set at the amount that would otherwise be required under the three-prong test, which is also the maximum amount allowable for a reasonably required reserve fund under the Internal Revenue Code. A graphic representation of the step-up reserve requirement is provided below.

**Graphic Representation of Recommended 2009A Bonds Reserve Requirement**



The source of additional funding for the higher 2009A Bonds reserve requirement could be either the funds returned to the enterprise from the 2005A Bonds Reserve Fund when the 2005A Bonds mature or from the funds that the Authority would otherwise use to pay debt service on the 2005A Bonds in 2016 if the amounts on deposit in the 2005A Bonds Reserve Fund are used to redeem 2005A Bonds in 2015. This step-up approach to the 2009A Bonds

reserve requirement will minimize the costs associated with funding the 2009A Bonds Reserve Fund.

In the memorandum dated December 8, 2008, staff recommended that the 2009A Bonds reserve requirement be met by depositing a portion of the 2009A Bonds proceeds in the 2009A Bonds Reserve Fund. Based on the anticipated all-in interest rate for the 2009A Bonds, the projected interest earnings rate for the City's Investment Pool, and the enterprise's current cash position, staff now recommends that the 2009A Bonds reserve requirement be met by transferring approximately \$1,700,000 from the enterprise to the bond trustee because the cash on hand with the enterprise is anticipated to provide a lower cost of funds than bond proceeds. The amounts transferred from the enterprise and deposited in the 2009A Bonds Reserve Fund may be returned to the enterprise if at some point in the future the 2009A Bonds reserve requirement is met through the deposit of a reserve financial guaranty, may be returned to the enterprise once no 2009A Bonds remain outstanding, or may be used to redeem 2009A Bonds in 2020 if the 2021 maturity of the 2009A Bonds are issued as callable bonds.

#### **MODIFICATIONS TO THE THIRD AMENDMENT TO THE IMPROVEMENT AGREEMENT**

Following staff's submission of the December 8, 2008 memorandum, the City of Santa Clara requested that the Third Amendment to the Improvement Agreement be revised to: (1) make clear that certain obligations under the Improvement Agreement apply to the City of Santa Clara only in the event that the City of Santa Clara has obligations to pay debt service on the San José-Santa Clara Clean Water Financing Authority Bonds; (2) to make technical changes to certain defined terms; and (3) to clarify the tests specified in the Improvement Agreement which control the amount of additional debt secured by Net System Revenues that the Authority, the City of Santa Clara or the City of San José may issue. These provisions are included in the draft Third Amendment to the Improvement Agreement that was posted on the City's agenda webpage. The final wording of these provisions remains under discussion with the City of Santa Clara.

#### **TRIBUTARY AGENCY DEBT PAYOFF**

Staff has had initial discussions with the City of Milpitas and West Valley Sanitation District regarding their requests to pay off their respective portions of the outstanding debt: both bonded debt and the California State Revolving Fund Loan in the case of the City of Milpitas and only 2005B Bonds in the case of West Valley Sanitation District. Discussions with the City of Milpitas are currently anticipated to continue beyond the closing date of the 2009A Bonds whereas discussions with West Valley Sanitation District are on an expedited schedule in order for the pay-off amount to be incorporated into the 2005B Bonds refunding so that the total principal amount of the 2009A Bonds would be reduced by the pay-off amount.

In the event that the tributary agencies make their payments following the issuance of the 2009A Bonds, Bond Counsel has advised that IRS regulations will limit the uses of the funds paid by the tributary agencies to the City to make debt service payments on the Authority's Bonds. Staff will continue to work with the City Attorney's Office and Bond Counsel in order to structure the payment from the tributary agencies in a manner that is consistent with IRS regulations.

Staff recommends that the City Manager be authorized to negotiate and execute amendments to the Master Agreements with Treatment Plant tributary agencies for the payment of their respective debt service obligations related to the Treatment Plant in a manner that is consistent with IRS regulations governing the bonds. In the event that the City Council accepts staff's recommendation, the draft resolution posted on the City's agenda webpage will be modified in order to incorporate this authorization.

**BUDGETARY IMPACT**

Funding of the 2005A Bonds reserve requirement and the 2009A Bonds reserve requirement from the enterprise's ending fund balance will have an impact on the enterprise's capital and/or operating budget of potentially \$7,000,000 for fiscal year 2009-10. Staff anticipates that the 2009A Bonds financing will close as scheduled on January 29, 2009 and as a result, approximately \$3,500,000 of the \$3,700,000 that is requested in the current fiscal year for additional debt service payments will return to Ending Fund Balance; however, if the 2009A Bonds financing does not close in the current year fiscal year, then the impact to the enterprise's capital and/or operating budget for fiscal year 2009-10 would potentially be \$10,802,000. As a result, reprioritization of projects or alternative funding mechanisms will be evaluated and recommended as part of the upcoming budget process.

Any amounts transferred from the enterprise to the bond trustee and used to fund a bond series reserve fund will be invested in accordance with the City's Investment Policy. Interest earned will be used to offset debt service payments on the bonds.

**BUDGET REFERENCE**

The table below identifies the fund and appropriation proposed to fund the action recommended in the memorandum dated December 8, 2008 as revised by this supplement.

Fund No.	App. No.	Appn Name	Total Appn	Additional Amount for Debt Service and Reserve Funds	2008-09 Adopted Capital Imp. Program (Page)	Last Budget Action (Date, Ord. No.)
512	8999	Ending Fund Balance	\$14,587,159	\$10,802,000	V-148	10/21/2008, 28422

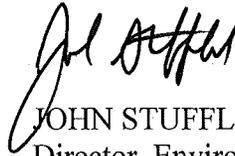
HONORABLE MAYOR AND CITY COUNCIL

January 7, 2009

Subject: SJ-SC CWFA Sewer Revenue Refunding Bonds, Series 2009A

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