COUNCIL AGENDA: 01-11-11
ITEM: 3.2

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: **AIRPORT COMMERCIAL PAPER PROGRAM LETTER OF CREDIT REPLACEMENT**

DATE: December 14, 2010

Approved

Date 12/15/10

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

It is recommended that the City Council:

(a) Adopt a resolution continuing the authorization of the issuance of City of San José, San José International Airport Subordinated Commercial Paper Notes in several series in an aggregate amount not to exceed $600,000,000 outstanding at any one time and superseding Resolution No. 69200, as amended; and authorizing the City's designated officers to establish terms and conditions for the issuance and payment of such commercial paper notes and to take other necessary actions in connection therewith.

(b) Adopt a resolution authorizing the City's designated officers to negotiate, execute and deliver the following agreements related to the City of San José, San José International Airport Subordinated Commercial Paper Notes: (1) letter of credit and reimbursement agreements with each of JPMorgan Chase Bank, N.A., Bank of America, N.A., Citibank, N.A. and Wells Fargo Bank, N.A. and the related fee agreements; (2) a Second Amended and Restated Issuing and Paying Agreement with Deutsche Bank Trust Company Americas; (3) amended and restated dealer agreements with each of Barclays Capital Inc., Citigroup Global Markets Inc., and Morgan Stanley & Co. Incorporated; and authorizing the City's designated officers to take other necessary actions in connection therewith.

OUTCOME

Approval of this recommendation will result in the issuance of replacement letters of credit for a portion of the San José International Airport Commercial Paper Program. The replacement letters of credit will allow the outstanding commercial paper notes to remain outstanding and continue to provide capacity to finance the remaining projects related to Phase I of the Airport Development Program at the Norman Y. Mineta San José International Airport.

BACKGROUND

History of the City's Airport Commercial Paper Program

On November 2, 1999, the City Council adopted Resolution No. 69200 approving the implementation of a commercial paper program (the "Airport CP Program") for the Norman Y. Mineta San José International Airport (the "Airport"), which authorized the issuance of up to $100 million through a combination of three series of commercial paper notes: Series A (Non-AMT), Series B (AMT), and Series C (Taxable). The Airport CP Program was established to provide interim financing for Airport capital needs in anticipation of issuance of Airport revenue bonds that would replace the short-term notes with permanent long-term financing. Airport commercial paper notes are debt obligations backed by Net General Airport Revenues and are subordinate to Airport senior lien debt, also backed by these revenues. Net General Airport Revenues are the Airport's gross revenues less maintenance and operation expenses and are first pledged to repay Airport revenue bonds and then Airport commercial paper notes. The technical aspects of how commercial paper works are described in the attached Appendix A.

Since 1999, the commercial paper notes have been used to initially fund the Airport's runway projects, consolidated rental car garage project design efforts, costs associated with the 2002 Refunding Bonds, the initial costs associated with the implementation of the requirements under the federal Aviation and Transportation Security Act, the Claims Loss Reserve for the Airport's Owner Controlled Insurance Program for the North Concourse Project, the Terminal Area Improvement Program, and to fund associated interest costs during construction of these projects.

On June 20, 2006, the City Council approved an expansion of the Airport CP Program from $100 million to $200 million to ensure that funding would be available for the award of the design and construction contracts related to the amended Airport Master Plan projects and to pay costs related to the Airport's lease of the former FMC property.

On January 9, 2007, the City Council approved an expansion of the Airport CP Program from $200 million to $450 million to ensure that funding would be available for the design and construction contracts related to the rephased Airport Master Plan projects. The Series A-C Notes of the Airport CP Program are secured by letters of credit issued on a several, not joint, basis by JPMorgan Chase Bank, N.A. ("JPMorgan"), Bank of America, N.A. ("Bank of America"), and Dexia Credit Local, acting through its New York Branch ("Dexia")[1], pursuant to the Second Amended and Restated Letter of Credit and Reimbursement Agreement (the "Agreement").

