COUNCIL/AUTHORITY AGENDA: 12-08-09
ITEM: 2

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

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

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: November 16, 2009

Approved

Date 11/20/09

COUNCIL DISTRICT: Citywide

SUBJECT: ACTIONS RELATED TO THE CITY OF SAN JOSE FINANCING AUTHORITY'S COMMERCIAL PAPER PROGRAM

RECOMMENDATION

It is recommended that the City Council adopt a resolution to:

a. Approve an amendment to the Letter of Credit and Reimbursement Agreement related to the City of San José Financing Authority's Lease Revenue Commercial Paper Notes Program and authorize other related actions.

It is recommended that the City of San José Financing Authority Board adopt a resolution to:

a. Approve and authorize the execution of an amendment to the Letter of Credit and Reimbursement Agreement and other related actions in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Notes Program in order to allow for the extension of the existing credit facility.

OUTCOME

Approval of these recommendations will result in the renewal of the Letter of Credit and Reimbursement Agreement for a period of three years, effective January 27, 2010 through January 27, 2013.

BACKGROUND

On January 13, 2004, the City Council and the City of San José Financing Authority Board (the "Authority") approved the implementation of a tax-exempt Lease Revenue Commercial Paper ("CP") Program to provide funding for certain projects related to the new City Hall, including an off-site employee parking garage, technology, furniture, equipment and relocation costs, and interim space planning costs. The total amount authorized to be issued under the CP Program at that time was $98.0 million.

On June 21, 2005, the City Council and the Authority Board approved the issuance of taxable CP Notes in order to increase the CP Program's flexibility with respect to a portion of the previously identified projects. The aggregate total amount authorized to be issued under the CP Program remained at $98.0 million.

On November 15, 2005, the City Council and the Authority Board approved the expansion of the CP Program to provide additional funding for the "Integrated Utility Billing, Customer Service and Performance Management System" (the "CUSP Project") and to expand the list of authorized uses to include the Central Service Yard Phase II Project and the demolition of the City's Main Yard.

At the time of the City Council/Authority Board approval of the expanded CP Program, approval was also received to authorize the Authority to have up to $116.0 million in CP Notes outstanding at any time. It was also contemplated that the City could at a future date authorize the issuance of CP Notes to provide funding for additional projects.

On May 22, 2007, the City Council and the Authority Board approved the issuance of CP Notes in an amount not to exceed $8.25 million to provide funding for capital enhancements to HP Pavilion which is owned by the City and operated by San Jose Arena Management under the Amended and Restated San Jose Arena Management Agreement.

At the January 13, 2004 joint meeting of the Authority Board and the City Council, the City Council conducted a public hearing in accordance with Government Code Section 6586.5 regarding the issuance of the CP Notes for the authorized projects. The City Council also conducted a public hearing in accordance with Government Code Section 6586.5 at the joint meetings of the City Council and the Authority Board on November 15, 2005 and May 22, 2007 when the City Council and the Authority Board approved additional projects and purposes for which CP Notes may be issued.

On October 21, 2008, the City Council and the City of San José Financing Authority Board approved the issuance of CP Notes to refund bonds and other obligations of the City or the Authority pursuant to Government Code Sections 53570 et seq and 53580 et seq.

ANALYSIS

Overview

The CP Program utilizes a lease revenue financing structure. The City has leased to the Authority various City-owned facilities pursuant to a Site Lease, as amended (the "Site Lease"). The Authority subleased these same facilities back to the City pursuant to a Sublease, as amended (the "Sublease") in exchange for the rental payments which support repayment of the CP Notes. The facilities subject to the Site and Sublease are: the former City Hall, the Health Building, and "C" and "E" parking lots located at the former City Hall site, the San José Museum of Art, the Tech Museum, the Mexican Cultural Heritage Plaza, the former Martin Luther King Main Library, the Animal Care Center, Fire Station No. 1, the Mabury Yard and the South Yard.

The Authority issues the CP Notes under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to an Amended and Restated Trust Agreement, as amended and supplemented, between the Authority and Wells Fargo Bank, National Association (the "Trust Agreement") and an Amended and Restated Issuing and Paying Agent Agreement between the Authority and Wells Fargo Bank, National Association. Barclays Capital Inc. currently serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. The CP Notes are backed by a Letter of Credit ("LOC") issued by State Street Bank and Trust Company and the California State Teachers' Retirement System (together, the "Banks"), pursuant to the Letter of Credit and Reimbursement Agreement, as amended (the "Letter of Credit Agreement"). Per the terms of the Letter of Credit Agreement, 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%.

The current Letter of Credit Agreement between the Authority and the Banks expires on January 26, 2010. Staff has negotiated for a renewal of the LOC for a three year period through January 27, 2013. A more detailed description of the proposed amendments to the Letter of Credit Agreement is provided in the section below.

The form of the proposed amendment will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about November 27, 2009. Staff recommends that the Executive Director of the Authority or the Executive Director's designees (the "Authority Designated Officers") be authorized to execute these amendments as posted, on behalf of the Authority and that the City Manager or the Assistant Director of Finance or their designees (the "City Designated Officers") be authorized to execute these amendments, as posted, on behalf of the City, as applicable, with such modifications as the Authority Designated Officers or the City Designated Officer determines to be desirable or appropriate, upon consultation with the City Attorney.

