



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia Harper Cooper
Jennifer A. Maguire

SUBJECT: PROPOSITION 1A SECURITIZATION
PROGRAM TO OFFSET STATE BUDGET
IMPACT ON CITY'S GENERAL FUND

DATE: October 6, 2009

Approved

Date

10/7/09

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Adopt a resolution approving the form of Purchase and Sale Agreement and related documents with respect to the sale of the City of San José's Proposition 1A Receivable from the State of California and authorizing the City Manager, or other authorized officers, to execute and deliver these documents, and authorizing and directing other actions as necessary in connection with the completion of the sale of the Proposition 1A Receivable.

OUTCOME

Approval of the recommendations will result in the sale of the City of San José's Proposition 1A Receivable of approximately \$20.4 million to California Statewide Communities Development Authority ("California Communities") prior to December 31, 2009. The proceeds of the sale are expected to be received in two equal installments, on January 15, 2010 and May 3, 2010 to offset the City's reduced property tax allocation in 2009-2010 due to the State Proposition 1A borrowing.

BACKGROUND

Suspension of Proposition 1A

Proposition 1A was passed by California voters in 2004 to ensure local property tax and sales tax revenues remain with local government thereby safeguarding funding for public safety, health, libraries, parks, and other local services. Provisions can only be suspended if the Governor declares a "severe fiscal hardship" and two-thirds of the Legislature concur. The State is required to repay the borrowed sums within three years with interest, and the State cannot suspend Proposition 1A again until all previous loans are paid in full with interest. The State cannot suspend Proposition 1A more than twice in a 10-year period.

The emergency suspension of Proposition 1A was passed by the Legislature and signed by the Governor as part of the 2009-2010 State Budget package on July 28, 2009. As allowed under Proposition 1A, the State will borrow 8% or approximately \$1.9 billion of the amount of

property tax revenue apportioned to cities, counties and special districts. The State will repay those obligations plus interest by June 30, 2013.

On September 15, 2009, the County of Santa Clara provided the estimated Proposition 1A property tax reduction amounts for local agencies in Santa Clara County who are subject to Proposition 1A borrowing by the State. The City of San José's estimated amount is \$20.4 million and is otherwise known as the City's Proposition 1A Receivable.

On September 25, 2009, the State Department of Finance established an interest rate of 2.00% for the repayment of Proposition 1A Receivable held by local agencies that do not assign their Receivable to California Communities as discussed below.

California Communities

California Statewide Communities Development Authority ("California Communities") is a joint powers authority sponsored by the California State Association of Counties and the League of California Cities. The member agencies of California Communities include approximately 230 cities and 54 counties throughout California, including the City.

Proposition 1A Securitization Program

In addition to suspending Proposition 1A, the 2009 State Budget package also authorized the securitization of Proposition 1A Receivables. California Communities has been authorized to implement the Proposition 1A Securitization Program to enable local agencies to sell their respective Proposition 1A Receivable to California Communities. Under the Securitization Program, California Communities will simultaneously purchase the Proposition 1A Receivable from participating local agencies, issue bonds, and provide each participating local agency with the cash proceeds in two equal installments, on January 15, 2010 and May 3, 2010, to coincide with the dates that the State will be shifting property tax from local agencies thereby not impacting the City's expected cash flow. The purchase price of Proposition 1A Receivable paid to the local agencies will equal 100% of the amount of the property tax reduction. All transaction costs of issuance and interest will be paid by the State of California. Participating local agencies will have no obligation on the bonds and no credit exposure to the State.

The Legislature is expected to consider a budget clean-up bill in this month (currently scheduled for October 13, 14, and 15) which, among many other budget provisions, will provide for a few critical changes to the enacted legislation for Proposition 1A Securitization, including but not limited to providing for: financing to occur in November; county auditor certification of amount of Proposition 1A Receivable; tax-exempt structure; California Communities as the only issuer; more flexibility on bond structure (interest payments, State payment date and redemption features); sales among local agencies; and revision to the hardship mechanism. If for any reason the clean-up bill is not enacted and the bonds cannot be sold by December 31, 2009, California Communities has stated that it will cancel the Proposition 1A Securitization Program.

ANALYSIS

Due to the State's suspension of Proposition 1A, the City is faced with a property tax revenue shortfall of approximately \$20.4 million in the current fiscal year. To address this shortfall without accompanying expenditure and service level reductions, the City can participate in the Proposition 1A Securitization Program or borrow the funds internally from other City funds and hold the Proposition 1A Receivable for a period of up to three years. An analysis of each option follows with a recommendation to participate in the Proposition 1A Securitization Program.