On March 25, 2008, the City Council approved an expansion of the Airport CP Program from $450 million to $600 million primarily to refund Airport Auction Rate Securities that were adversely impacted by disruptions in the financial markets related to auction rate securities. This

[1] Dexia Credit Local is a subsidiary of Dexia SA, which is a limited liability company and is incorporated and domiciled in Belgium.

expansion was accomplished through a combination of three additional series of commercial paper notes: Series D (Non-AMT), Series E (AMT), and Series F (Taxable), and is secured by a letter of credit issued by Lloyds TSB Bank plc pursuant to a Letter of Credit and Reimbursement Agreement (the "Lloyds Agreement").

On September 1, 2009, the City Council adopted a resolution authorizing the issuance of tax-exempt private activity non-AMT commercial paper notes as provided for in the American Recovery and Reinvestment Act of 2009. At that time, the Series A Notes were redesignated as Series A-1 (Non-AMT) and Series A-2 (Non-AMT/Private Activity) and the Series D Notes were authorized to be redesignated as Series D-1 (Non-AMT) and Series D-2 (Non-AMT/Private Activity).

On November 9, 2010, the City Council authorized an amendment to the Agreement that extended the term of the agreement for two months from December 2, 2010 to February 2, 2011, removed Dexia Credit Local as a party to the agreement, reduced the amount of available credit from $450 million to approximately $283 million, and amended other terms of the Agreement. The two-month extension provided additional time to complete negotiations related to the replacement letters of credit described below.

ANALYSIS

This section of the memorandum includes subsections discussing the result of the Request for Proposals ("RFP") process, the long-term strategy for the Airport CP Program, the financing team, and the financing schedule.

RFP Results

On August 12, 2010, the Finance Department issued an RFP to letter of credit banks for the purpose of providing direct-pay letters of credit ("LOCs") for the Airport CP Program. The Finance Department posted the RFP on the BidSync solicitation posting system and distributed a notice to banks providing letters of credit.

The City received responses to the RFP from Bank of America, Citibank, JPMorgan, and Wells Fargo. The initial proposals, in aggregate, totaled $340 million of capacity. Through subsequent negotiations, the aggregate capacity was increased to $383 million. The following table provides a summary of the credit capacity proposals:

Bank	Letter of Credit Amount (*$ in millions*)	Term of Agreement
Bank of America, N.A.	$ 109	2 years
Citibank, N.A.	83	1 year
JPMorgan Chase Bank, N.A.	109	2 years
Wells Fargo Bank, N.A.	82	3 years
Total	**$ 383**	

As of the date of this memorandum, negotiations are continuing, and the final business terms of the agreements will be provided to the City Council through a supplemental memorandum on or about January 3, 2011. In conjunction with the $140 million letter of credit provided by Lloyds TSB Bank, overall capacity in the Airport CP Program will be approximately $523 million after the closing of the new agreements.

The proposed $383 million of capacity will provide support for the Airport commercial paper notes Series A-2, Series B and Series C currently outstanding in the aggregate amount of approximately $279 million. The Airport intends to issue an estimated $60 million of Airport commercial paper notes to fund the remaining projects related to Phase I of the Airport Development Program ("Phase I").

<u>Long-Term Strategy for Airport CP Program</u>

As discussed in the memorandum dated July 23, 2007 related to the Series 2007 Airport Revenue Bonds (Council Agenda 8/14/2007, Item #3.9), the plan of finance for Phase I called for the Airport CP Program to serve as an interim financing vehicle during the construction period. The memorandum also indicated an expectation that some or all of the commercial paper issued to fund Phase I projects would be refinanced with long-term bonds on or around the completion date of the Phase I projects, subject to market conditions, the Airport's operations and performance, and other factors.

Given that the Phase I projects are largely complete at this time, staff is taking steps to initiate the previously contemplated long-term bond financings with one or more anticipated closing dates in mid-2011. At this time, staff anticipates refunding a significant portion of the currently outstanding Airport commercial paper and, in conjunction with the refinancing, substantially reducing the size of the Airport CP Program. A specific recommendation will be developed based on updated analysis as the date of the bond financing approaches.

