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Sent to Council:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Nadine Nader

SUBJECT: Early Council Packet

DATE: March 1, 2011

Approved Deanna Santana Date 3/1/11

EARLY DISTRIBUTION COUNCIL PACKET FOR MARCH 15, 2011

Please find attached the Early Distribution Council Packet for the March 15, 2011 Council Meeting.

San Jose Financing Authority:

Authorization of Bond Financing for the Convention Center Project.

Recommendation:

(a) It is recommended that the City Council take the following actions:

(1) Hold a Public Hearing on the proposed issuance of City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds").

(2) Adopt a resolution to authorize the issuance of the City of San José Special Hotel Tax Revenue Bonds, Series 2011 (Convention Center Expansion and Renovation Project) ("Hotel Tax Bonds") in the not-to-exceed principal amount of $120,000,000 in order to finance certain public capital improvements of the City, consisting of the expansion and renovation to the San José McEnery Convention Center, approve in substantially final form the Official Statement, Indenture, Bond Purchase Agreement, and Continuing Disclosure Certificate, and authorize the City Manager, or other authorized designees, to execute and deliver these documents and any other related documents as necessary in connection with the issuance of the Hotel Tax Bonds.

(3) Adopt a resolution to authorize the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds") in

the not-to-exceed principal amount of $50,000,000 and, together with the 2011 Hotel Tax Bonds, a not-to-exceed combined aggregate principal amount of $150,000,000 and approve in substantially final form the Official Statement, Trust Agreement, Facility Lease, Site Lease, Continuing Disclosure Certificate, and Bond Purchase Agreement and authorize the Executive Director, or other authorized designees, to execute and deliver these documents and other related documents as necessary in connection with the issuance of the Lease Revenue Bonds.

(4) Adopt a resolution to approve and authorize the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, and other related actions pertaining to the City of San José Financing Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease.

(b) It is recommended that the City of San José Financing Authority Board take the following actions:

(1) Adopt a resolution to authorize the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds") in the not-to-exceed principal amount of $50,000,000 and, together with the 2011 Hotel Tax Bonds, a not-to-exceed combined aggregate principal amount of $150,000,000 and approve in substantially final form the Official Statement, Trust Agreement, Facility Lease, Site Lease, Continuing Disclosure Certificate, and Bond Purchase Agreement and authorize the Executive Director, or other authorized designees, to execute and deliver these documents and other related documents as necessary in connection with the issuance of the Lease Revenue Bonds.

(2) Adopt a resolution to approve and authorize the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, a Second Amendment to the Memorandum of Assignment and other related actions pertaining to the City of San José Financing Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site lease and the Sublease.

CEQA: Resolution No. 72767 and Addenda thereto. File No. PP08-002. (Finance)

This item will also be included in the Council Agenda Packet with item numbers.

Nadine Nader

NADINE NADER
Assistant to the City Manager

COUNCIL/SJFA: 03-15-11
ITEM: 2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

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

FROM: Julia H. Cooper

SUBJECT: **SEE BELOW**

DATE: February 22, 2011

Approved

Date 2/25/11

COUNCIL DISTRICT: Citywide

SUBJECT: APPROVAL OF THE SALE AND ISSUANCE OF THE CITY OF SAN JOSE SPECIAL HOTEL TAX REVENUE BONDS, CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE BONDS AND RELATED ACTIONS FOR THE SAN JOSE MCENERY CONVENTION CENTER RENOVATION AND EXPANSION PROJECT AND APPROVAL OF ASSET SUBSTITION FOR THE CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE COMMERCIAL PAPER PROGRAM

RECOMMENDATION

a. It is recommended that the City Council take the following actions:

1. Hold a Public Hearing on the proposed issuance of City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds").

2. Adopt a resolution to authorize the issuance of the City of San José Special Hotel Tax Revenue Bonds, Series 2011 (Convention Center Expansion and Renovation Project) ("Hotel Tax Bonds") in the not-to-exceed principal amount of $120,000,000 in order to finance certain public capital improvements of the City, consisting of the expansion and renovation to the San José McEnery Convention Center, approve in substantially final form the Official Statement, Indenture, Bond Purchase Agreement, and Continuing Disclosure Certificate, and authorize the City Manager, or other authorized designees, to execute and deliver these documents and any other related documents as necessary in connection with the issuance of the Hotel Tax Bonds.

3: Adopt a resolution to authorize the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds") in the not-to-exceed principal amount of $50,000,000 and, together with the 2011 Hotel Tax Bonds, a not-to-exceed combined aggregate principal amount of $150,000,000 and approve in substantially final form the Official Statement, Trust Agreement, Facility Lease, Site Lease, Continuing Disclosure Certificate, and Bond Purchase Agreement and authorize the Executive Director, or other authorized designees, to execute and deliver these documents and other related documents as necessary in connection with the issuance of the Lease Revenue Bonds.

4. Adopt a resolution to approve and authorize the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, and other related actions pertaining to the City of San José Financing Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease.

b. It is recommended that the City of San José Financing Authority Board take the following actions:

   1. Adopt a resolution to authorize the issuance of the City of San José Financing Authority Lease Revenue Bonds, Series 2011A (Convention Center Expansion and Renovation Project) ("Lease Revenue Bonds") in the not-to-exceed principal amount of $50,000,000 and, together with the 2011 Hotel Tax Bonds, a not-to-exceed combined aggregate principal amount of $150,000,000 and approve in substantially final form the Official Statement, Trust Agreement, Facility Lease, Site Lease, Continuing Disclosure Certificate, and Bond Purchase Agreement and authorize the Executive Director, or other authorized designees, to execute and deliver these documents and other related documents as necessary in connection with the issuance of the Lease Revenue Bonds.

