SUPPLEMENTAL

COUNCIL AGENDA: 3-30-10
ITEM: 9.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR, CITY COUNCIL AND REDEVELOPMENT AGENCY BOARD

FROM: Debra Figone
Harry S. Mavrogenes

SUBJECT: **REDEVELOPMENT AGENCY HOUSING SET-ASIDE TAX ALLOCATION BONDS, SERIES 2010A, 2010B AND 2010C**

DATE: March 25, 2010

COUNCIL DISTRICT: Citywide

SUPPLEMENTAL MEMORANDUM

Recommendation

(a) Holding of a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing by the City in connection with the 2010A Bonds relating to certain affordable housing projects identified in Exhibit A **(Hearing held on 3/23/2010)**.

(b) Adoption of a resolution of the Redevelopment Agency Board:

(1) Authorizing the issuance of the following series of Redevelopment Agency of the City of San Jose Merged Area Redevelopment Project housing set-aside tax allocation bonds;
   (a) Housing Set-Aside Tax-Exempt Refunding Tax Allocation Bonds, Series 2010A in an amount not to exceed $57,000,000 (the "2010A Bonds");
   (b) Housing Set-Aside Taxable Tax Allocation Bonds, Series 2010B in an amount not to exceed $15,000,000 (the "2010B Bonds")[1]; and
   (c) Taxable Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds, Series 2010C in an amount not to exceed $93,000,000 (the "2010C" Bonds and collectively with the 2010A Bonds and 2010B Bonds, the "Bonds").

(2) Approving in substantially final form the Bonds, Eighth Supplemental Fiscal Agent Agreement, Subordinate Fiscal Agreement, a Continuing Covenant Agreement supplementing the Subordinate Fiscal Agreement, a Bond Purchase Agreement relating to the 2010A and 2010B Bonds, one or more Continuing Disclosure Agreements, a preliminary Official Statement relating to the 2010A and 2010B Bonds;

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[1] Recommendation language modified from March 11, 2010 staff report.

authorizing the Agency's Executive Director and Chief Financial Officer to execute and, as appropriate, negotiate these documents and other related documents as necessary, after consultation with Bond Counsel and the Financial Advisor for the Bonds;

(3) Authorizing the Agency's Executive Director and Chief Financial Officer, and their designees, to take all necessary actions in connection with the issuance of the Bonds, and;

(4) Authorizing the Agency General Counsel to negotiate and execute an agreement with Hawkins, Delafield & Wood LLC, for a total amount not to exceed $270,000 for Bond Counsel and Disclosure Counsel fees.

(c) Adoption of a resolution of the City Council:

(1) Approving the issuance of the Bonds by the Redevelopment Agency; approving the execution and delivery of one or more tax regulatory agreements; and making a finding pursuant to Redevelopment Law that the Merged Area will benefit from the projects located outside of the Merged Area that are financed or refinanced by the Bonds;

(2) Authorizing the City Manager and her designees to take all necessary actions in connection with issuance of the Bonds, and;

(3) Certifying that a TEFRA hearing was held in accordance with applicable federal regulations.

<u>Reasons for Supplemental Memorandum</u>

The reasons for this Supplemental Memorandum are as follows:

1) To update the Agency Board and City Council on developments since the March 11, 2010 staff report, including the approach to funding the Reserve Account associated with the 2010A and 2010B Bonds (as defined below), a revised sources and uses of bond proceeds, increasing the 2010B Bonds not to exceed amount increase from $12 million to $15 million, a slightly modified recommended bond structure, and the ratings assigned to the 2010A and 2010B Bonds.