In addition to the letters of credit that are recommended for approval in this memorandum, the Airport CP Program is also supported by a letter of credit from Lloyds TSB Bank. This letter of credit, which provides $140 million of capacity, is scheduled to expire on May 7, 2011. Lloyds TSB Bank has indicated that it will likely not renew the letter of credit on a long-term basis but will consider a short-term extension in order to accommodate the City's completion of a long-term bond financing. Staff intends to make a formal request for a short-term extension of the

Lloyds Agreement to provide the time necessary to complete the long-term bond financing. Upon completion of the long-term bond financing, this credit capacity will no longer be required and the Lloyds Agreement will be terminated.

Financing Documents

This section contains a general description of the documents that require the City Council's approval. All of the documents described below, in substantially final form, will be posted on the City's agenda webpage on or about January 3, 2011. Staff recommends that the City Manager or the Assistant Director of Finance or their designees (the "Designated Officers") each be authorized to execute the agreements described below. As modifications may be required prior to the closing, staff also recommends that the Designated Officers each be authorized to execute the final version of these agreements as may be modified upon consultation with the City Attorney's Office.

Resolution Continuing Airport CP Program. The City Council adopted Resolution No. 69200 in November, 1999 in order to implement the Airport CP Program. As noted above, Resolution No. 69200 has been amended a number of times in order to address changes in the Airport's development program, tax law and market conditions. The proposed resolution will consolidate the changes made to date in a single document and will supersede Resolution No. 69200, as amended. Additionally, each of the banks proposing to provide credit support for the Series A-1/A-2, Series B and Series C Notes desire to issue its letter of credit to support particular series or subseries of notes (as opposed to severally providing a letter of credit with other banks as is currently the case). In order to accommodate the banks, the proposed resolution will provide for the division of the Series A, Series B and Series C Notes into a number of sub-series.

Second Amended and Restated Issuing and Paying Agent Agreement. The Issuing and Paying Agent Agreement is between the City of San José and Deutsche Bank Trust Company Americas as the Issuing and Paying Agent. This agreement sets forth the procedures for issuing commercial paper notes, payment of the matured commercial paper notes and the application of the funds received from the sale of commercial paper notes. The amendments to the Issuing and Paying Agent Agreement will allow for the commercial paper notes supported by the new letters of credit to be issued in a number of sub-series and will make conforming changes necessitated by the execution of the new Letter of Credit and Reimbursement Agreements.

Letter of Credit and Reimbursement Agreements and associated Fee Letters. Each Letter of Credit and Reimbursement Agreement ("Reimbursement Agreement") is an agreement between the City and a participating bank. According to the terms of each bank's respective agreement, the bank agrees to advance funds to the Issuing and Paying Agent in an amount sufficient to pay the principal and interest due on maturing commercial paper notes in an amount not to exceed the stated amount of the related letter of credit. In the event that the commercial paper dealer is unable to find investors to purchase commercial paper notes to repay the advance from the bank, the City must pay interest to the bank based on a formula specified in the Reimbursement Agreement. Additionally, each bank has proposed a separate Fee Letter to specify the commitment fee payable by the City and the other fees and charges imposed by the bank related to the issuance of its letter of credit. The terms of the Reimbursement Agreements and the Fee Letters with the banks are currently being finalized and a discussion of the major terms and conditions for each particular bank will be provided in a supplemental memo.

Delegation of Authority for Extensions of the Reimbursement Agreements and associated Fee Letters. Staff recommends that the Designated Officers, each acting alone, be authorized to enter into one or more extensions of the Reimbursement Agreements and associated Fee Letters on the same terms and conditions, provided that the annual fees for each extension do not exceed 2.50% per annum of the commitment under the respective agreements.