   2. Adopt a resolution to approve and authorize the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, a Second Amendment to the Memorandum of Assignment and other related actions pertaining to the City of San José Financing Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site lease and the Sublease.

OUTCOME

Approval of these recommendations will authorize the issuance of the Hotel Tax Bonds and Lease Revenue Bonds in a combined amount not to exceed $150 million to fund the costs of the expansion and renovation to the San José McEnery Convention Center (the "Project") and authorize the substitution of certain components of the property under the Site Lease and the Sublease for the Commercial Paper ("CP") Program.

EXECUTIVE SUMMARY

Approval of these recommendations will authorize the issuance of the Hotel Tax Bonds and Lease Revenue Bonds in a combined amount not to exceed $150 million to fund the costs of the expansion and renovation to the Project and authorize the substitution of certain components of the property under the Site Lease and the Sublease for the CP Program in order to release the former Martin Luther King Jr. Library and certain other assets as a pledged asset. This will allow for demolition of the building in connection with the Project and enable the land from the former Martin Luther King Jr. Library and temporarily the Mexican Heritage Plaza and possibly other assets to be used as collateral for the Lease Revenue Bonds during the construction period. The pledge of the Mexican Heritage Plaza and other possible assets will be released from the Lease Revenue Bonds upon completion of the construction of the Convention Center expansion and upon meeting certain other conditions outlined in the Site and Facility Lease Agreements. Upon release of these assets, the Lease Revenue Bonds will be supported solely by the land and certain portions of the Convention Center expansion at the former Martin Luther King Jr. Library site.

BACKGROUND

In 2009, the City established its Convention Center Facilities District No. 2008-1 (the “CCFD”) to generate a source of funding for the Project. The CCFD was created pursuant to the San José Municipal Code, which incorporates State law regarding community facilities districts. Qualified electors in the CCFD (generally, hotel owners throughout the City) approved the establishment of the special tax and the issuance of bonds for the Project by a 78% affirmative vote (based on one vote per hotel room). Since July 1, 2009, the City has levied a special tax on hotel property within the CCFD calculated as a percentage of taxable hotel revenues collected by such hotels. The CCFD is currently comprised of two zones based on proximity to the Convention Center, as discussed below. The CCFD special tax is levied annually and collected monthly through the same process as used for general City transient occupancy tax collections. To date, more than $7.1 million of CCFD special tax revenues have been collected.

The CCFD formation documents established three elements designed to provide security to bondholders:

- A base special tax is levied throughout the CCFD at the rate of 4% of taxable hotel revenues in Zone 1, and phased in at the rates of 1% for the first half of FY10, 2% for the second half of FY10, 3% for FY11 and 4% for FY12 and thereafter in Zone 2.
- A Revenue Stabilization Reserve (the “RSR”) was created to buffer against the inherent cyclicality of hotel tax revenues and provide a cushion to cover debt service in the event of a revenue shortfall.
- An Additional Special Tax (or “blinker tax”) can also be levied at an additional rate of 1% of taxable hotel revenues in both zones in any fiscal year when bonds are outstanding

to replenish the Revenue Stabilization Reserve when the balance has fallen below certain thresholds.

Citywide TOT Revenues

In addition to the CCFD special tax revenues described above, the City imposes a transient occupancy tax ("TOT") on hotel guests, which is collected and remitted to the City by the hotels. The current TOT rate is 10% of the rent charged to the hotel guest. These TOT revenues are used for a mix of General Fund and special fund purposes. Historically, the City has used approximately 1.5% of TOT revenues (the "1.5% TOT") to fund a convention and visitor's bureau. To enhance debt capacity, the City Council directed staff to consider this 1.5% TOT as a potential additional source of security for the proposed financing. This 1.5% TOT cannot be directly pledged to debt, however the Council can choose to appropriate these revenues for the Convention Center debt service each year.

Project Construction

On December 14, 2010, City Council authorized the City Manager to negotiate and execute a design-build contract with Hunt Construction for the Project in an amount not to exceed $117 million, and establish a City-controlled contingency of $3 million, subject to the completion of the related bond financing and appropriation actions, and City Council's approval of the spending reduction plan for the current operator of the Convention Center (Team San José). The City Council is scheduled to review and approved the recommended spending reduction plan on March 1, 2011. Construction completion is expected within 24 months of project start.

The construction elements and the estimated costs are outlined below.

Summary of Project Costs

Element	Cost (millions)	Notes
Demolition	$ 2.6	Former Martin Luther King Jr. Main Library
New Construction	62.8	125,000 new square feet
Central Plant	13.7	New chillers, boilers, cooling towers, pumps
Systems	12.9	New fire alarm, building management system
Renovation	20.0	Cosmetic front of house
Delivery Costs	5.0	Project delivery, art
Contingency	3.0	2.5% of $120 million
Total	**$120.0**	