2) To transmit a revised draft of the Preliminary Official Statement relating to the Agency's Housing Set-Aside Tax-Exempt Refunding Tax Allocation Bonds, Series 2010A and Housing Set-Aside Taxable Tax Allocation Bonds, Series 2010B (the "2010A and 2010B Bonds") and the Continuing Covenant Agreement with respect to the Agency's $93,000,000 Taxable Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds, Series 2010C (the "2010C Bonds");

<u>Developments Since March 11, 2010 Staff Report</u>

<u>Reserve Account Deposit</u> The Fiscal Agent Agreement requires that the Reserve Account be funded at a level equal to aggregate maximum annual debt service on all Senior Bonds, which consist of the outstanding fixed rate bonds issued on a parity with the 2010A and 2010B Bonds. As additional bonds are issued, an incremental deposit to the Reserve Account is required. As of the date that the 2010A and 2010B Bonds are issued, the Reserve Requirement will be approximately $20 million. Pursuant to the Fiscal Agent Agreement, the Agency may satisfy this requirement through the deposit of bond proceeds or a "Qualified Surety Bond", whose claims paying ability is rated in the highest category by A.M. Best, Standard & Poor's and Moody's.

The outstanding Senior Bonds funded their respective Reserve Account deposits with Qualified Surety Bonds – from MBIA, Syncora Guarantee (formerly, XL Capital) and FGIC (collectively, the "Sureties") – bond insurance companies that were rated "Aaa/AAA" at the time the Sureties were issued. Each Surety is in the amount of maximum annual debt service for the relevant series and secures only such series. The rating agencies have downgraded and/or withdrawn the ratings on the claims-paying ability and financial strength of these Sureties. Further, Syncora and FGIC are restructuring under regulatory supervision by the New York Insurance Department ("NYID") and have announced that they are under an NYID order to not pay any claims until such order is lifted (although FGIC's surety has been reinsured by MBIA).

The Fiscal Agent Agreement is silent as to whether the Sureties must qualify as Qualified Surety Bonds at the time of each parity issuance. To provide additional comfort to bondholders, the Agency intends to fund a new deposit to the Reserve Account with the proceeds of the 2010B Bonds in an amount equal to approximately $10.1 million rather than approximately $5.8 million as described in the March 11, 2010 report. This larger deposit will enable the Reserve Account to contain a cash funded portion equal to 50% of the overall Reserve Requirement and should be viewed positively by investors.

Bond Ratings The Agency received the following ratings on the 2010A and 2010B Bonds:

- Moody's: A2
- Standard & Poor's: A
- Fitch: A

These ratings are the same as the current ratings on the outstanding Senior Bonds. Moody's changed its outlook on the Senior Bonds from "Stable" to "Negative", whereas Standard & Poor's and Fitch maintained "Stable" outlooks. The change in Moody's outlook reflects the potential for lower growth rates and potential declines in tax increment due to the perceived uncertainty of the commercial real estate market, the State Budget situation and the lack of extensive cash reserves (liquidity). Nonetheless, the assigned ratings are among the highest ratings provided for non-credit enhanced tax allocation bonds in California.

Updated Sources and Uses The larger deposit to the Reserve Account will cause an increase in the 2010B Bond amount from $6.9 to $11.7 million. The table below shows the revised sources and uses of Bond proceeds:

REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE
Housing Set-Aside Tax Allocation Bonds, Series 2010A, 2010B and 2010C
Sources and Uses of Funds*

	Series 2010A	Series 2010B	Series 2010C	Total
Sources				
Par value	$56,695,000	$11,670,000	$93,000,000	$161,365,000
Original Issue Discount	(343,000)	-	-	(343,000)
Cash Deposit for Accrued Interest	65,000	-	-	65,000
Total Sources	**$56,417,000**	**$11,670,000**	**$93,000,000**	**$161,087,000**
Uses				
Repay 2005C and 2005D Bonds + Accrued Interest	$56,760,000	-	-	$56,760,000
Original Issue Discount	(343,000)	343,000	-	-
Repay Bank of New York line of credit/Term Loan	-	-	42,535,000	42,535,000
Reserve Fund Deposit	-	10,128,000	-	10,128,000
Deposit to (re)finance outstanding loans	-	-	50,000,000	50,000,000
Costs of Issuance	-	$342,000	272,000	614,000
Upfront Bank Fees/Bank Counsel	-	-	193,000	193,000
Underwriters' Discount/Issuance Costs	-	857,000	-	857,000
Total Uses	**$56,417,000**	**$11,670,000**	**$93,000,000**	**$161,087,000**

*Preliminary and subject to change.