Participation in the Proposition 1A Securitization Program

If the City chooses to participate in the Proposition 1A Securitization Program, the City would sell the Proposition 1A Receivable to California Communities and receive 100% of the Receivable in two equal installments, on January 15, 2010 and May 3, 2010. The City's sale of its Proposition 1A Receivable will be irrevocable. Bondholders will have no recourse to the City if the State does not make the Proposition 1A repayment. The sale proceeds may be used for any lawful purpose of the City and are not restricted by the program. Successful implementation of the Proposition 1A Securitization Program is dependent on the Legislature convening this month (currently scheduled for October 13, 14, and 15), passing the clean-up legislation related to this program as discussed in the Background Section above, and the Governor approving the legislation.

The benefits to the City of participating in the Proposition 1A Securitization Program include:

- Avoidance of property tax revenue shortfall – the sale of the City's Proposition 1A Receivable will provide the City with 100% of its Proposition 1A Receivable in two equal installments, on January 15, 2010 and May 3, 2010, completely offsetting the reduced City property tax allocation in 2009-2010 due to the State Proposition 1A borrowing.
- All costs of financing are borne by the State of California - the City will not have to pay any interest cost or costs of issuance in connection with its participation in the program.
- No obligation or credit exposure on bonds - the City will have no obligation or credit exposure with respect to the payment of the bonds; nor any reporting, disclosure or other compliance obligations associated with the bonds.

According to California Communities, approximately 770 agencies have enrolled in the Proposition 1A Securitization Program as of October 2, 2009. This number is comprised of 55 counties, 300 cities, and 415 special districts. Enrolled county and city volume amounts to an estimated \$1.4 billion. The enrolled cities include a number of cities in the Bay Area.

Financing Documents

In order to participate in the Proposition 1A Securitization Program, the City must deliver certain executed financing documents as described below to California Communities' transaction counsel, Orrick, Herrington & Sutcliffe no later than November 6, 2009. These documents, as described below, will be posted to the City's agenda website on the date that this memo is posted.

Resolution: Resolution approving the form of Purchase and Sale Agreement and related documents with respect to the sale of the City of San José's Proposition 1A Receivable from the State of California and authorizing the City Manager, the Assistant Director of Finance or other authorized officers, to execute these documents as necessary in connection with the completion of the sale of the Proposition 1A Receivable. This requirement is fulfilled with Council accepting the recommendation set forth in this report prior to the due date of November 6, 2009.

Purchase and Sale Agreement: Agreement providing for the sale of the Proposition 1A Receivable to California Communities which contains representations and warranties of the City to assure California Communities that the Proposition 1A Receivable has not been previously sold, is not encumbered, that no litigation or other actions is pending or threatened to disrupt the transaction and that this is an arm's length "true sale" of the Proposition 1A Receivable, and other miscellaneous provisions.

The Purchase and Sale Agreement includes the following exhibits:

- **Opinion of Counsel:** This is an opinion of the City Attorney covering basic approval of the documents, litigation, and enforceability of the document against the City as the seller of its Proposition 1A Receivable.
- **Bringdown Opinion:** This simply "brings down" or extends the legal opinions to the date that the bond sale is closed ("Closing Date").
- **Certificate of the City Clerk:** A certificate of the City Clerk confirming that the City's resolution was duly adopted and is in full force and effect.
- **Seller Certificate:** A certification of the City dated as of the date that the bonds are sold to the underwriters confirming that the representations and warranties of the City are true as of that date, confirming authority to sign, confirming due approval of the resolution and providing payment instructions.
- **Bill of Sale and Bringdown Certificate:** The Bill of Sale documents the City's sale of its Proposition 1A Receivable to California Communities. The Bringdown Certificate brings the certifications of the City Clerk down to the Closing Date and confirms the sale of the Proposition 1A Receivable as of the Closing Date.

- **Irrevocable Instructions to the Controller:** Required in order to let the State Controller know that the Proposition 1A Receivable has been sold and directing the State to make payment of the receivable to the Trustee on behalf of California Communities.
- **Escrow Instruction Letter:** Instructs Transaction Counsel (Orrick) to hold all documents in escrow until closing, and if closing does not occur by December 31, 2009 for any reason, to destroy all documents.