ANALYSIS

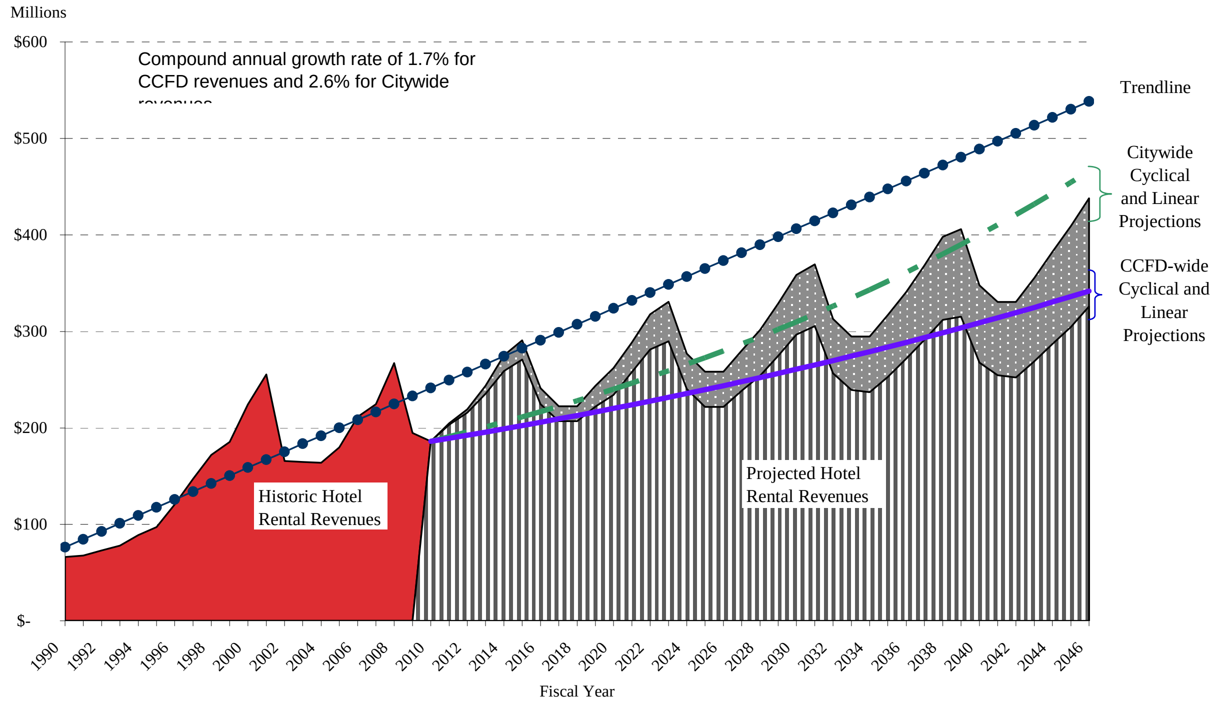
Convention Center Expansion and Renovation Project

The Finance Department has been working with a financing team comprised of bond counsel, financial advisor, underwriter, hospitality revenue consultant, and various City departments and stakeholders to structure a financing plan to deliver sufficient funds for the Project without subjecting the General Fund to undue risk. During this time, expectations regarding project scope, current and future hotel tax revenues, municipal bond market conditions, and available Redevelopment Agency resources for the Project have changed considerably. The City and its financing team have explored a variety of potential financing options and are recommending a structure that balances the desire to raise $120 million in project funds against the limitations of an inherently volatile revenue source, current capital market conditions, Council's desire to mitigate risk to the General Fund, and the current uses of the 1.5% TOT.

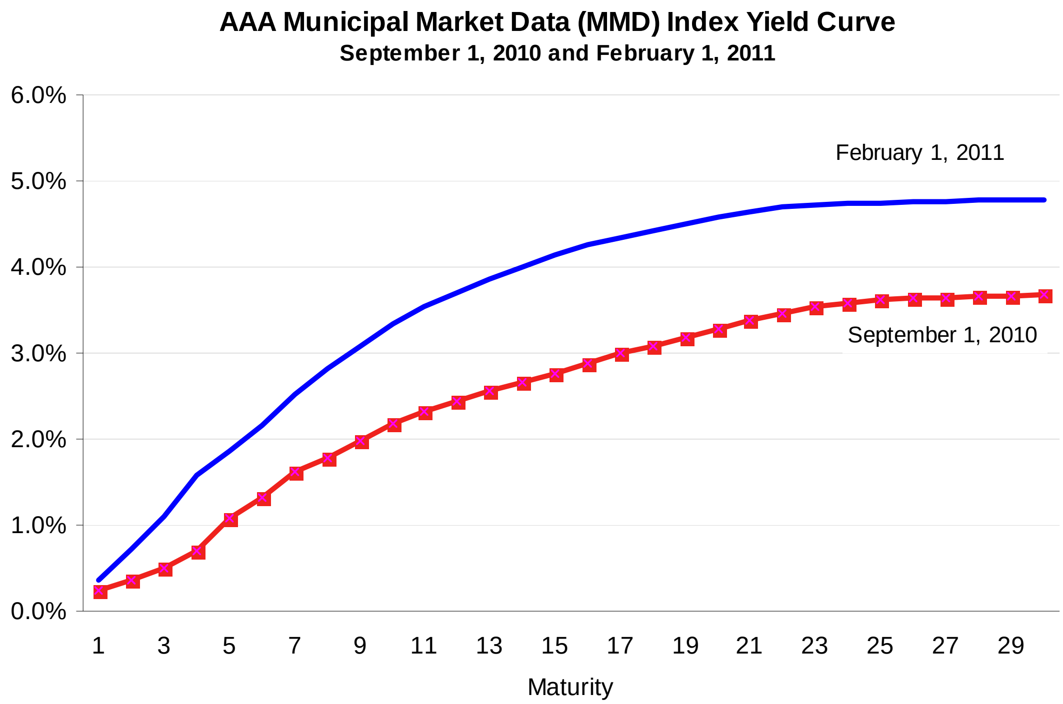
CCFD Annexation The CCFD is comprised of hotel parcels in the District at the time the District was created, and currently includes all hotels in the City. As new hotels are built over time, the new properties can be annexed into the CCFD upon the owner's election. It is possible that the owners of new hotels in the downtown, and larger full-service hotels in other parts of the City, will elect to join the CCFD in order to fully participate in the City's convention and tourism community. Given that the addition of new hotels to the District is an owner election, the hotel tax revenue projections and analysis assumes that no new supply of hotel rooms will enter the CCFD as part of the analysis

