COUNCIL/AUTHORITY AGENDA: 02-23-10
ITEM:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

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

FROM: Debra Figone
Harry S. Mavrogenes

SUBJECT: **SEE BELOW**

DATE: February 12, 2010

COUNCIL DISTRICT: Citywide

SUBJECT: FINANCING PLAN TO FUND THE AGENCY'S PAYMENT TO THE SUPPLEMENTAL EDUCATIONAL REVENUE AUGMENTATION FUND ("SERAF")

RECOMMENDATION

It is recommended that the City Council, City of San José Financing Authority (the "Authority") and the Redevelopment Agency (the "Agency") Board adopt resolutions authorizing the City Manager, the Authority Executive Director, and the Agency Executive Director to negotiate and execute a Loan Agreement to provide funds to the Agency in the total amount of $75 million, from various funding sources, for the purpose of making the FY 2009-10 and 2010-11 State mandated payments to the Supplemental Educational Revenue Augmentation Fund, pursuant to the terms and conditions outlined in this memorandum.

OUTCOME

Approval of the recommendation will authorize the implementation of the proposed financing plan for the Agency to meet the State mandated payments to the Supplemental Educational Revenue Augmentation Fund ("SERAF") in 2010 and 2011.

EXECUTIVE SUMMARY

Proposed SERAF Financing Plan

The proposed SERAF financing plan was developed in consideration of Council actions taken on December 15, 2009 as outlined in the Background section of this report. The SERAF financing plan will be implemented as follows:

- Sources of funding:
    - FY 2009-10: $62 million total payment to be funded as follows: (1) $10 million will be loaned to the Agency from the City through Inter-Fund loans and (2) $52 million will be a loan from the City's Low and Moderate Income Housing Fund (the "Low-Mod Housing Fund") fund balance of which $40 million will be generated through the issuance of Housing Set-Aside Tax Allocation Bonds ("Housing Bonds") and $12 million will be generated through the City of San José Financing Authority's issuance of Commercial Paper ("CP") Notes.
    - FY 2010-11: $13 million total payment, funded by the Low-Mod Housing Fund fund balance to be generated through the City of San José Financing Authority's issuance of CP Notes.

- The funds from the Housing Bonds and the CP Program will be used to finance or refinance various affordable housing loans, programs and administration costs. These proceeds will free up funds in the Low-Mod Housing Fund previously allocated to those affordable housing projects. The funds from the Inter-Fund loans will be loaned from the City directly to the Agency.

The City will loan a total of $75 million to the Agency to enable the Agency to make the SERAF payments as required by the State (the "SERAF Loan").

Terms, Conditions, Timing of Funding, and Repayment Provisions

The SERAF Loan is subject to the terms and conditions described in this report and as set forth in Attachment 1.

Payment Dates. The SERAF Loan funds will be disbursed to the Agency in two installments, in sufficient time for the Agency to make the required payments on the following dates:

- $62 million on May 10, 2010
- $13 million on May 10, 2011

Repayment Provisions. The Agency's repayment to the City shall be from any legally available unrestricted funds. The SERAF Loan shall be repaid in accordance with the terms and conditions set forth in Attachment 1 (in particular, the *Maturity and Pre-Payment* sections), but no later than June 30, 2015 for the first installment of $62 million plus associated interest, fees and other carrying costs, and June 30, 2016 for the second installment of $13 million plus associated interest, fees and other carrying costs.

Priority of Repayment. The priority of repayment for the SERAF Loan will be made when Agency funds are available based on the circumstances at the time, with priority consideration for repayment to the Low-Mod Housing Fund.

Interest and Fees. Consistent with the Guiding Principles outlined later in this report, interest on the SERAF Loan, including associated fees, will be due quarterly on each August 1, November 1, February 1 and May 1, commencing August 1, 2010. To the extent that interest and ongoing fees cannot be paid currently, they will be added to principal balance owed, with interest due on the increased amount.

Call Provisions. The SERAF Loan will be callable, to the extent necessary, without penalty, to the extent that funding sources for the SERAF Loan need to be repaid. For example, if the banks that credit enhance the CP Program do not renew their letters of credit ("LOCs"), and/or one of the City's contributing funds of the Inter-Fund Loan needs to be replenished and/or the LOC securing the Housing Bonds cannot be renewed, the City may need to accelerate the repayment from the Agency of the corresponding portion of the SERAF Loan.

Security. The Agency owned California Theatre, which has an estimated value at least equal to $25 million will be used to provide collateral for the City of San José Financing Authority CP Program.

If the Agency fails to repay the Housing Fund Loan in full on the payment dates, the percentage of housing set-aside tax increment will increase as required by Sections 33690 and 33690.5 of the Redevelopment Law. Therefore, if this were to occur, the Low-Mod Housing Fund would be obligated to repay the CP Notes from this additional revenue source.

BACKGROUND

Supplemental Educational Revenue Augmentation Fund

On July 28, 2009 Governor Schwarzenegger signed a package of 26 bills, as amended, to close the $23.24 billion budget shortfall in the 2009-2010 State Budget. The budget package required redevelopment agencies across the state to make payments totaling $1.7 billion in FY 2009-10 and $350 million in FY 2010-11 to K-12 school districts serving students living in or near their redevelopment areas. Redevelopment agencies must deposit these payments into a new county Supplemental Educational Revenue Augmentation Fund for allocation to the designated school districts. For the Agency, the impact is estimated at $62 million in FY 2009-2010 and an additional $13 million in FY 2010-2011. If the Agency does not make the SERAF payments, the Agency faces a "death penalty" which essentially requires the Agency to suspend all operations other than existing obligations. This includes ending all funding to the City for future affordable housing projects.

The courts have previously determined that a similar "taking" by the state of $350 million in redevelopment funds statewide proposed in 2008-2009 was unconstitutional. In response to this year's unconstitutional taking of redevelopment funds, the California Redevelopment Association ("CRA") has filed another lawsuit to challenge the State's budget action this year. On February 5, the case was heard by Judge Lloyd Connelly of the Sacramento Superior Court. The judge rendered no decision and asked for additional briefing from both sides. All briefs and responses are due to the Court by March 2. The judge is then expected to take the case under submission and has 90 days to rule. The CRA has asked for a court ruling before May 2010, the date redevelopment agencies must make their FY 2009-2010 payment. While there is no way to predict how long a court proceeding will take, given the magnitude of the raid and the impact it will have on redevelopment agencies, a ruling by early 2010 is hopeful, however the State will likely appeal this ruling and a final decision may take two years. To avoid the "death penalty", the Agency is required to deposit the SERAF funds by the specified dates.

Tax Increment Revenues

Redevelopment agencies in California receive an annual funding stream known as tax increment revenues. Tax increment revenues are based on the growth in assessed value in a redevelopment project area since its establishment. Under Redevelopment Law, 20% of all tax increment revenues must be used for affordable housing. This increment is known as the "20% housing set-aside." The remaining 80% of the tax increment revenues, subject to certain other funding requirements, may be used for general redevelopment purposes in the redevelopment project area. Redevelopment agencies may issue "tax allocation" bonds that are secured either by the 20% housing set-aside tax increment revenues or the 80% portion of tax increment revenues.

City of San José Redevelopment Agency Overview

Since its formation in 1956, the Agency has successfully leveraged tax increment revenues to pursue a comprehensive program to revitalize Downtown, industrial areas, neighborhoods and business districts. The Agency is active in 21 Project Areas comprising 16% of the City's land mass and nearly 40% of total jobs.

The returns on Agency investments have been impressive and the Agency has made a significant difference in the lives of San José residents and businesses. The $2.5 billion that the Agency has invested in its core services is estimated to have generated approximately $19 billion in private investment.

SERAF Payment Options

The economic downturn that began in 2007 has negatively impacted the Agency's budget. With the Agency's finances hampered by the severe economic crisis and pre-existing obligations and the State's SERAF take to temporarily fix the State's budget deficit, the Agency has limited options to fund the SERAF payments. To assist the City and the Agency with formulating a viable financing plan, a financing team was formed with representatives from the Department of Finance, Housing, City Manager's Office, Budget Office, City Attorney's Office, the Agency, Bond Counsel, and Financial Advisors (the "SERAF Financing Team"). The SERAF Financing Team evaluated several options and formulated the proposed financing plan outlined in this report. The proposed financing plan allows the Agency to make the SERAF payments on the required payment dates and achieves the goals of the Guiding Principles outlined below, including: maintaining the fiscal health of the City and the Agency, minimizing the risks to the General Fund and Housing Fund, maximizing flexibility, ensuring lowest cost of funds available, and minimizing impact to the City's Housing programs (see Analysis – Guiding Principles).