Modifications to the Bond Structure To minimize its overall cost of borrowing, the Agency will amortize the taxable 2010B Bonds prior to the tax-exempt 2010A Bonds. In the March 11, 2010 staff report, the Agency anticipated that the final maturity for the 2010B Bonds would be August 1, 2015 and the final maturity for the 2010A Bonds would be August 1, 2035. With the increased 2010B Bond sizing, the expected final maturities are August 1, 2018 (2010B Bonds) and August 1, 2038 (2010A Bonds), subject to change based on market conditions at the time of sale. Debt Service coverage on the Senior Bonds is approximately 1.98 times.

TEFRA Hearing

On October 18, 2004 and May 23, 2005, public hearings under the Tax Equity and Fiscal Responsibility Act of 1982 (each a "TEFRA hearing") were held with respect to the affordable housing projects listed in Exhibit A in connection with the 2005C and 2005D Bonds. To maximize the Housing Department's flexibility to restructure those Bonds with the 2010A Bonds, the City is required to hold a new TEFRA hearing to allow for public comment relating to the Bonds and the projects. The TEFRA hearing associated with this action was held on March 23, 2010.

Documents Related to the Financing

As discussed in the March 11, 2010 staff report, a copy of the draft Preliminary Official Statement to the 2010A and 2010B Bonds has been posted to the Agenda website. Also posted is a copy of the Continuing Covenant Agreement respect to the 2010C Bonds. The following documents are also posted and on file in the City Clerk's Office:

- Eighth Supplemental Agreement
- Subordinate Fiscal Agent Agreement
- Continuing Disclosure Agreement
- Bond Purchase Agreement

These documents are described in the staff report and are presented for City Council/Agency Board approval in substantially final form.

Preliminary Official Statement – 2010A and 2010B Bonds The Preliminary Official Statement for the 2010A and 2010B contains updated disclosure relating to the Reserve Account that secures the 2010A and 2010B Bonds and all parity senior lien bonds (the "Senior Bonds"). The revised disclosure updates the current status of the Sureties and reflects the discussion above related to the downgrade of the Sureties and the funding of the Reserve Requirement.

If any Council Member has any personal knowledge that any of the material information in the Official Statement is false or misleading, he or she must raise these issues prior to approval of the distribution of the document. City staff, bond counsel, and the financial advisor will be available at the City Council/Board meeting on March 30, 2010 to address any questions, issues and/or concerns.

Continuing Covenant Agreement This document is between the Agency and Wells Fargo Bank as purchaser of the 2010C Bonds. This document, along with the Subordinate Fiscal Agent Agreement currently on file with the City Clerk, sets forth the terms under which Wells Fargo will purchase the 2010C Bonds, including:

- The right of Wells Fargo to tender the 2010C Bonds in three years, unless that tender date is extended;
- The requirement that 2010A and 2010B Bonds be rated "A2/A/A" by Moody's, Standard & Poor's and Fitch as a condition to its purchase of the subordinate 2010C Bonds;
- The Agency pay Wells Fargo a fee of $93,000 (0.1% of the 2010C Bonds) to purchase the 2010C Bonds and pay fees and expenses of its counsel in an amount not to exceed $100,000;
- The Agency does not suspend the collection of housing set-aside tax increment;
- Housing set-aside tax increment must cover maximum annual debt service on outstanding bonds, including the 2010A, 2010B, and 2010C Bonds by at least 1.25 times;
- The Agency may not issue additional housing set-aside tax increment bonds unless housing set-aside tax increment covers combined maximum annual debt service on outstanding

bonds and bonds to be issued by at least 1.25 times (compared to the current Fiscal Agent Agreement requirement of 1.15 times); and

- The City will continue to use Wells Fargo for general banking purposes for as long as Wells Fargo is the holder of the Bonds. The current initial term of the Agreement with Wells Fargo Bank for general banking services expires on June 2012. If the City decides to change the banking relationship, the City would have to either refund the 2010C Bonds or renegotiate the terms the Agreement as direct purchaser of the 2010C Bonds.

CEQA

Exempt, PP10-058

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