Volatility of Hotel Tax Revenues Taxes based on hotel room revenues are inherently volatile as hotel occupancy rates and room rates vary with economic cycles and competitive forces. The City's hospitality revenue consultant (Horwath HTL) has analyzed historic taxable room revenues and surveyed current market conditions to project future taxable room revenues. These projections assume a continued pattern of revenue cyclicality with an overall increasing revenue trend. While the overall supply of hotel rooms in the City is expected to increase over the forecast horizon, only new hotels affirmatively annexed into the CCFD will be subject to the CCFD special taxes. Consequently, this projection recognizes revenues from new hotel rooms only in the 1.5% TOT revenues, and not the CCFD special tax revenues. The projected compound annual growth rates are 2.6% for TOT revenues citywide and 1.7% for CCFD special tax revenues. The following graph illustrates historic taxable hotel revenues since 1989 and projected future hotel revenues.

San Jose Hotel Rental Revenues
Historic FY1990-FY2010, Projected FY2011-FY2045



<u>Market Conditions</u> Over the last several months, municipal interest rates have trended sharply upward due to both broad macro-economic forces and municipal market specific factors. The Fed's quantitative easing program, the extension of the Bush-era tax cuts, and positive economic data have fueled concerns about inflation. Heavy municipal issuance volume in the fourth quarter of 2010, the sunset of the Build America Bond program, recent press, and municipal fiscal health and pension-related liabilities have added pressure to the municipal market. All in all, these forces have resulted in record-setting withdrawals from municipal mutual funds since November 2010. The following graphs illustrate the change in market interest rates from September 1, 2010 through February 1, 2011.



Rising interest rates have led to smaller coverage expectations for the planned financing and could, ultimately, limit the City's ability to fund the full $120 million project if these market trends continue. For this reason, staff has recommended not-to-exceed principal estimates at a level that should be sufficient to account for any volatility in the market before pricing the bonds.

Plan of Finance The City is planning to leverage the special tax revenues levied in the CCFD through the issuance of both Hotel Tax Bonds and Lease Revenue Bonds. Total annual average CCFD special tax revenues are estimated at $10.3 million per year over the life of the bonds with estimated average annual debt service payments of $10.0 million for both series of bonds. The Hotel Tax Bonds will be secured by a first lien on the CCFD special tax revenues and any of the 1.5% TOT appropriated by City Council as part of the City's annual budget process to pay debt service. To mitigate the risk of volatile hotel tax revenues and secure investment grade ratings, the Hotel Tax Bonds will be structured with debt service coverage of at least 150% from the combined CCFD special tax revenues and the 1.5% TOT. Based on these parameters and current market conditions, the Hotel Tax Bonds are expected to generate approximately $88 million towards the Project cost from an estimated par amount of approximately $103 million (see Source and Use of Funds below for details).

To generate the balance of $32 million in needed project funds, the Authority will also issue the Lease Revenue Bonds secured by lease payments made from the City's General Fund appropriations to the Authority under a Facility Lease for use and occupancy of certain facilities. The estimated par amount for the Lease Revenue Bonds is $37 million, of which $32 million will be used to fund the remaining Project cost (see Source and Use of Funds below for details). The

CCFD special tax revenues remaining after paying the Hotel Tax Bonds would be applied to these lease payments prior to any City's General Fund appropriations being applied.