The proposed SERAF financing plan was also developed in consideration of Council/Agency Board actions taken on December 15, 2009 with regard to the direction for the Agency's SERAF obligations:

- Staff to inform the State at the required deadline that the Agency will pay the required $62 million in Year 1 and $13 million in Year 2

  As required by law and dependent on action taken by the Council today, the Agency Staff will notify the Santa Clara County Auditor by March 1 how it intends to fund the SERAF payment.

- Initially require a loan from the 20% Housing Funds of no more than $40 million in Year one to help pay for the Agency's obligations to the State

  The recommended financing plan as described in this report includes $40 million from the Low-Mod Housing Fund.

- Accept the Mayor's proposal for the use of $10 million in other funds to pay the State, *The recommended financing plan as described in this report includes $10 million from the Inter-Fund Loan per the Mayor's proposal (see Attachment 2).*

- and direct staff to evaluate other sources of funds for the remainder of the obligation to the State ($12 million in Year 1 and $13 million in Year 2), including the following in order of priority:

  1. Savings from additional project cuts in the Redevelopment budget;
     As more fully described in the Agency's revised budget proposal which is being considered by the Council and Agency Board on this same date, the Agency has made significant cuts in operating and capital budgets, has liquidated surplus funds in existing contracts and has used best efforts to renegotiate committed/encumbered funds. Those efforts are ongoing. The Agency is facing continuing uncertainties as to demands on its available unrestricted cash. It is unclear whether Agency will be able to sell bonds to obtain $30 million as anticipated in FY 2009-10. Negotiations with the County are ongoing and it is unclear what effect the conclusion of those negotiations may have on available unrestricted Agency funds.

  2. City of San José Financing Authority issuance of Commercial Paper with full reimbursement of costs by the Agency;
     The recommended financing plan as described in this report includes $25 million in CP Notes. It should be noted that this option may be expanded if any of the proposed financing plan components are not available (subject to LOC provider's approval).

  3. Additional borrowing from two of the funds identified by the Mayor ($14.9 million from Fund 539 – Sewage Treatment Plant Connection Fee Fund and $3.1 million from Fund 432 – Ice Centre Revenue Fund); and
     Additional borrowings from other City Funds is not recommended at this time (see Attachment 4), however, this option may be revisited if any of the proposed financing plan components are not available.

  4. Temporary loans (interest paid by Agency) from:
     - Fund 423 – Integrated Waste Management Fund
     - Fund 541 – Sewer Service and Use Charge Fund
     - Fund 446 – Storm Service Operating Fund
     - Fund 418 – Library Parcel Tax Fund
     - Fund 426 – Anti-Tobacco Master Settlement Agreement Revenue Fund

> *Additional borrowings from other City Funds is not recommended at this time (see Attachment 4), however, this option may be revisited if any of the proposed financing plan components are not available.*

ANALYSIS

Financing Proposal for Agency's SERAF Payments

Guiding Principles

In order to structure the SERAF payments, City and Agency staff established "Guiding Principles" to help facilitate the development of the proposed financing structure and terms. The Guiding Principles consist of:

- Maintain Fiscal Health (City and Agency)
  - Goal to maintain City and Housing ratings
  - Conforms to fiscal management best practices
  - Agency to continue as a viable economic development engine for the City

- Minimize risks to the General Fund and Housing Fund
  - General Fund and Housing Fund made whole
  - Follow City Council's Inter-Fund Loan Policy
  - City and Agency staff to develop loan terms collaboratively (repayment period, interest rate, etc.)

- Maximize flexibility
  - Allows Council/Agency Board discretion
  - Terms can be flexible based on changes in economic conditions
  - Allows the Agency to retire SERAF debt without prepayment penalties

- Ensure lowest cost of funds available

- Minimize Impact to Housing Programs
  - Continue to fund the Housing Department homebuyer, mobilehome, and rehabilitation programs at traditional levels
  - Fund construction for the Markham Terrace project
  - Complete refinancing of current debt that must be addressed by June 2010

Financing Proposal

The proposed SERAF financing plan was developed in consideration of Council actions taken on December 15, 2009 (see Background section). Staff proposes to fund the Agency's SERAF payments through a loan to the Agency from the following sources:

1. $10 million from the following City special funds: the Subdivision Park Trust Fund ($3 million), the Sewage Treatment Plant Connection Fee Fund ($5 million), and the Ice Centre Fund ($2 million) (the "Inter-Fund Loan"); and

2. The Low-Mod Housing Fund in an amount sufficient to fund the remaining $65 million in SERAF payments plus the associated issuance and carrying costs of debt issued to create flexibility in the Housing Funds so as to make the loan (the "Housing Fund Loan").

   The Housing Fund Loan will be funded by amounts on deposit in the Low-Mod Housing Fund at the time the SERAF payments are due.

   - $40 million attributable to the issuance of Merged Area Redevelopment Project Taxable Housing Set-Aside Variable Rate Demand Bonds, Series 2010C and Series 2010D (the "2010C and 2010D Bonds") to finance and refinance loans in connection with certain affordable housing projects. These Bonds will free up funds previously allocated to those affordable housing projects to be loaned to the Agency.

   - A loan from the City of San José Financing Authority to the Low-Mod Housing Fund in an amount that will net the Fund $25 million. This loan will enable the Low-Mod Housing Fund to continue to support $25 million in various existing affordable housing projects and programs over the next two years. This will free up $25 million in the Low-Mod Housing Fund that otherwise would be used for such programs to be loaned to the Agency to meet its SERAF payments. The source of this loan to the Low-Mod Housing Fund is the issuance of the Authority Commercial Paper Notes in an amount sufficient to fund $25 million of affordable housing programs and the projected capitalized interest and fees associated with the CP over the term of the loan.

The Inter-Fund Loan and the Housing Fund Loan (together, the "SERAF Loan") are subject to the terms and conditions described in this report and as set forth in Attachment 1. The SERAF Loan funds will be disbursed to the Agency in two installments, in sufficient time for the Agency to make the required payments of $62 million on May 10, 2010 and $13 million on May 10, 2011. The first installment will be funded by the Inter-Fund Loan ($10 million) and the Housing Fund Loan ($52 million total, of which $40 million is attributable to the 2010C and 2010D Bonds and $12 million is attributable to CP Notes). The second installment will be funded by the Housing Fund Loan ($13 million attributable to CP Notes).

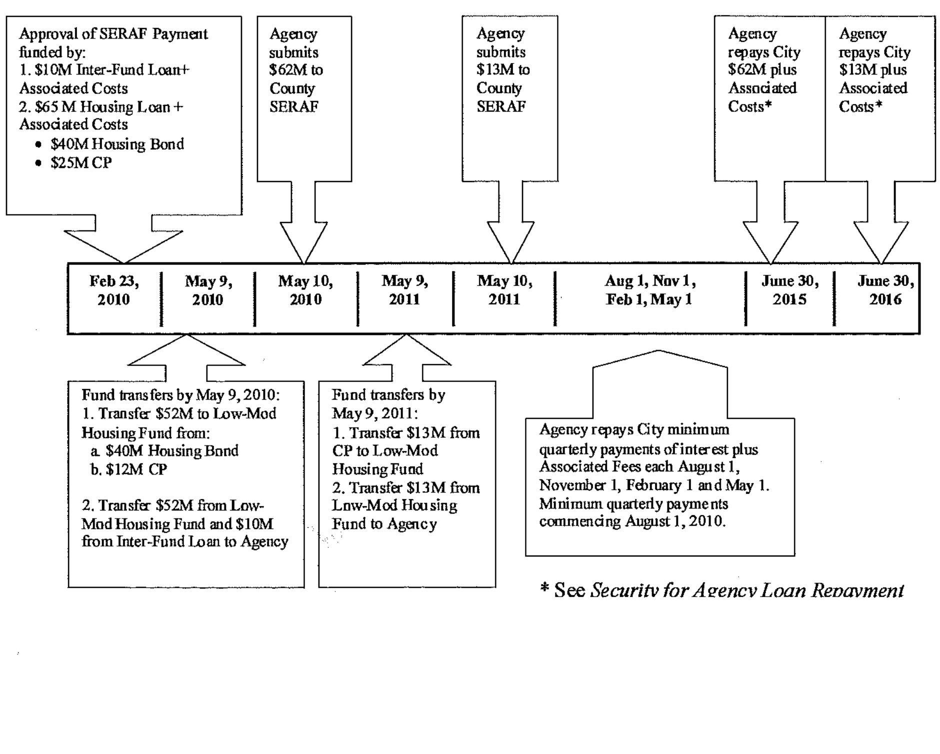
Provisions in the Event that the CRA Lawsuit Prevails