Dealer Agreements. The Commercial Paper Dealer Agreement ("Dealer Agreement") is between the City of San José with each of Barclays Capital Inc., Citigroup Global Markets Inc., and Morgan Stanley & Co. Incorporated as non-exclusive dealers for the commercial paper notes. Each Dealer Agreement sets forth the procedures and compensation for serving as a commercial paper dealer. The amendments to each Dealer Agreement will create provisions for each dealer to serve as a dealer for the redesignated subseries of commercial paper notes. The compensation payable to the commercial paper dealers and the other material terms and conditions of the existing agreements with the commercial paper dealers will remain the same.

Delegation of Authority related to Substitute Commercial Paper Dealers. Staff recommends that the Designated Officers, each acting alone, be authorized to select substitute commercial paper dealers and to enter into agreements with such substitute dealers on substantially the same terms as contained in the Dealer Agreements described above with such additions, changes and corrections therein as necessary and desirable, as the Designated Officer approves upon consultation with the City Attorney; provided that the compensation paid to the commercial paper dealer does not increase.

Financing Team

The financing team participants consist of:

- City's Co-Financial Advisors: Public Financial Management; Public Resources Advisory Group
- Bond Counsel: Orrick Herrington & Sutcliffe LLP

• Letter of Credit Banks:	Bank of America, N.A. Citibank, N.A. JPMorgan Chase Bank, N.A. Wells Fargo Bank, N.A.
• Bank Counsels:	Chapman and Cutler LLP Kutak Rock LLP
• Commercial Paper Dealers:	Barclays Capital Inc. Citigroup Global Markets Inc. Morgan Stanley & Co. Incorporated
• Commercial Paper Dealers' Counsel:	Kutak Rock LLP
• Issuing and Paying Agent:	Deutsche Bank Trust Company Americas

Financing Schedule

The current proposed schedule for the letter of credit replacement is as follows:

City Council:	January 11, 2011
Document closing:	January 13, 2011

EVALUATION AND FOLLOW-UP

This memorandum presents a recommendation related to the City Council's approval of various actions related to the City of San José Airport Commercial Paper Program and requires no follow-up to the City Council.

PUBLIC OUTREACH/INTEREST

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

☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

This report has been prepared by the Finance Department in coordination with the City Attorney's Office, Airport Department, and financing team participants.

COST IMPLICATIONS

Professional services (bank expenses, bank counsel fees, dealer counsel fees, and rating agency fees) and other related costs are estimated to be approximately $240,000 and will be paid from Airport operating funds. Not included in this amount are financial advisor fees and bond counsel fees that are billed on a time and materials basis and will also be paid from Airport operating funds. Any necessary budget adjustments due to the final outcome of the LOC renewal/replacement process will be brought back to City Council at a future date.

BUDGET REFERENCE

Not applicable.

CEQA

Not a project, File No. PPIO-066, Agreements/Contracts (New or Amended)

/s/
JULIA H. COOPER
Assistant Director of Finance

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

APPENDIX A

TECHNICAL ASPECTS OF COMMERCIAL PAPER

The Mechanics of Commercial Paper

Commercial paper is debt that is sold with a maturity of between 1 and 270 days. The maturity of an individual commercial paper note is determined by the commercial paper dealer and the issuer at the time it is sold. Each commercial paper note bears interest at a fixed rate for the 1-270 day period of time it is outstanding; or is sold at a discount, and such interest or discount is payable when the note matures. (The procedures for the payment of interest on the commercial paper are described below under "Payment of Principal and Interest on Commercial Paper".)

Municipal commercial paper programs typically require the issuer to obtain credit support through one of more letters of credit provided by a commercial bank. Upon each note maturity, the paying agent is authorized and required to draw on the supporting letter of credit in the amount of principal and interest due on that date. The issuer may then "roll over" the commercial paper notes by issuing renewal notes and using the proceeds of the renewal notes to reimburse the draw on the letter of credit. To the extent that the commercial paper dealer is unable to find an investor for the renewal notes, the draw on the letter of credit remains unreimbursed and the issuer is responsible for repaying the bank or banks that provided the letter of credit. The terms and conditions governing the letter(s) of credit and the reimbursement process are memorialized in a reimbursement agreement entered into by and between the issuer and the bank or bank(s) that provided the letter of credit.