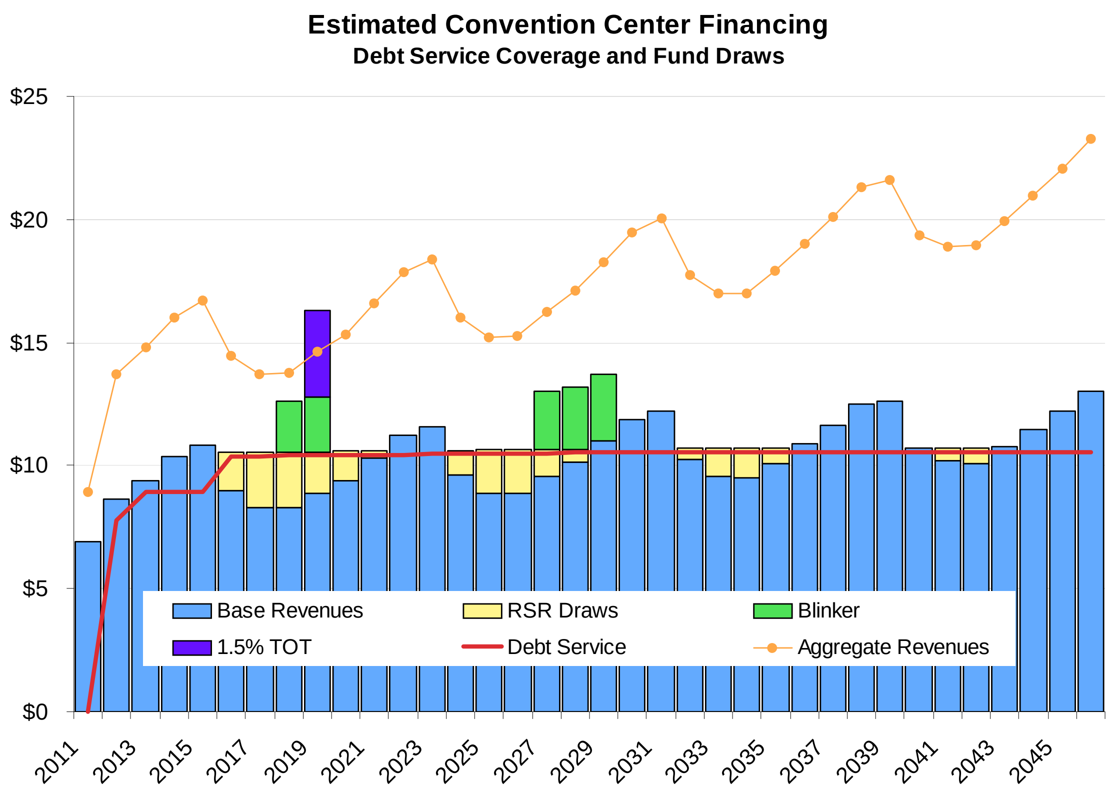
The Revenue Stabilization Reserve ("RSR") will be pledged as additional security for both the Hotel Tax Bonds and the Lease Revenue Bonds to provide a cushion against any downturn in revenues. The requirement will be to maintain a RSR balance equal to approximately 100% of maximum aggregate annual debt service on both series of bonds secured by this reserve (the "maximum reserve") but no less than 75% of this target (the "minimum reserve"). The City will be required to evaluate the RSR balance on each May 2, which is after the May 1 payment of the annual principal and semi-annual interest due on each series of bonds. The additional 1% blinker tax will be levied in each subsequent fiscal year in the event the balance drops below the minimum reserve requirement until the full maximum balance is restored. If the RSR balance remains less than the minimum on May 2 in any year when the blinker tax is already in effect, then the City covenants to seek Council approval to budget and appropriate the 1.5% TOT in the next fiscal year to replenish the RSR to the minimum reserve requirement. In years when the 1.5% TOT is not appropriated for replenishment, it would remain available for appropriation for its current uses (Convention Center Visitor Bureau marketing) or any other allowable uses subject to Council approval. In any given year, once the bond and lease payment obligations for that year have been satisfied and the maximum RSR balance and all other required accounts as specified in the Indenture of Trust and the Trust Agreement are fully funded, any excess CCFD special tax revenues can be used for any eligible purposes, including a capital repair and replacement, for the Convention Center.

The initial deposit in the RSR will be from the base CCFD special taxes collected since July 2009. It is estimated that at the time of the closing of the bonds, the RSR will have $7.1 million or approximately 70% of the target reserve and that the RSR minimum reserve requirement will be satisfied prior to May 2 of this year. In addition to the RSR, each series of bonds will fund traditional debt service reserve funds sized in an amount equal to approximately maximum annual debt service on each series.

Based on current projections, the CCFD special tax revenues are expected to fully fund the lease payments with coverage of approximately 1.20%. *However*, in the event CCFD special tax revenues fall below projections and there are insufficient funds in the RSR, the General Fund could bear some or all of the lease payments. As illustrated above, the taxable hotel revenues have been volatile. Taxable hotel revenues dropped 30% from $267 million in FY 2007-08 to $186 million in FY 2009-10. Taxable hotel revenues appear to be stronger this year, reflecting a 13.4% increase for the first five months of FY 2010-11 over the comparable period in FY 2009-10.

A sensitivity analysis was performed to determine under what situation the General Fund could be making lease payments. Given the proposed debt service payment schedule and the RSR, the City could sustain a decline of approximately 16% below expected FY 2010-11 revenues - with no increased special tax revenues over the life of the financing - and funds would be sufficient to make debt service payments from CCFD special tax revenues and 1.5% TOT through maturity on the bonds without impacting the General Fund.

Using the projected cyclical hotel revenues prepared by Horwath HTL, an analysis was prepared on the frequency and duration of a levy of the blinker tax and the appropriation of the 1.5% TOT. The following graph illustrates the projected revenues and RSR balance available in each year relative to the proposed debt service on both series of bonds. Based on these projections, to meet the debt service and RSR requirements over the term of the Bonds, it is estimated that the blinker tax will need to be levied five times and staff will need to request Council appropriation of the 1.5% TOT one time.