As discussed earlier in the Background section of this report, the California Redevelopment Association has filed a lawsuit to challenge the State's budget action this year with regards to the SERAF payments. Should the CRA lawsuit prevail, at the time the lawsuit prevails (final judgment):

i) and the Agency has deposited the SERAF funds with the County, the Agency shall immediately repay to the City all outstanding SERAF Loan amounts, including any Associated Costs incurred to-date. This transaction must be completed within 30 days from the date the Agency's SERAF deposits are received by the Agency;
ii) and the SERAF funds are not yet loaned to the Agency and are held by the City and/or CP Notes have not yet been issued for purposes of this Loan, this SERAF Loan and related provisions will be null and void, and the Housing Department shall be entitled to use its $40 million of Low-Mod housing funds for its projects and programs; however, the Agency will be responsible for paying any Associated Costs accrued to-date within 30 days of the final judgment;
iii) and the SERAF funds are loaned to the Agency, the Agency shall relinquish such funds to the City for repayment of the SERAF Loan and pay any Associated Costs accrued to-date within 30 days of the final judgment.

The financing proposal and repayment timeline for the SERAF Loan is summarized in the chart below.

SERAF Financing Plan Timeline



* See *Security for Agency Loan Repayment*

Repayment Amount

Principal. $75 million total principal from the following sources: the Subdivision Park Trust Fund ($3 million), the Sewage Treatment Plant Connection Fee Fund ($5 million), the Ice Centre Revenue Fund ($2 million), and the Low-Mod Housing Fund ($65 million).

Associated Costs. The Agency's obligation to repay the SERAF Loan will include all costs borne by the City, including the Low-Mod Housing Fund, associated with the funding sources described as follows.

- Inter-Fund Loan – Repayment of the Inter-Fund Loan shall include interest accruing at a rate that is equal to the City's Investment Pool rate.
- Housing Bonds – Repayment of the Housing Bonds shall include third party costs of issuing bonds, interest on the bonds, letter of credit fees, ongoing third party administrative costs and related costs that are not funded with such Bonds.
    - Issuance costs are estimated at 1.25% to 1.50%.
    - Annual interest costs are estimated at 0.50%, based on current rates.
    - Annual letter of credit fees and other administrative costs are estimated at 1.70%, based on current rates. Fees and interest cost may increase if it is necessary to refinance the Bonds due to a decision by the LOC provider not to renew its LOC on the expiration date in April 2013.
- CP Notes – Repayment of the CP Notes shall include third party costs of issuance, interest, letter of credit and related banking fees and ongoing third party administrative costs and other related costs for the CP Program.
- Interest revenues earned from funds on deposit with the City associated with the SERAF Loan shall be netted against the Associated Costs.

City Administrative Costs. Consistent with Council's prior budget actions and the Council Policy for issuing housing revenue bonds, the SERAF Loan to the Agency is subject to the following loan fees:

- A onetime loan origination fee estimated at $375,000 based on a total SERAF loan value of $75 million. This loan origination fee of 0.50% (1/2 of 1%) is applied to the principal amount and is payable by May 1, 2010 (coinciding with the timing for the deposit to SERAF) to reimburse the City for the resources utilized to develop, analyze and implement the SERAF Loan funding components;

- An annual loan administration and monitoring fee estimated at $187,500 per year based on a loan value of $75 million. This annual loan administration and monitoring fee of 0.25% is applied to the original principal amount (not based on the declining par amount of the loan) for each year the SERAF Loan remains outstanding.

The loan fees described above are levied to compensate the City for the administration of the SERAF Loan which includes, but not limited to, the following activities: ongoing monitoring and reporting to third party stakeholders, annual review and adjustment of the repayment schedule, annual review, administration and enforcement of Agency compliance to the terms and conditions of the loan, and the ongoing management of the various funding sources of the SERAF Loan to balance the financing needs of these sources against the SERAF Loan.

Based on current market rates, the total estimated all-in Associated Costs noted above for FY 2010-11 is between 4 to 5 %, which consists of interest cost (~1-2%), banking fees (~1-2%) and the City's loan fees (~0.25%). These costs are reasonable and low compared to the true interest cost estimate of approximately 8.50% the Agency received in late 2008 for taxable bonds[1] or the costs that may be associated with a new financing debt issue of the Agency. The actual Associated Costs may vary depending on financial market factors that affect interest rates, liquidity, competition, demand, and other global macro and micro economic factors, in addition to the City's financial management policies and budgeting practices.

It should be noted that the estimated all-in Associated Costs meet the Guiding Principle of ensuring the lowest cost of funds available for the SERAF loan. The City's Financing Team was able to achieve this goal in developing the financing structure through the excellent credit ratings the City and Housing Department has that translate to lower costs of borrowing, The funds proposed to be borrowed by both the City and the Housing Department to provide funding for the SERAF loan are the lowest cost borrowing mechanisms available for the City and the housing program.

Source of Loan Repayments and Repayment Dates. Repayment to the City shall be from any legally available unrestricted funds. The SERAF Loan shall be repaid in accordance with the terms and conditions described in this report (in particular, the *Maturity and Pre-Payment* sections), but no later than June 30, 2015 for the first installment of $62 million plus associated interest, fees and other carrying costs, and June 30, 2016 for the second installment of $13 million plus associated interest, fees and other carrying costs.

Consistent with the Guiding Principles outlined in this report, interest on the SERAF Loan including fees (such as for letters of credit) will be due quarterly on each August 1, November 1, February 1 and May 1, commencing August 1, 2010. To the extent that interest and ongoing fees cannot be paid currently, they will be added to principal balance owed, with interest due on the increased amount.

Priority of Repayment. The priority of repayment for the SERAF Loan will be made when Agency funds are available based on the circumstances at the time, with priority consideration for repayment to the Low-Mod Housing Fund.

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[1] Per Agency Memorandum dated November 6, 2008 on the Proposed Issuance of Tax Allocation Bonds.

Call Features. The SERAF Loan will be callable, to the extent necessary, without penalty to the City or Authority, to the extent that funding sources for the SERAF Loan need to be repaid. For example, if the banks that credit enhance the CP do not renew their LOCs, and/or one of the contributing funds of the Inter-Fund Loan needs to be replenished and/or the LOC securing the 2010C and 2010D Bonds cannot be renewed, the City will need to fund the amount due and may at the City's discretion accelerate the Agency's obligation to repay the corresponding portion of the SERAF Loan.

Security for Agency Loan Repayment. The Agency owned California Theatre, which has an estimated value at least equal to $25 million, will be used to provide collateral for the City of San José Financing Authority CP Program.

Failure to Repay SERAF Loan. If the Agency fails to repay the Housing Fund Loan in full on the payment dates, the percentage of housing set-aside tax increment will increase as required by Sections 33690 and 33690.5 of the Redevelopment Law. Therefore, if this were to occur, the Low-Mod Housing Fund would be obligated to repay the CP Notes from this additional revenue source.

A summary of the sources and use of funds is provided in Table 1 below.

Table 1 – Summary of Sources & Use of Funds *(millions of dollars)*	**FY 2009-10**	**FY 2010-11**	**Total**
Sources of Funds			
Inter-Fund Loan:			
Subdivision Park Trust Fund	$3.0		$3.0
Sewage Treatment Plant Connection Fee Fund	5.0		5.0
Ice Centre Revenue Fund	2.0		2.0
Housing Fund Loan:			
Low-Mod Housing Fund	40.0		40.0
Commercial Paper Program	12.0	13.0	25.0
Total Sources of Funds	**$62.0**	**$13.0**	**$75.0**
Use of Funds			
SERAF Payment	**$62.0**	**$13.0**	**$75.0**

Inter-Fund Loan

In response to Budget Document #11 issued by Councilmembers Liccardo and Pyle as part of the Agency's budget process as well as Council questions on the topic of interdepartmental loans, a preliminary review of the City's 114 budgeted funds was conducted to evaluate the potential for Agency borrowing. Based on that review, while there are many considerations and risks as outlined in the information memoranda on Agency borrowing from City funds from the City Manager, dated November 18, 2009, and December 10, 2009 (see Attachments 3 and 4), it was determined that balances in the Subdivision Park Trust Fund (up to $10 million), the Sewage Treatment Plant Connection Fee Fund (up to $5 million), and the Ice Centre Revenue Fund (up to $2 million) could possibly be used for loans to the Agency, and no additional funding sources could be recommend for Agency borrowing (see attached memoranda).