Amendment No. 2 to the Letter of Credit and Reimbursement Agreement

Amendment No. 2 to the Letter of Credit Agreement will extend the term of the LOC Agreement by three years, effective January 27, 2010 through January 27, 2013. The commitment amount of $116 million and the leased asset pool will remain unchanged. The annual fee payable for the LOC will be increased from 0.35% for the utilized portion and 0.20% for the unutilized portion of the commitment, or approximately $400,000 per annum, to 1.25%, or approximately $1.5 million per annum, for both the utilized and unutilized portions of the commitment.

In the event that the long-term unsecured general obligation debt ratings of the City are downgraded by two or more Rating Agencies, the annual commitment fee shall increase by 15 basis points (0.15%) per annum for each rating category below the "Aa1" category by Moody's or the "AA+" category by Fitch or S&P through the "A2" category by Moody's or the "A" category by Fitch or S&P and by 20 basis points (0.20%) per annum for every rating category below the "A2" category by Moody's or the "A" category by Fitch or S&P (including each "+" or "-" or numerical designation).

Although the fee increase proposed by the Banks is significant compared to the current Letter of Credit Agreement, it is less than the fees being paid by other large California municipalities for similar credit facilities on similar financing programs. The long term relationship between the City and the Banks and the City's strong credit ratings has allowed the City to negotiate a more favorable fee structure. This fee increase has been expected given the severe financial market disruption that began in late summer 2008 and continues to affect the credit market environment. Over the past 18 months, the financial services and banking industries have transformed and consolidated significantly which has led to a tightening of credit standards, reduced credit capacity, and more stringent capital adequacy requirements for banks. All of these factors have lead to a shrinking supply of credit and an increase in the cost of utilizing credit.

Amendment No. 2 to the LOC Agreement includes amended and/or additional terms and covenants which are summarized below.

Alternative Base Rate:	Higher of (i) Reference Rate + 3%; (ii) Fed Funds Rate + 3%; or (iii) 3 months LIBOR + 3%; with a minimum Floor Rate of 7% per annum and Maximum Rate of 10% per annum. This is the interest rate charged to the Authority when the commercial paper dealer is unable to find buyers for the outstanding commercial paper notes and the Banks are obligated to purchase these notes from the note owners who no longer wish to hold them. Under this definition, the Authority would be obligated to pay interest at the minimum rate of 7% per annum, subject to the 10% annual cap.
Commitment Fee:	1.25% per annum for the utilized and unutilized portions of the commitment.

Stated Termination Date:	January 27, 2013
Additional Rights:	If the Authority enters into another agreement with another credit provider under which the credit provider is entitled to a more favorable interest rate or default interest rate with respect to any bank bonds or pledged bonds, such rights are automatically provided to the Banks.

The Additional Rights included in Amendment No. 2 as described above is commonly referred to as the "most favored nation clause". Staff has conducted informal surveys with other California Agencies and found that this clause has become a standard requirement of major LOC banks and are incorporated into recently executed LOC Agreements. Staff expects that this clause will also be required by the LOC banks providing the letters of credit for the Authority's variable rate bonds which are expiring in the next 6 to 12 months.

Staff also recommends that the Designated Officers each be authorized to enter into one or more extensions of the Letter of Credit and Reimbursement Agreement, provided that the annual fees for each extension do not exceed 2.0% of the commitment.

Financing Team Participants

The financing team participants consist of:

City's Financial Advisor:	Public Resources Advisory Group
Bond Counsel:	Jones Hall
Letter of Credit Banks:	State Street Bank and Trust Company California State Teachers' Retirement System
Bank Counsel:	Fulbright & Jaworski
Trustee/Issuing and Paying Agent:	Wells Fargo Bank
CP Dealer:	Barclays Capital Inc.

Financing Schedule

The current proposed schedule is as follows:

Council approval of amendments to financing documents:	December 8, 2009
Document closing:	December 16, 2009

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the City Council and the Authority's approval of various actions related to the City of San José Financing Authority Lease Revenue Commercial Paper Program and requires no follow-up to the City Council.

PUBLIC OUTREACH/INTEREST

The form of the proposed amendment will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about November 25, 2009.

☒ **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 Department in coordination with the City Attorney's Office.

COST SUMMARY/IMPLICATIONS

Compensation for the City's consultants (financial advisor, bond counsel and bank counsel) and other related costs will be paid from CP Note proceeds. There is no budgetary impact to the amortization of principal and repayment of interest and fees for the CP Program for FY 2009-10. The interest rate used in calculating the FY 2009-2010 debt service schedule for the tax-exempt CP Program is 2.15% which is sufficient to cover the fee increase resulting from the renewal of the Letter of Credit and Reimbursement Agreement. The interest and fees incurred for the CP Program are capitalized and allocated on a pro-rata basis for each of the projects funded by the

CP Program. The annual debt service schedule is calculated based on the specific repayment terms of each project as approved by City Council and the Authority Board.

CEQA

Not a project.

Julia Harper Cooper

JULIA HARPER COOPER
Assistant Director of Finance

For questions, please contact Arn Andrews, Treasury Division Manager, Finance, at (408) 535-7041.