<u>Legal Structure</u> The City will issue the Hotel Tax Bonds pursuant to an Indenture of Trust (the "Indenture"). The Authority will issue the Lease Revenue Bonds under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to a Trust Agreement, between the Authority and U.S. Bank National Association (the "Trust Agreement"). To effectuate the lease financing portion of the program, the City will lease to the Authority various City-owned facilities pursuant to a Site Lease (the "Site Lease"). The Authority will then sublease these same facilities back to the City pursuant to a Facility Lease (the "Facility Lease") in exchange for the rental payments which support repayment of the Lease Revenue Bonds. The facilities subject to the Site Lease and Facility Lease during construction will include the land of the former Martin Luther King Jr. Main Library site and the Mexican Heritage Plaza. Upon completion of the Convention Center

Expansion, the Mexican Heritage Plaza will be released from the leases and the ground floor of the new Expansion will be substituted. Additionally, other facilities may need to be included in the Site Lease and the Facility Lease to accommodate the ultimate size of the issuance of Lease Revenue Bonds. These additional facilities may include the San José Museum of Art and/or other property to the extent necessary. Since the former library, San José Museum of Art and the Mexican Heritage Plaza are currently used as collateral for the leases supporting the City's CP Program, an amendment to the CP Program leases is also proposed, as discussed below.

The preliminary sources and uses of funds for both series of bonds are provided below.

City of San José Special Hotel Tax, Series 2011
City of San José Financing Authority, Series 2011A
Estimated Sources and Uses of Funds[1]

	Hotel Tax Bonds 2011	Lease Revenue Bonds 2011A	Total
Sources of Funds:			
Par Amount of Bonds	$ 103,000,000	$ 37,000,000	$ 140,000,000
Original Issue Discount	(1,250,000)	(250,000)	(1,500,000)
Total Sources of Funds	$ 101,750,000	$ 36,750,000	$ 138,500,000
Uses of Funds:			
Project Fund	$ 88,000,000	$ 32,000,000	$ 120,000,000
Debt Service Reserve Fund	8,000,000	3,000,000	11,000,000
Capitalized Interest	4,800,000	1,350,000	6,150,000
Costs of Issuance	300,000	200,000	500,000
Underwriter's Discount	650,000	200,000	850,000
Total Uses of Funds	$ 101,750,000	$ 36,750,000	$ 138,500,000

(1) Preliminary; subject to change.

Bond Documents Below is a general description of the documents that will require approval for each series of bonds. Staff recommends that the Executive Director of the Authority or the Executive Director's designees (the "Authority Designated Officers") be authorized to execute these documents on behalf of the Authority, and that the City Manager or the Assistant Director of Finance or their designees (the "City Designated Officers") be authorized to execute these documents on behalf of the City, as applicable, with such modifications as the Authority Designated Officers or the City Designated Officers determine to be desirable or appropriate, upon consultation with the City Attorney. Copies of these documents will be available in the City Clerk's Office and on the Council agenda website on or about February 24, 2011.

Preliminary Official Statements A Preliminary Official Statement, or prospectus, has been prepared for the City and the Authority by disclosure counsel for each series of bonds. Appendix A to each Official Statement, which has been prepared by City staff, describes the City's current financial situation and provides other information useful to investors regarding the City. Appendix A has been prepared by Finance staff in close coordination with the City Attorney's Office, City Manager's Budget Office, Retirement Services Department, Office of Employee Relations and other City departments as necessary, the financial advisor, bond counsel, and disclosure counsel.

As described above, a feasibility analysis included as Appendix G of the Official Statement has been prepared by the City's hospitality revenue consultant (Horwath HTL) in close coordination with Finance staff, the City Attorney's Office, other City departments as necessary, as well as the financial advisor, bond counsel, and disclosure counsel.

Each Official Statement generally discloses material information on the bond issue, such as the project, the repayment source, potential risks, and credit ratings. Investors use this information to evaluate the credit quality of the issue. Staff has carefully reviewed the information contained in the Official Statement and believes it to be accurate and complete in all material respects.

As part of the process of the Authority and the City issuing new debt, it is important that elected officials read through the Official Statements and Appendix A. Understanding the following elements of the bond issue is key to your review of these documents:

- Purpose of the bond issue
- Sources of repayment of the bonds
- Risks that the sources of repayment may be insufficient to repay the bonds
- Discussion of any other events that could affect the deliberations of a reasonable investor

After such review of the document the following additional elements should be considered:

- Have identified risks and events been brought to the attention of staff, bond counsel and other professionals?

- Have such risks and events been disclosed, and if not, what is the rationale for the non-disclosure?

The information to address these areas in the Official Statements for each series can be found in the INTRODUCTION section which describes the purpose of the bonds and the source of repayment, among other things. More detailed information on these topics and on the risks related to repayment of the bonds is provided in the SECURITY AND SOURCES OF PAYMENT FOR THE BONDS; THE PROJECT, CERTAIN RISK FACTORS; CONSTITUTIONAL AND STATUTORY PROVISIONS AFFECTING CITY REVENUES AND APPROPRIATIONS.

If any Councilmember or Authority Board member has any personal knowledge that any of the material information in either of the Official Statements is false or misleading, the Councilmember/Authority Board member must raise these issues prior to approval of the distribution of the document.

Staff recommends that the Designated Officers each be authorized to sign the Official Statements on behalf of the City and the Authority, as applicable, and to make such modifications to these documents as may be necessary upon consultation with the City Attorney's Office. Staff also recommends that the Designated Officers each be authorized to execute certificates regarding these documents as required to comply with securities laws and to authorize the underwriters to distribute these documents for the purpose of marketing the bonds.

City staff, bond counsel, disclosure counsel, and the financial advisor will be available at the City Council/Authority Board meeting on March 8, 2011 to address any questions, issues and/or concerns.

Indenture of Trust This agreement is by and between the City, as the issuer of the Hotel Tax Bonds and U.S. Bank National Association, as the trustee for the Hotel Tax Bonds. This agreement sets forth the terms of the Hotel Tax Bonds, the basic security pledge and covenants of the City and contains the responsibilities and duties of the trustee and the rights of the bondholders.