The City Council Policy on Inter-Fund Loans specifies that such loans must have an identified repayment source and date; include an interest component that equals the investment earnings the fund would have received had the loan not occurred; and be immediately due and payable if needed by the fund that provided the loan. As noted in the Financing Proposal section of this memorandum, the loans to the Agency from the Subdivision Park Trust Fund, the Sewage Treatment Plant Connection Fee Fund, and the Ice Centre Revenue Fund will be repayable from the Agency's 80% tax increment revenue and/or other legally available unrestricted funds in accordance to the terms and conditions of the SERAF Loan as set forth in Attachment 1. The appropriate interest component will be the City's actual monthly pooled investment rate over the life of the loan. As noted in the attached information memoranda, in the event that the Agency ultimately was unable to repay these loans, the City's General Fund may become liable for the loan repayment to these lending funds to meet the needs of these special funds.

With regard to the Inter-Fund Loan from the various special funds recommended, it should be noted that Council approved the Mid-Year Budget Review Report recommendations on February 9, 2010 which included a reduction of $2.7 million to the Sewage Treatment Plant Connection Fee Fund fund balance for 2009-2010. This reduction is a combination of: 1) the continuing impact of the recent recession on connection fee revenues related to development activity and, 2) adjustments to reconcile actual loan repayment receipts from the Storm Sewer Operating Fund. This mid-year action reduced the estimated ending fund balance in that fund from $14.9 million to $12.2 million and, after the further reduction of $5.0 million for the recommended loan to the Agency, would leave $7.2 million of available ending fund balance, increasing the likelihood of capital project or equipment replacement delays during the term of the loan. As discussed above, for any of the three funds proposed for borrowing, in the event of a time-sensitive urgent repair, replacement, or other need, where the City has little discretion to delay, the Agency would be required to repay any portion of the Inter-Fund Loan immediately, in the amount required for such urgent repair, replacement, or other need.

The SERAF Financing Team reviewed the terms and conditions of the SERAF Loan, including the Inter-Fund Loan, with the City Auditor's Office.

Financing Needs of the Low-Mod Housing Fund and Housing Bond Issuance

The Low-Mod Housing Fund currently has approximately $57 million in variable rate Housing Bonds outstanding which are backed by a LOC issued by the Bank of New York (BNY) with an expiration of June 29, 2010 and $50 million in a line of credit with BNY that expired on April 1, 2009. In September 2008, Bank of New York announced that it had stopped issuing new letters or lines of credit in connection with municipal obligations ("credit facilities") and that it would not renew existing credit facilities upon their expiration. A financing team that includes the Departments of Finance and Housing, City Attorney's Office, Redevelopment Agency, Bond Counsel, and Financial Adviser was formed in late 2008 to structure a comprehensive financing plan to meet the Low-Mod Housing Fund's financing needs for future projects and to refinance the BNY credit facilities ("Housing Bonds", Series 2010A-E). The overall bond financing plan is designed to optimize the Housing Department's housing set-aside bonding capacity and cash flow to enable it to fund over the next five fiscal years annual administrative costs and existing loan program for Teachers and Rehabilitation loans.

The scope of the Housing financing plan was further expanded as a result of Council direction for the Low-Mod Housing Fund to loan up to $40 million to the Agency. The financing team is currently in the process of finalizing the financing plan for the Housing Bonds, with an estimated aggregate principal amount not to exceed $166,695,000 to meet its overall funding needs. The full scope of the Housing Bonds and the related financing documents is scheduled for City Council and Agency Board approval on March 2, 2010. The Housing Bonds are scheduled for closing in late March or early April 2010.

The Series 2010C and 2010D Bonds will be issued to finance and refinance loans made or to be made in connection with certain affordable housing projects including Brookwood Terrace, Orvieto Family, Belovida, Fourth Street and Markham Terrace. Upon the issuance of the Housing Bonds, Series 2010C and 2010D, $40 million from the Low-Mod Housing Fund will be freed up to loan to the Agency.

The 2010C and 2010D Bonds will be issued as taxable variable rate demand housing set-aside bonds payable on a subordinate basis to the fixed rate senior lien housing set-aside bonds. Wells Fargo has committed to provide a direct pay LOC that guarantees the payment of principal and interest on the 2010C and 2010D Bonds and liquidity to investors that may tender their bonds. Interest rates on the 2010C and 2010D Bonds are reset weekly; interest will be paid on the first of each month, commencing May 1, 2010. Principal is payable on August 1 of each year, with the anticipated first principal payment date on August 1, 2016. The Wells Fargo LOC has an expiration date of three years. The annual letter of credit fee is anticipated to be1.50% subject to increase in the event that the Agency's senior lien housing set-aside bonds are downgraded.

Due to the increase in debt service related to these bond issues, and maintaining funding levels for core housing programs, the Housing Department is proposing a $1 million budget reduction in staffing levels for FY 2010-11.

Commercial Paper Program

There are several benefits of using the CP Program to fund affordable housing projects, including the relative low cost of the program, market demand for high quality CP Notes, matching of funding date to the actual issuance of the CP Notes which minimizes actual interest expense, and mitigates further needs for Inter-Fund Loans. Another major benefit of using the CP Program is that no CP Notes would be issued if the CRA wins the lawsuit against the State prior to the required funding dates.

The use of the CP Program to fund affordable housing projects and programs is subject to the consent of the LOC banks. Staff has received preliminary indications from one of the banks that it would approve such a use of proceeds. Amendments to the CP program will need further approval of the Council and the Authority. Should the banks reject this use, staff will evaluate and present to Council and Agency Board an alternative option, including the potential of additional borrowings from the Sewage Treatment Plant Connection Fee Fund, the Ice Centre Fund, and temporary loans from various funds as directed by the Mayor and City Council at the December 15, 2009 Redevelopment Agency Board meeting .

Background on City CP Program

Pursuant to the City Council and the Authority Board approval received on November 15, 2005, the Authority is authorized to have up to $116.0 million in CP outstanding at any time. Approximately $48.5 million in CP is currently outstanding, which leaves approximately $67.5 million in available capacity for the City and Authority to utilize for other eligible projects.

The CP Program utilizes a lease revenue financing structure secured by the following City properties: 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. Staff has reviewed the list of pledged assets and identified potential replacement assets including the California Theater the Agency shall be pledging for the SERAF Loan, if the need for replacement arises.

The CP Program is backed by an LOC issued by State Street Bank and Trust Company and the California State Teachers' Retirement System (together, the "Banks"). 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 Letter of Credit Agreement has recently been extended for a three year period with an expiration date of January 27, 2013. The Banks have approval rights regarding the projects funded by the Authority and the City under the CP Program.

A summary of the projects currently funded by the CP Program is provided in Table 2 below.

Table 2 – Summary of Commercial Paper Capacity and Outstanding Commercial Paper Notes	**Outstanding CP (Millions)**
Commercial Paper Capacity	$116.0
Commercial Paper Notes Outstanding:	
Central Service Yard II	24.3
Integrated Utility Billing, Customer Service and Performance Management System	8.0
Technology, Furniture & Equipment	8.2
HP Pavilion	8.0
Total Commercial Paper Capacity Remaining	**$67.5**

Risks associated with the CP Program

The CP Program is subject to the following risks:

- LOC Renewal Risk - Should the Banks decide not to renew the LOC at the end of the current three year term and no replacement banks are identified, the CP Notes outstanding will need to be repaid in full. The General Fund is ultimately responsible for the repayment of outstanding notes. LOC fees are subject to change at future renewal dates based on market conditions

  To mitigate the risk to the General Fund, the proposed financing plan requires the Agency to provide additional security as collateral (see *Security for Agency Loan Repayment* section above).

- Interest Rate Risk – interest rate for CP Notes may increase significantly depending on the overall financial market conditions.