The renewal notes may be sold through a commercial paper dealer either to a new investor or to the investor who held the maturing note. The process of rolling over commercial new paper is not considered to be the issuance of additional debt as long as the amount of commercial paper outstanding is not increased as a result of the "roll over." Through the "roll over" mechanism, commercial paper can be kept outstanding indefinitely, as individual commercial paper notes continually mature and new commercial paper notes are issued.

Commercial paper is considered a form of variable-rate debt. Even though the interest rate on each commercial paper note is fixed at the time such note is issued, the rate on each commercial paper note will be based on market conditions at the time. The rates on new commercial paper notes will thus vary from one week or month to another. The actual cost of the program to the issuer will be the average rate on all of its outstanding commercial paper notes over time. Most issuers calculate such average rates on a quarterly or annual basis. Overall, commercial paper rates tend to be among the lowest available in the tax-exempt and taxable markets for municipal debt.

The buyers of commercial paper are considered short-term investors, because their investments in commercial paper mature in 270 days or less. One of the attractive features commercial paper offers to an investor is that the maturities can be matched to the specific timing needs of an investor (such as 27 days, or 112 days). This helps an investor invest amounts for a very precise period of time until such funds are needed for a specific known payment obligation in the future. Buyers of commercial paper include major corporations and money market funds. Commercial paper is attractive to money market funds because it complies with the maturity limitations imposed on such funds, and the flexibility in setting the maturity of commercial paper may help the fund achieve or maintain the average maturity it is seeking. Money market funds are likely to continue to buy a given issue of commercial paper as it rolls over, and thus may own an issue for an extended period of time.

Payment of Principal and Interest on Commercial Paper

Commercial paper is not sold with a fixed principal repayment schedule. Instead, the issuer maintains almost complete flexibility with respect to the timing and amounts in which the principal amount of commercial paper will be repaid. Basically, the issuer can repay commercial paper on any date on which a commercial paper note is scheduled to mature by providing the funds to repay such note to the paying agent for the issue. The paying agent uses such funds to pay the holder of the commercial paper. At the same time, the issuer instructs its commercial paper dealer not to attempt to sell new commercial paper to roll over the paper, which is maturing. Hence, if such steps were taken, the amount of commercial paper outstanding at the end of the day is reduced.

The individual commercial paper notes are likely to have different maturities, so an issuer repaying a commercial paper program would do so in a series of steps as the individual notes mature. However, since each note would have a maximum maturity of 270 days, an entire program could be repaid at the option of the issuer in not more than 270 days from the time the issuer decided to commence such a repayment. It is likely that an issuer planning to pay a program off in the near future would instruct its commercial paper dealer to issue the paper with short maturities as it rolls over, so that the issuer could retire the commercial paper quickly when it begins the repayment process.

As noted above under “The Mechanics of Commercial Paper” interest or discount is payable on each commercial paper note as it matures. During the construction period for a project, the interest payable can be “capitalized” by adding the amount of interest due on the maturing commercial paper to the amount of new paper being sold. If this approach is used, the principal amount of paper outstanding over time will increase as additional interest is capitalized (subject to the maximum authorized amount of notes permitted to be outstanding at any one time under the program).

Interest on tax-exempt debt generally cannot be capitalized following completion of the projects financed with commercial paper. At that point, the issuer must provide to the paying agent the interest due at the time each note matures. The paying agent then pays such interest to the investor together with the proceeds received from rolling over the principal amount of the commercial paper. Since the interest at that point is being paid by the issuer, and not by increasing the amount of paper being rolled over, the principal amount of commercial paper outstanding will stay constant after the projects are completed. That principal amount outstanding could either be reduced in the future if the issuer decides to repay some, or all, of the program, or increased if the issuer decides to undertake additional projects (which may require an increase in the authorized amount of the program).