Trust Agreement This agreement is by and between the Authority, as the issuer of the Lease Revenue Bonds and U.S. Bank National Association, as the trustee for the Lease Revenue Bonds. This agreement sets forth the terms of the Lease Revenue Bonds, the basic security pledge and covenants of the City and contains the responsibilities and duties of the trustee and the rights of the bondholders. Under this agreement, the lease payments received by the Authority pursuant to the Facility Lease are, in turn, pledged to the repayment of the Lease Revenue Bonds.

Site Lease Pursuant to this agreement, the City will lease to the Authority various City-owned facilities related to the Lease Revenue Bonds.

Facility Lease Pursuant to this agreement, the Authority will lease back to the City the facilities leased to the Authority under the Site Lease; the City will make lease payments subject to general fund appropriations for use and occupancy of the facilities. The Facility Lease and the Site Lease will also provide for release of the Mexican Heritage Plaza upon completion of the Project.

Continuing Disclosure Certificates These documents are executed for the benefit of the bondholders and obligate the City to immediately disclose to the marketplace the occurrence of any material events that are required to be disclosed by federal securities laws. Each also requires the City to prepare an annual report to the marketplace, the contents of which are outlined in the Continuing Disclosure Certificates. These actions are taken in accordance with Rule 15c2-12(b) adopted by the Securities and Exchange Commission.

Bond Purchase Agreement The Bond Purchase Agreements are between the issuer (the City and Authority, respectively) and the senior managing underwriter for each series. The agreements describe the required conditions precedent to closing and commemorates the final interest rates, principal amounts, maturities and underwriters' compensation for the bonds.

Convention Center Financing Team Participants

The Convention Center financing team participants consist of:

Financial Advisor:	Stone & Youngberg
Bond Counsel:	Orrick, Herrington & Sutcliffe
Disclosure Counsel:	Jones Hall
Hospitality Revenue Consultant:	Horwath HTL
Underwriters:	Bank of America (Senior-manager)
	Wells Fargo (Co-manager)
	Citibank (Co-manager)
Underwriter's Counsel:	Hawkins, Delafield & Wood
Trustee:	U.S. Bank National Association

Stone & Youngberg was selected as the financial advisor from the City Council approved Financial Advisory Pool.[1] Horwath HTL was selected based on their ongoing role to provide projections for hotel tax-related revenues for the City's General Fund. A Request for Proposals ("RFP") for underwriting services to finance the Project was issued on June 14, 2010. Based on the results of the RFP process, Bank of America was selected as senior manager with Citibank and Wells Fargo selected as co-managers. U.S. Bank National Association was selected as trustee through a competitive process.

Financing Schedule

The current proposed schedule is as follows:

Council approval of documents:	March 8, 2011
Bond pricing:	Week of March 21, 2011
Bond closing:	Week of April 4, 2011

Substitution of Property pledged to the Commercial Paper Program

As noted above, the land of the former Martin Luther King Jr. Main Library site and temporarily the Mexican Heritage Plaza and possibly other assets are proposed to be pledged to the Lease Revenue Bonds during the construction period of the Project. These properties are currently pledged assets in the CP Program. In order to facilitate a pledge of these assets to the Lease Revenue Bonds, these properties must first be released from the CP Program and an alternate property must be identified and provided as a substitute to be pledged to the CP Program.

Staff proposes to substitute certain properties currently pledged to the CP Program, including the former Martin Luther King Jr. Main Library, the Mexican Heritage Plaza, and the San José Museum of Art with the newly constructed South San José Police Substation. This strategy provides the City with the flexibility to meet its future business needs and strategic asset management plans associated with the properties that are proposed to be released and minimizes the administrative and legal costs associated with amending the CP Program. Implementation of the proposal would limit the assets pledged to the CP Program to the following properties: Tech Museum, Animal Care Center, Fire Station No. 1, and the South San José Police Substation.

The proposed substitution of properties will require that the City obtain a title insurance policy that covers the assets subject to the Site Lease and Sublease. The estimated cost of the policy is approximately $85,000. A portion of this cost, as well as a portion of other costs associated with this substitution, will be paid from the proceeds of the bonds issued for the Convention Center.

[1] Per the Financial Advisory Services Agreements and Pool Assignments approved by City Council on February 27, 2007 (Item No. 3.6)

A more detailed description of funding for the substitution is provided in “Cost Summary/Implications”.

Per the terms of the Sublease and the Trust Agreement, the proposed substitution of properties requires the consent of State Street Bank, as the agent for the letter of credit banks, State Street Bank and Trust Company and California Teachers’ Retirement System. Both banks have indicated that it will give its consent.

Attachment A to this memorandum provides an overview of the mechanics of the City’s CP Program and a summary of the program amendments since initially established in January 2004.

Financing Documents for CP Program Property Substitution Below is a general description of the documents that will require approval. Staff recommends that the Executive Director of the Authority or the Executive Director’s designees (the “Authority Designated Officers”) be authorized to execute the documents below on behalf of the Authority, and that the City Manager or the Assistant Director of Finance or their designees (the “City Designated Officers”) be authorized to execute these documents on behalf of the City, as applicable, with such modifications as the Authority Designated Officers or the City Designated Officers determine to be desirable or appropriate, upon consultation with the City Attorney. Copies of these documents will be available in the City Clerk’s Office and on the Council agenda website on or about February, 24, 2011.