- Downgrade Risk – the Banks' credit ratings may be downgraded in the future due to changes in the market's perception of the financial health of the Banks. To the extent a downgrade occurs, the CP Notes may become unmarketable.
- Marketability Risk – If there is a lack of market demand for CP Notes, the notes may be tendered back to the Authority and the Authority may not be able to find buyers for these notes.
- The LOC is backed by certain real properties pledged as leased assets by the City and Authority with a total replacement value of approximately $125 million. If any of the underlying leased assets are no longer available (e.g. former Martin Luther King Main Library and the former City Hall), replacement assets would need to be identified or the CP Program capacity may adversely be impacted. Replacement assets require approval by LOC providers. Staff has reviewed the list of pledged assets and identified potential replacement assets if the need for replacement arises.

Utilization of the CP Program

As stated above, the CP Program has a total capacity of $116.0 million, of which approximately $48.5 million in CP Notes is currently outstanding, which leaves approximately $67.5 million in available capacity for the City and Authority to utilize for other eligible projects after funding the Housing projects as described in this report. Although the Agency is required to make minimum quarterly payments for Associated Costs, to the extent that such costs are not paid currently, they will be added to the principal balance owed. This means that the Authority will need to allocate CP capacity in excess of the $25 million principal amount for Housing projects in order to ensure sufficient coverage for both the principal and capitalized interest and fees, which is estimated at $34 million for the 5 year loan period.

This may limit the City and the Authority's ability to fund other capital projects in the future, until the Agency repays the SERAF loan. Examples of potential capital projects that may be considered by Council in the future for use of the CP Program include, but are not limited to, the LED streetlights project, various energy improvements and solar energy projects, technology acquisition and improvements, Airport West project (former FMC site), and other potential capital equipment acquisitions. It should be noted that these projects are provided as examples only and do not represent staff recommendations. None of these projects have been analyzed internally for project feasibility and none have been discussed with Council for further guidance.

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the City Council, the Agency and the Authority's approval of the proposed financing plan to meet the Agency's SERAF payments and authorization to negotiate and execute a Loan Agreement pursuant to the attached Term Sheet. The details relating to the issuance of Merged Area Redevelopment Project Taxable Housing Set-Aside Variable Rate Demand Bonds, Series 2010C and Series 2010D to finance and refinance City loans in connection with certain affordable housing projects are provided in a separate Council Memorandum agendized for the March 2, 2010 Council Meeting. Staff will return to the Council and the Authority Board to request approvals for various actions related to the CP Program and other budget actions at subsequent Council Meetings prior to May 10, 2010. Additionally, the Housing Department is proposing to reduce its administrative budget by $1 million in the Proposed FY 2010-11 Budget to enable the SERAF payment and meet the Guiding Principles outlined earlier in this memorandum. This proposal will be further discussed as a part of the City's FY 2010-11 budget process.

PUBLIC OUTREACH/INTEREST

☒ **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 Offices of the City Manager and City Attorney, the Housing Department, the City Manager's Budget Office, and the Redevelopment Agency.

COST SUMMARY/IMPLICATIONS

As stated above, repayment of SERAF Loan principal will be due on or prior to June 30, 2015 in the amount of $62 million plus Associated Costs and on or prior to June 30, 2016 in the amount of $13 million plus Associated Costs. Interest on the SERAF Loan, including fees will be paid quarterly by the Agency to the City on each August 1, November 1, February 1 and May 1, commencing August 1, 2010. To the extent that interest and ongoing fees cannot be paid currently, they will be added to principal balance owed, with interest due on the increased amount.

Staff will return to the Council and the Authority Board to request approvals for the actions related to the CP Program and other budget actions related to the SERAF Loan at subsequent Council Meetings prior to May 10, 2010.

CEQA

Not a project.

Debra Figone
City Manager

Harry S. Mavrogenes
Executive Director, Redevelopment Agency

For questions, please contact Scott P. Johnson, Director of Finance, at (408) 535-7000.

Attachments:

1. SERAF Loan Terms & Conditions
2. Mayor's Budget Message Fiscal Year 2009-2010 Redevelopment Agency Capital and Operating Budget and 2010-2015 CIP - Supplemental (December 8, 2009 Agency Board Agenda, Items 8.3/8.4)
3. Information Memorandum – *Sources of Financing Beyond Affordable Housing Fund* (November 19, 2009)
4. Information Memorandum - *Agency Sources of Funding from City Funds* (December 11, 2009)

Attachment 1 - SERAF Loan Terms & Conditions

Parties to Agreement(s)	• City of San José • City of San José Financing Authority • Redevelopment Agency
SERAF Funding Requirements	City will make available to the Agency the following amounts by the following dates: • $62 million by May 10, 2010 • $13 million by May 10, 2011 Actual timing may depend on CRA lawsuit *(see Background section above for details)*
Sources of Funding for SERAF Loan	The SERAF Loan will be funded through 2 loan agreements among the parties identified above: • **Inter-Fund Loan**: $10 million – to be transferred in sufficient time to make the payment on May 10, 2010, or the required funding date depending on CRA lawsuit • **Housing Fund Loan:** $65 million from the Low-Mod Housing Fund to be made available on the following dates and sources: May 10, 2010: a) **Housing Bond**: $40 million to be made available as a result of a taxable variable rate bond issue by May 10, 2010. *Funds to be held in a restricted account pending their use, with interest earnings to be applied to debt service, pending transfer to Agency before required funding date (depending on CRA lawsuit).* b) **CSJFA CP**: $12 million to be held in the Low-Mod Fund pending transfer to Agency before required funding date (depending on CRA lawsuit). May 10, 2011 c) **CSJFA CP**: $13 million to be to be held in the Low-Mod Fund pending transfer to Agency before required funding date (depending on CRA lawsuit).

Loan Funding Mechanics	• $10M Inter-Fund Loan to be provided directly from the City to the Agency from the following sources: Subdivision Park Trust Fund to loan $3 million, Sewage Treatment Plan Connection Fee Fund to loan $5 million, and the Ice Centre Revenue Fund to loan $2 million to the Agency • Financing Authority is party to the SERAF Loan Agreement to loan proceeds of CP Program to the City for deposit into the Low-Mod Housing Fund. Then the Low-Mod Housing Fund loans other available monies to the Agency. The Low-Mod Housing Fund will be required to repay the Financing Authority.
Agency Repayment Obligations – Principal & Associated Fees	• Principal amount - $75 million + issuance costs associated with housing set-aside bonds and CP + out-of-pocket expenses + loan fees + cumulated interest (collectively, "Associated Costs"): o Associated Costs for Inter-Fund Loan: The actual City investment pool rate earned for each of the years the loan remains outstanding (per City's Inter-fund Loan Policy) o Associated Costs for Housing Bond: The actual interest rates & associated fees paid on the tax allocation bonds for each year the bonds remain outstanding. o Associated Costs for CP: The actual all-in interest rate for the CP Program (interest plus associated banking fees) until the CP Notes are redeemed in full. • Loan fees: Consistent with the Council's prior budget actions and the Council Policy for issuing housing revenue bonds, the SERAF Loan to the Agency is subject to the following loan fees: o A onetime loan origination fee estimated at $375,000 based on a total SERAF loan value of $75 million. This loan origination fee of 0.50% (1/2 of 1%) is applied to the principal amount and is payable by May 1, 2010 (coinciding with the timing for the deposit to SERAF)to reimburse the City for the resources utilized to develop, analyze and implement the SERAF Loan funding components; o An annual loan administration and monitoring fee estimated at $187,500 per year based on a loan value of $75 million. This annual loan administration and monitoring fee of 0.25% is applied to the original principal amount (not based on the declining par amount of the loan) for each year the

	SERAF Loan remains outstanding.
Maturity	The SERAF Loan must be repaid in full by the dates specified below for each component of the SERAF Loan: • Inter-Fund Loan: $10 million plus Associated Costs due by June 30, 2015. • Housing Fund Loan: o $52 million + Associated Costs – due by June 30, 2015 o $13 million + Associated Costs – due by June 30, 2016
Pre-Payment	The Agency may prepay all or a portion of the SERAF Loan amount, without penalty, at any time. The Agency shall prepay a portion of the SERAF Loan amount if, at any time during the term of the SERAF Loan, the Agency issues new money Tax Allocation Bonds in excess of $30 million. The amount of the SERAF Loan to be prepaid shall be determined by the City Council and Agency Board at the time of the issuance of such Bonds, based on the circumstances at the time. The Agency shall prepay the entire SERAF Loan amount should the CRA lawsuit prevail, at the time the lawsuit prevails (final judgment): iv) and the Agency has deposited the SERAF funds with the County, the Agency shall immediately repay to the City all outstanding SERAF Loan amounts, including any Associated Costs incurred to-date. This transaction must be completed within 30 days from the date the Agency's SERAF deposits are received by the Agency; v) and the SERAF funds are not yet loaned to the Agency and are held by the City and/or CP Notes have not yet been issued for purposes of this Loan, this SERAF Loan and related provisions will be null and void, and the Housing Department shall be entitled to use its $40 million of Low-Mod housing funds for its projects and programs; however, the Agency will be responsible for paying any Associated Costs accrued to-date within 30 days of the final judgment; vi) and the SERAF funds are loaned to the Agency, the

	Agency shall relinquish such funds to the City for repayment of the SERAF Loan and pay any Associated Costs accrued to-date within 30 days of the final judgment.