Financing Schedule

October 15, 2009	Legislature passes the Proposition 1A Securitization Program "Clean-up" Legislation
October 20, 2009	Council approval of Proposition 1A Securitization Program
November 6, 2009	All signed documents must be delivered to bond counsel (Orrick, Herrington & Sutcliffe)
Late Nov 2009	Sale of Proposition 1A Bonds by California Communities
January 15, 2010	1st installment payment to the City of approximately \$10.2 million from California Communities
May 3, 2010	2nd installment payment to the City of approximately \$10.2 million from California Communities

Borrow from Other City Funds

Instead of participating in the Proposition 1A Securitization Program, the City could retain the Proposition 1A Receivable and borrow from other City funds to make up the \$20.4 million revenue shortfall to the General Fund for Fiscal Year 2009-2010. The General Fund would repay the loan from other City funds when the City receives the repayment of Proposition 1A Receivable from the State. Per the aforementioned legislation, the State is required to pay the City the borrowed property tax including interest by June 30, 2013. The State of California, Department of Finance, set the interest rate for borrowing the funds at 2%.

Staff did not identify any benefits to the City from borrowing the funds internally when compared to the Proposition 1A Securitization Program. Rather, the following concerns with this approach have been identified:

- Given that the City's cash pool is currently projected to earn an average rate of 2.06%, the anticipated interest revenues earned from retaining the Proposition 1A Receivable versus the Proposition 1A Securitization Program is nearly identical.
- Although the State has a constitutional obligation to repay all local jurisdictions for the borrowed property taxes, the City would still bear the risk of non-payment or deferred

payment from the State, whereas under the Proposition 1A Securitization Program, the bondholders bear any risk of non-payment.

- City would be challenged to identify internal funds with uncommitted fund balance for the next three years without impacting planned utilization of such funds for other purposes

Conclusion

Based on the analysis above, participation in the Proposition 1A Securitization Program is recommended. As discussed, staff did not identify any benefits to the City from borrowing the funds internally when compared to the Proposition 1A Securitization Program. Rather, several concerns with internal borrowing have been identified which make this approach less desirable for the City to implement.

EVALUATION AND FOLLOW-UP

The Finance Department will inform the Mayor and Council of major milestones achieved in the implementation of the Proposition 1A Securitization Program through the City Manager's Weekly Information Memo.

In the event that passage of the clean-up legislation is not approved by the Legislature and the Governor, the Administration will return to the Mayor and City Council with a plan for the General Fund to borrow from other internal City funds to offset the \$20.4 million property tax revenue shortfall later this fall.

POLICY ALTERNATIVES

In the Analysis section, the alternative to participation in the Proposition 1A Securitization Program by borrowing the revenue shortfall from internal City funds was discussed. This policy alternative is not recommended at this time.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 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)**
- Criterion 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)**

October 6, 2009

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This item meets Criterion 1. This item was not posted in time to meet the early distribution requirements for City Council consideration at the October 20, 2009 meeting. At the Rules and Open Government Committee meeting on October 7, 2009, the City Manager's Office will request a waiver of the early distribution requirements so that both this item and the City's Annual Report may be considered by the City Council at the October 20, 2009 City Council meeting.

COORDINATION

This report was coordinated with the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

The recommended action aligns with the City's budget policy that states that the City will maintain the fiscal integrity of its operating, debt service, and capital improvement budgets.

COST SUMMARY/IMPLICATIONS

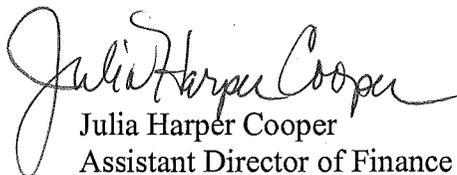
No appropriation of funds is required. The City will not have to pay any interest cost or costs of issuance in connection with participation in the Proposition 1A Securitization Program. All costs of financing are paid for by the State of California.

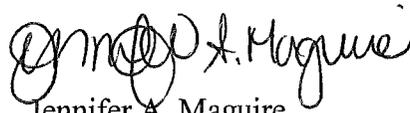
BUDGET REFERENCE

Not applicable.

CEQA

Not a project.


Julia Harper Cooper
Assistant Director of Finance


Jennifer A. Maguire
Budget Director

For questions please contact Julia H. Cooper, Assistant Director of Finance at 408-535-7011.