> ***Third Amendment to the Site Lease*** The Third Amendment to the Site Lease between the City as lessor and the Authority as the lessee amends the properties leased under the Site Lease as described above.
>
> ***Third Amendment to the Sublease*** The Third Amendment to the Sublease between the Authority as sublessor and the City as the sublessee amends the properties subleased under the Sublease as described above and revises the base rental schedule to reflect the schedule for the substituted properties.
>
> ***Second Amendment to Memorandum of Assignment*** The Memorandum of Assignment among the Authority, Wells Fargo Bank National Association (the “Trustee”), and State Street Bank and Trust Company (the “Bank Agent”) documents the assignment of the Authority’s right to receive the base rental payments from the City for use of the pledged properties. It is prepared for the purpose of recordation in order to put the public on notice of the assignment and does not modify the provisions of the Trust Agreement, the Reimbursement Agreement, the Sublease or the Site Lease.

CP Financing Team Participants

The CP financing team participants consist of:

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

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the City Council and/or the Authority Board's consideration of various actions related to the City of San José Special Hotel Tax Revenue Bonds, the City of San José Financing Authority Lease Revenue Bonds and Commercial Paper Program. Staff will return to Council in April to present the results of the sale and request appropriation of the bond proceeds.

PUBLIC OUTREACH/INTEREST

The City Council will hold a public hearing on March 8, 2011, as required by Section 6586.5 of the Government Code of the State of California to consider information concerning the approval of issuance of the Lease Revenue Bonds. The Notice of Public Hearing to be held in conjunction with the approval of the issuance of the Lease Revenue Bonds will be published in the *San José Mercury News* on or about March 3, 2011 announcing the time and location of the public hearing.

The proposed resolutions of the City Council and the Financing Authority Board, the legal documents and the Preliminary Official Statements will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about March 3, 2011.

☒ **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 Department of Public Works the City Manager's Office, and the City Attorney's Office.

COST SUMMARY/IMPLICATIONS

Costs related to the bond issuance for the financial advisor, bond counsel, disclosure counsel, underwriter and trustee are contingent on the sale of the bonds and will be paid from bond proceeds. Costs incurred for the CP Program asset substitution will be paid from bond proceeds to the extent that it is directly related to the Project. All remaining costs related to the asset substitution will be paid from the FY 2010-11 debt service budget for the CP Program and allocated on a pro-rata basis to each of the projects funded by the CP Program.

CEQA

Resolution No. 72767 and Addenda thereto. File No. PP08-002

/s/
JULIA H. COOPER
Assistant Director of Finance

<u>Attachment A</u>

Mechanics and Utilization of the City of San José Financing Authority Commercial Paper Program

The City's CP Program utilizes a lease revenue financing structure. Under this program, the Authority is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. The CP Notes are secured by a pledge of lease revenues from various City assets and additionally secured by a direct-pay letter of credit ("LOC") provided by State Street Bank and Trust Company ("State Street") and the California State Teachers' Retirement System ("CalSTRS") (together, the "Banks"). The current Letter of Credit Agreement between the Authority and the Banks expires on January 27, 2013.

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

The City has leased to the Authority various City-owned facilities pursuant to a Site Lease, as amended (the "Site Lease"). The City of San José Financing Authority subleased these same facilities back to the City pursuant to a Sublease, as amended (the "Sublease") in exchange for the rental payments which support repayment of the CP Notes. The facilities subject to the current Site and Sublease are: the former City Hall, the Health Building, and the "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. As noted in the memorandum, implementation of the asset substitution proposal would limit the assets pledged to the CP Program to the following properties: Tech Museum, Animal Care Center, Fire Station No. 1, and the South San José Police Substation.

The CP Program was initially established in January 2004 and has been amended and expanded through various City Council and Authority Board actions over time. A summary of these program amendments is provided below.

Date	**City Council/City of San José Financing Authority Board Actions**
January 13, 2004	Authorized the issuance of tax-exempt lease revenue commercial paper notes in an amount not to exceed $98 million to finance public improvements of the City including the offsite parking garage for the new City Hall and non-construction costs for technology, furniture, equipment, and relocation services for the new City Hall.
November 9, 2004	Authorized use of the commercial paper program to finance the acquisition of the City's consolidated utility billing system.
June 21, 2005	Authorized the issuance of taxable lease revenue commercial paper notes, under the same $98 million not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable commercial paper notes to pay for expenses otherwise authorized under the commercial paper program, but ineligible to be paid from tax-exempt commercial paper proceeds.
November 15, 2005	Authorized expanding the capacity of the lease revenue commercial paper program from $98 million to $116 million and authorizing the issuance of commercial paper notes to pay a portion of the costs of the Phase II improvements at the City's Central Service Yard and a portion of the demolition and clean-up costs at the City's Main Service Yard.
May 22, 2007	Authorized the issuance of lease revenue commercial paper notes to pay for capital improvements at the City's HP Pavilion.
October 21, 2008	Authorized the issuance of lease revenue commercial paper notes to refund bonds and other obligations of the City or the Authority pursuant to Government Code Sections 53570 et seq and 53580 et seq.
December 8, 2009	Authorized staff to amend and renew the letter of credit agreement supporting the lease revenue commercial paper notes. The current Letter of Credit Agreement between the Authority and the Banks expires on January 27, 2013.
April 20, 2010	Authorized the issuance of lease revenue commercial paper notes to fund a loan to low and moderate income housing fund and to fund short-term cash flow needs of the City.