Agency Repayment Obligations - Interest	• Budgeted rate based on all-in borrowing costs (interest rate + annual admin/LOC fees/remarketing); periodic adjustments based on actual rate.
	• Minimum Payment – Quarterly on [2/1/; 5/1; 8/1; 11/1]
	  o To be paid on current basis or
	  o Rolled in principal obligation and compounded

Agency Repayment Obligations – Call Features	The SERAF Loan will be callable, to the extent necessary, without penalty to the extent that funding sources for the SERAF Loan need to be repaid. For example, if the banks that credit enhance the CP do not renew their LOCs, and/or one of the contributing funds of the Inter-Fund loan program needs to be replenished and/or the LOC securing the 2010C and 2010D Bonds cannot be renewed, the City will need to fund the amount due and may at the City's discretion need to accelerate the Agency's obligation to repay the corresponding portion of the SERAF Loan.
Source of Agency's Repayment	The Agency's repayment to the City shall be from any legally available unrestricted funds.
Priority of Repayment	The priority of repayment for the SERAF Loan will be made when Agency funds are available based on the circumstances at the time, with priority consideration for repayment to the Low-Mod Housing Fund.
Security	The Agency owned California Theatre, which has an estimated value at least equal to $25 million, will be used to provide collateral for the City of San José Financing Authority CP Program.
Failure to Repay Housing Fund Loan and the Associated Costs in Full by Required Dates	If the Agency fails to repay the Housing Fund Loan plus Associated Costs in full on the payment dates, the percentage of housing set-aside tax increment will increase as required by Sections 33690 and 33690.5 of the Redevelopment Law. Therefore, if this were to occur, the Low-Mod Housing Fund would be obligated to repay the CP Notes from this additional revenue source.

Attachment 2 –

Mayor's Budget Message Fiscal Year 2009-2010 Redevelopment Agency Capital and Operating Budget and 2010-2015 CIP - Supplemental

(December 8, 2009 Agency Board Agenda, Items 8.3/8.4)

Attachment 3 –

Information Memorandum – Sources of Financing Beyond Affordable Housing Fund

(November 19, 2009)

Attachment 4 –

Information Memorandum – Agency Sources of Funding from City Funds

(December 11, 2009)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: CITY COUNCIL/REDEVELOPMENT AGENCY BOARD

FROM: Mayor Chuck Reed

SUBJECT: **MAYOR'S BUDGET MESSAGE FISCAL YEAR 2009-2010 REDEVELOPMENT AGENCY CAPITAL AND OPERATING BUDGET AND 2010-2015 CIP**

DATE: December 11, 2009

Approved Chuck Reed Date 12/11/09

SUPPLEMENTAL

RECOMMENDATION

Approve the direction to as staff set forth in the Mayor's Budget Message released on November 20, 2009 with the following modifications:

1) Defer adoption of the Fiscal Year 2009-2010 Redevelopment Agency Capital and Operating Budget and 2010-2015 CIP until February 23, 2010.

2) Approve the Executive Director's recommendations for certain Agency contracts and payments during the interim budget period of December 16, 2009 and February 23, 2010 as detailed in the Executive Director's memorandum dated December 10, 2009.

3) Direct the City Manager to develop a method to fund \$62 million of the SERAF in Year 1 and present that plan through an information memorandum by February 1, 2010. Until any viable alternative borrowing sources have been identified and approved by the City Council, the Housing Department should continue to pursue making a loan of up to a \$52 million loan in Year 1 and a \$13 million loan in Year 2. The plan developed to pay for the SERAF obligation should seek to minimize borrowing costs and avoid any potential long-term negative impacts on the General Fund and ensure that to the extent Housing funds are accessed, the Housing fund is made whole when the SERAF loan is repaid. Defer the decision of how much the City should loan the Agency until February 23, 2010.

4) Direct the City Manager and Executive Director to return to the City Council/Agency Board in 45 days with a recommendation to consider whether or not the timeline of the convention center expansion should be accelerated and whether the advancing funding

from Year 4 to Year 2 is viable and necessary. That report should include a description of the proposed expansion project and an outline of how it would be financed along with any recommendations from the Convention Center Expansion Technical Advisory Committee.

5) Report to the City Council/Agency Board on February 23, 2010 on the status of all City and Agency staff actions to fund SERAF payments, negotiations with the County of Santa Clara, as well as updates on assessed value and tax increment projections, schedule of pipeline projects, and impacts of financial market and economic conditions on the Agency's Capital and Operating budgets.

BACKGROUND

Current financial and economic conditions are much the same as they were at the time that my Budget Message was presented. The future still looks uncertain and decision making becomes ever so difficult under these circumstances. I have carefully considered the recommendations of the Agency Board and the community, and weighed the opportunities thoughtfully. Much work has yet to be done. It seems to me that postponing the adoption of the Redevelopment Agency Budget to February 2010 is the most prudent step to take at this point in time.

This deferral will also enable ongoing negotiations with the County of Santa Clara (regarding Agency obligation) to be furthered, which is an important element of the Agency's work scope in the coming months. The County of Santa Clara obligation is one of our largest obligations that need to be renegotiated. As part of the negotiations with the County, the County of Santa Clara has requested that the Agency defer approval of the proposed Agency budget until February 23, 2010. To help facilitate these negotiations, I am recommending the formal adoption of the budget be deferred until February 23, 2010.

Distributed on:

NOV 1 0 2009
by City Manager's Office

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: SAN JOSE REDEVELOPMENT AGENCY: SOURCES OF FINANCING BEYOND THE AFFORDABLE HOUSING FUND

DATE: November 18, 2009

INFORMATION

BACKGROUND

This memorandum responds to Budget Document #11 issued by Councilmembers Liccardo and Pyle as part of the Proposed 2009-2010 Redevelopment Agency of San José's (RDA) budget process. In this Budget Document, it was requested that the City identify capital funds which the City could potentially use as a source for granting loans to the RDA during the next 2 – 3 years in order to relieve the burden on the Low and Moderate Income Housing Fund. Specifically, the memorandum identified the Underground Utility (Rule 20A/B) Fund, the Sewage Treatment Plant Connection Fee Fund, and Transportation Impact Fee funds. Additionally, it was requested to analyze the possibility of issuing any bonds or other financing leveraged from these funds. Other information requested in the Budget Document #11 will be provided under separate cover.

ANALYSIS

Sources for Granting Loans to the RDA

In response to the Councilmembers' memorandum, staff reviewed both capital and operating funds with a minimum $1.0 million unrestricted fund balance available for loan purposes. This analysis was initially completed to address the Proposition 1A Property Tax borrowing from the State of California as an alternative to participation in the Proposition 1A Securitization Program.

While there are many considerations and risks associated with borrowing that are discussed later in this memorandum, based on a preliminary analysis, staff was able to identify the Subdivision Park Trust Fund, the Sewage Treatment Plant Connection Fee Fund, and the Ice Centre Revenue Fund, which could be possibly used for a loan to the RDA. The Underground Utility Fund and Transportation Impact Fee funds do not have sufficient fund balance available to loan to the RDA. The cumulative potential loan amount is estimated at approximately $17 million. Attachment A provides a fund description, the fund balance as of November 2009, and potential loan amounts from these funds.

In general, any potential loan to the RDA, however, requires further analysis and consideration of the following issues:

1. Per City Council Policy, loans need to have an identified loan repayment source and be repaid with interest within an established time frame. Also, the loan must be immediately due and payable if needed by the fund that provided the loan.
2. In case of non-payment, the General Fund would become liable for the repayment to these funds.
3. Granting a loan from a fund which depends on fees, may prevent the City from raising fees until the loan is repaid.
4. Potentially loaning funds to the RDA from the identified funds precludes the City from addressing potential future fiscal emergencies affecting the General Fund such as State take aways.
5. Concerns from community related to delaying projects and not using funds as intended may arise.
6. Infrastructure improvement and equipment replacements may need to be deferred.
7. The availability of matching funds for grants may be impacted.

In addition to these general issues, Attachment B provides a more detailed preliminary analysis for the Subdivision Park Trust Fund, the Sewage Treatment Plant Connection Fee Fund, and the Ice Center Fund. The analysis includes a Risk Matrix classifying the following risk types as low, moderate, and high: Fund Availability, Statutory Restrictions, Community Sensitivity, Opportunity Cost, and Impact of Non-Payment of Loan.

Issuing of Bonds from Identified Capital Funds

The identified capital funds derive revenue from developer fees, which are one-time payments versus recurring and reliable payments such as ongoing rate payer payments for a utility fund. It is not possible to issue bonds without an ongoing, reliable source of repayment. Even if a stable source of repayment were identified for repayment, any securitization of restricted funds would require a nexus between the purpose of the restricted funds and the use of the bond proceeds.

The City Administration understands RDA's difficult financial situation and it is feasible to consider loans as an option. However, any loans from the preliminarily identified funds require a careful analysis of the considerations outlined above and any other potential issues.

DEBRA FIGONE
City Manager

Attachments

<u>Preliminary Analysis of Potential Loans to the Redevelopment Agency from City Funds</u>

Name of Fund	Fund Description	Fund Balance as of 11/09	Potential Loan Amount
Subdivision Park Trust Fund (Fund 375)	This fund accounts for payments of fees from developers in lieu of dedication of land for park and recreation purposes in residential subdivisions.	$25.9 M	$3 M – 10 M
Sewage Treatment Plant Connection Fee Fund (Fund 539)	This fund accounts for revenues from new residential, commercial and industrial connections to the San José/Santa Clara Water Pollution Control Plant. These revenues are used to pay San José's share of the costs of the acquisition, construction, reconstruction, or enlargement of the Water Pollution Control Plant.	$14.9 M	$5 M
Ice Centre Revenue Fund (Fund 432)	This fund accounts for rental revenues received from Sharks Ice at San José operations and provides funding for debt service payments and for repairs and improvements at the facility.	$5.1 M	$2.0 M
Underground Utility (Rule20A/B) Fund (Fund 416)	This fund accounts for developer fees collected when the developer opts out of placing utility facilities underground at the time of development. The fund is used to establish Rule 20B Underground Utility Districts.	$853,000	$0
North San José Traffic Impact Fee Fund (Fund 349) and the Evergreen Traffic Impact Fees (reserve in the Construction Excise Tax Fund - Fund 465)	These funds account for traffic impact fees to be charged to new industrial and residential development and are allocated to improvements in these areas.	$493,000	$0

SUBDIVISION PARK TRUST FUND

Summary

The Subdivision Park Trust Fund (SPTF) accounts for the payments of fees in lieu of dedication of land for park and recreation purposes in residential subdivisions. Moneys in the fund, including accrued interest, may be expended solely for the acquisition or development or renovation of park facilities, recreation facilities, or park or recreation facilities on public agency property pursuant to a Joint Use Agreement to serve or benefit the residential project for which the fees were paid. This means the City must use the parkland fees for neighborhood parks or recreational facilities that are located within ¾ miles of the development that paid the fees or for community facilities that are located within 2 miles of the development that paid the fees (nexus requirement).

Potential loans to the San Jose Redevelopment Agency (RDA) from this fund in the amounts of $3 to $5 million or $10 million have been reviewed. Based on this preliminary analysis, there is sufficient ending fund balance in 2009-2010 to potentially loan $3 to $5 million to the RDA without significantly impacting current projects. This loan would, however, limit the amount of funding available to start new projects or to front and match money for future grants. At the $10 million loan level, several projects would be impacted as well as the ability to provide matching funds for grants. In addition, there are legal restrictions that require the SPTF funds to be committed within a five-year period and a loan to the RDA could limit the City's ability to comply with this statutory requirement.

Discussion of Scenario 1 ($3 - 5 Million):

A potential loan would limit the amount of funding available from SPTF to front and match money for future grants and could impact the ability to start new projects. Staff has identified the following levels of risk associated with a potential loan of $3M to $5M to the RDA. This risk assessment is in addition to all of the items stated below under "General Principles & Risks" below.

Type of Risk	Level of Risk		
	Low	Moderate	High
Fund Availability [1]			X
Statutory Restrictions			X
Community Sensitivity [2]		X	
Opportunity Cost		X	
Impact of Non-Payment of Loan			X

[1] See No. 3 under General Principles and Risks below for details.
[2] Staff rates the Community Sensitivity Level of Risk for Residents as moderate and for Developers as high.

Discussion of Scenario 2 ($10 Million):

A potential $10 million loan would significantly impact current and future PTF projects and would limit the availability of matching funds, including but not limited to the following:

(1) All grant applications, including potential 2010 transportation bill. In the last bill, the City fronted approximately $5M from the SPTF. Currently $30M of Prop 84 candidate projects have been identified.
(2) Communications Hills Parks;
(3) Shady Oaks Sports Field Development;
(4) Scottish Rite Park;
(5) Guadalupe River Park Dog Park;
(6) Infrastructure rehab to the various parks, including: Carrabelle, Cataldi, DeAnza, Evergreen, Glenview, Los Paseos, Parkview, Roosevelt, Fontana, and others to be identified.

Staff has identified the following levels of risk associated with a potential loan of $10M to the RDA. This risk assessment is in addition to all of the items stated below under "General Principles & Risks" below.

Type of Risk	Level of Risk		
	Low	Moderate	High
Fund Availability			X
Statutory Restrictions			X
Community Sensitivity			X
Opportunity Cost			X
Impact of Non-Payment of Loan			X

[1] See No. 3 under General Principles and Risks below for details.

General Principles & Risks:

As outlined above, the SPTF accounts for the payments of fees in lieu of dedication of land for park and recreation purposes in residential subdivisions. When these fees are collected and set aside, an expectation for parkland and open space for recreational purposes is created by the developers and community members who paid the fees. Therefore, the use of SPTF funds for a purpose other than delivery of capital projects to serve or benefit the residents who paid the fees will have a direct negative impact on residents in these immediate areas, and possible legal issues as follows:

1. The City's General Fund would become liable for the Park Development commitments if RDA is ultimately unable to repay the loan, thereby increasing the City's Structural Budget Deficit. There is already $8.1 million currently owed by the RDA to the City for parkland fees since 2005 through the voucher program and the RDA has continuously sought deferment of payment of those fees.

2. The SPTF has been considered as a lending source in the past for park projects and has not been used as there have been concerns about using the funding outside of, and for a different purpose than, the nexus for which the fee was paid. Any proposed loan should be discussed and coordinated with the City Attorney's Office.

3. Parkland fees are required to be committed within five (5) years of the date in which the fees were paid or be required under State Law and the Municipal Code to be returned to the residents who paid the fees. The City cannot commit the funds if they are not in the SPTF

and therefore, may be required to return the parkland fees loaned to the RDA to the residents who paid the fees.

4. The development community has commented on the amount of parkland fees charged by the City, the timing of the payment of required parkland fees, and the possibility of deferring, waiving, or even loaning parkland fees to them in the current economy. A loan from the SPTF could continue to raise concerns and challenges to the enforcement of the Parkland Dedication and Park Impact Ordinance.

5. There is a certain expectation from the development community and the community-at-large that the parkland fees will be used in the very near future for certain capital projects. Concerns will be heightened as acquisition of parkland, development of trails and parks, or other community facilities will be delayed because the money is not in the SPTF for the projects.

6. Any interfund loan must be consistent with City Council Policy 1-18 which requires, including but not limited to, the following:
    a. Interfund loans may not be used to solve ongoing structural budget problems.
    b. Interfund loans must have an identified repayment source and date; include an interest component that equals the investment earnings the fund would have received had the loan not occurred; and be immediately due and payable if needed by the fund that provided the loan.
    c. Loan amount, term, and repayment source will be identified any time a loan is recommended.
    d. Loans will be coordinated with the City Attorney's Office to ensure compliance with the Municipal Code and will be approved by the City Council.

7. Although a loan to the RDA is not an interfund loan, many of the same principles and policies apply. Based upon the above criteria, it is doubtful that a loan to RDA could meet these requirements, especially items 6 (b) and 6 (c).

8. Loaning of money would jeopardize the City of San José's ability to deliver on Key Council Priorities, Green Vision – 100 miles of trails, land banking, sports fields and infrastructure backlog projects.

9. The SPTF is the primary source for fronting and matching funds for grants such as Proposition 84. If a substantial loan is made to RDA then the City would need to find another source for this or stop applying for and accepting grants.

10. Since the SPTF is the primary source (other than grants) for trail development, this could make the 100 miles of trails by 2022 an unachievable goal in the Green Vision. Particularly because the SPTF is currently being used to fund design projects which make "shovel ready" candidates for federal and state grant opportunities such as Penitencia and Thompson Creek Trails.

11. Currently, \$3.7M SPTF and \$7.7M in Construction and Conveyance Tax Funds are already on loan to RDA from earlier this year.

Ultimately a delay of projects may result in more staffing eliminations in City departments.

SEWAGE TREATMENT PLANT CONNECTION FEE FUND

Summary ($5 Million):

The Sewage Treatment Plant Connection Fee Fund (STPCFF) accounts for revenues from new residential, commercial, and industrial connections to the San José/Santa Clara Water Pollution Control Plant. These resources are used to pay San José's share of the costs of the acquisition, construction, reconstruction or enlargement of the Water Pollution Control Plant (WPCP), including principal and interest on any bonds or state or federal loans. Based on the current scheduled expenditure plan of funds from the Sewage Treatment Connection Fee Fund (STCF), a current decline in revenues, and the Water Pollution Control Plant capital activities, there is sufficient ending fund balance (reserves) in 2009-2010 to potentially loan $5.0 million to the RDA.

In addition to all of the items stated below under "General Principles & Risks", staff has identified the following levels of Risk associated with a potential loan.

Type of Risk	Level of Risk		
	Low	Moderate	High
Fund Availability	X		
Statutory Restrictions		X	
Community Sensitivity	X		
Opportunity Cost		X	
Impact of Non-Payment of Loan			X

General Principles & Risks:

As discussed above, funds in the STPCFF can only be used for expenditures in connection with the WPCP. Therefore, any loan of these funds for other uses must be repaid within an established time frame and the appropriate interest. Following is a discussion of the general risks with such a loan:

1. The City's General Fund would become liable for the loan repayment if RDA is ultimately unable to repay the loan, thereby increasing the City's Structural Budget Deficit.
2. Any interfund loan must be consistent with City Council Policy 1-18 which requires, including but not limited to, the following:
   a. Interfund loans may not be used to solve ongoing structural budget problems.
   b. Interfund loans must have an identified repayment source and date; include an interest component that equals the investment earnings the fund would have received had the loan not occurred; and be immediately due and payable if needed by the fund that provided the loan.
   c. Loan amount, term, and repayment source will be identified any time a loan is recommended.
   d. Loans will be coordinated with the City Attorney's Office to ensure compliance with the Municipal Code and will be approved by the City Council.

3. Although a loan to the RDA is not an interfund loan, many of the same principles and policies apply. Based upon the above criteria, it is doubtful that a loan to the RDA could meet these requirements, especially items 2 (b) and 2 (c).
4. Granting of the loan may prevent the City raising the sewer connection fee until the loan is repaid.
5. Assuming a repayment of the loan within four years, there may be a potential for capital project or equipment replacement delays as a result of the loan.

ICE CENTER REVENUE FUND

Summary ($2 Million):

The Ice Centre Revenue Fund (ICRF) accounts for rental revenues received from Sharks Ice at San José operations and provides funding for debt service payments and for repairs and improvements at the facility. Based on the current spending plan for the ICRF, there is sufficient ending fund balance in 2009-2010 to potentially loan $2 million to the RDA.

In addition to all of the items stated below under "General Principles & Risks", staff has identified the following levels of Risk associated with a potential loan.

Type of Risk	Level of Risk		
	Low	Moderate	High
Fund Availability	X		
Statutory Restrictions	X		
Community Sensitivity	X		
Opportunity Cost		X	
Impact of Non-Payment of Loan			X

General Principles & Risks:

Funds in the ICRF can only be used for expenditures in connection with the facility. Therefore, any loan of these funds for other uses must be repaid with the appropriate interest. Following is a discussion of the general risks with such a loan:

1. The City's General Fund would become liable for the loan repayment if RDA is ultimately unable to repay the loan, thereby increasing the City's Structural Budget Deficit.
2. Any interfund loan must be consistent with City Council Policy 1-18 which requires, including but not limited to, the following:
    a. Interfund loans may not be used to solve ongoing structural budget problems.
    b. Interfund loans must have an identified repayment source and date; include an interest component that equals the investment earnings the fund would have received had the loan not occurred; and be immediately due and payable if needed by the fund that provided the loan.
    c. Loan amount, term, and repayment source will be identified any time a loan is recommended.
    d. Loans will be coordinated with the City Attorney's Office to ensure compliance with the Municipal Code and will be approved by the City Council.
3. Although a loan to the RDA is not an interfund loan, many of the same principles and policies apply. Based upon the above criteria, it is doubtful that a loan to the RDA could meet these requirements, especially items 2 (b) and 2 (c).
4. Granting a loan from this fund would limit the amount of funding available for additional investments in the Ice Centre facility and emergency repairs and would reduce funding available to address any significant interest rate fluctuations that could increase debt service payments in this fund.

Distributed on:

DEC 11 2009
by City Manager's Office

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: SAN JOSE REDEVELOPMENT AGENCY SOURCES OF FUNDING FROM CITY FUNDS

DATE: December 10, 2009

INFORMATION

BACKGROUND

Several requests for information regarding potential other internal fund borrowing scenarios have been received since the information memorandum titled *San Jose Redevelopment Agency: Sources of Financing Beyond the Affordable Housing Fund* dated November 18, 2009 was released in respond to Budget Document #11 issued by Councilmembers Liccardo and Pyle as part of the Proposed 2009-2010 Redevelopment Agency of San José's budget process. While many considerations and risks are associated with borrowing from the funds identified in that memorandum and subsequently proposed as part of the Mayor's Budget Message Fiscal Year 2009-2010 Redevelopment Agency Capital and Operating Budget and 2010-2015 CIP, consideration was given to other City funds for a potential loan to the Agency.

ANALYSIS

This City has 114 budgeted funds. A preliminary review of all funds was initially conducted to evaluate whether potential internal borrowing from City funds could be feasible to address the State's suspension of Proposition 1A that negatively impacted General Fund Property Tax revenues.

The following analysis and consideration was given to all City funds evaluated for potential borrowing:

- The legality of executing a loan for each fund, taking into account whether the fund was subject to an existing agreement that restricted its use or whether State or Federal law restricted its use;
- The actual unrestricted ending fund balance available, including cash flow requirements, in each fund;
- The ability to raise rates if there was an outstanding loan where the source of funds originate from other agencies or rate payers;
- The ability to address fiscal emergencies in any given fund;
- Concerns from the community related to delaying projects and not using funds as intended;

- The need for infrastructure improvements and equipment replacements for various City operations; and,
- The availability of matching funds for grants.

In addition, it is important to note the following, if any loan agreements were executed within City funds for any purpose:

- Per City Council Policy, loans need to have an identified loan repayment source and be repaid with interest within an established time frame. Also, the loan must be immediately due and payable if needed by the fund that provided the loan.
- In case of non-payment, the General Fund may become liable for the repayment to these lending funds in order that the purposes of these special funds are able to be met. In some cases where the source fund has been funded with general-purpose funds of the City, it may become necessary for the source fund of the executed loan to absorb the impact in the event of non-payment.

Based on a review of the analysis noted above, while there are many considerations and risks outlined in the November 18th memorandum, it was determined that balances in the Subdivision Park Trust Fund, the Sewage Treatment Plant Connection Fee Fund, and the Ice Centre Revenue Fund could be possibly used for loans to the RDA if approved by the City Council/Agency Board. Therefore, no additional funding sources other than those in the Mayor's Redevelopment Agency Budget Message dated November 20, 2009, are recommended at this time for Agency borrowing.

DEBRA FIGONE
City Manager