COUNCIL AGENDA: 04-26-11
ITEM: 3.3

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 EXTENSION

DATE: April 4, 2011

Approved [signature] Date 4/8/11

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

It is recommended that the City Council:

> Adopt a resolution authorizing the City's designated officers to negotiate, execute and deliver an amendment to, or an amendment and restatement of, the Letter of Credit and Reimbursement Agreement by and between the City and Lloyds TSB Bank plc, acting through its New York Branch, related to the City of San José, San José International Airport Subordinated Commercial Paper Notes, Series D-F, to extend the term of this agreement and make certain other modifications thereto, and authorizing the City's designated officers to take other necessary actions in connection therewith.

OUTCOME

Approval of this recommendation will extend the term of the Letter of Credit and Reimbursement Agreement for four months from May 7, 2011 to September 7, 2011. The amendment will also modify other terms of the Agreement as discussed in the Analysis section of this memorandum. This extension is anticipated to provide staff with additional time to convert to long-term bond financing a portion of the interim commercial paper financing 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 "JPM/BofA/Dexia 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 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 ("Lloyds") pursuant to a Letter of Credit and Reimbursement Agreement (the "Agreement").

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

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 JPM/BofA/Dexia 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 approved by the City Council on January 11, 2011.

On January 11, 2011, the City Council approved letter of credit and reimbursement agreements with each of JPMorgan Chase Bank, N.A., Bank of America, N.A., Citibank, N.A. ("Citibank") and Wells Fargo Bank, N.A. ("Wells Fargo"). The terms of the agreements range from one year to three years and the replacement letters of credit provide aggregate credit support of $383 million to the Airport CP Program.

ANALYSIS

Amendment to the Agreement

The amendment to the Agreement with Lloyds (the "Amendment") will extend the term of the Agreement for four months from May 7, 2011 to September 7, 2011. This extension is anticipated to provide staff with additional time necessary to convert to long-term bond financing a portion of the interim commercial paper financing related to Phase I of the Airport Development Program at the Norman Y. Mineta San José International Airport. The Agreement will be terminated after the long-term refinancing bonds are issued.

As a condition of the extension, Lloyds requires that certain terms and conditions of the Agreement be amended as follows. The fee payable for the letters of credit (the "Base Fee") will be increased from the current fee of 0.84% of the commitment amount (current fee is approximately $97,000 per month) to the new renegotiated fee of 1.40% of the commitment amount (amended fee is estimated at approximately $161,000 per month). This represents an increase of approximately $256,000 in fees over the four-month period of the extension if the letter of credit remains outstanding for the full term of the extension period; however, staff anticipates that the long-term bonds will be issued prior to the end of the four-month period and the letter of credit will be terminated after the bonds are issued. The amended fee structure is consistent with current market pricing for credit and the fee structure for the letters of credit for the Airport CP Program that the City Council approved in January 2011.

The revised pricing is subject to maintenance of the current underlying credit ratings on the Airport bonds of A2/A/A- (Moody's/Standard & Poor's/Fitch). The fee will be determined according to the following table with the lowest rating used to determine the fee. The Base Fee during the four-month extension period is 1.40%.

Level	Moody's Rating	S&P Rating	Fitch Rating	Annual Fee
1	A2 or above	A or above	A- or above	Base Fee (1.40%)
2	A3	A-	A- or above	Base Fee + 0.30 %
3	Baa1	BBB+	BBB+	Base Fee + 0.55 %
4	Baa2	BBB	BBB	Base Fee + 0.75 %
5	Baa3	BBB-	BBB-	Base Fee + 0.95 %
6	Below Baa3	Below BBB-	Below BBB-	Base Fee + 1.20 %

If a rating from any rating agency is suspended, withdrawn or otherwise unavailable for credit related reasons, the Annual Fee will be the fee corresponding to Level 6 in preceding table. If a rating from any rating agency is suspended, withdrawn or otherwise unavailable for non-credit related reasons, the Annual Fee will be the fee corresponding to the Level that was applicable prior to such suspension or withdrawal. Additionally, the Annual Fee will increase immediately by an additional 1.00% from and after the occurrence of an Event of Default from the Annual Fee in effect immediately prior to such Event of Default.

Additional provisions of the Agreement are anticipated to be modified by the Amendment. These modifications are primarily to make the Agreement consistent with the other agreements that the City Council approved in January 2011 related to letters of credit for the Airport CP Program; however, those terms and conditions are currently under negotiation. The final terms and conditions of the Amendment will be provided to the City Council in a supplemental memorandum after negotiations are complete and prior to the City Council meeting on April 26, 2011.

Long-Term Strategy for Airport CP Program

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 has initiated the previously contemplated long-term bond financings with one or more anticipated closing dates in mid-2011. At this time, staff anticipates using bond proceeds to refinance 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 forthcoming in a memorandum dedicated to the bond financing.

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 Bank: Lloyds TSB Bank, plc
- Bank Counsel: Chapman and Cutler LLP
- Issuing and Paying Agent: Deutsche Bank Trust Company Americas

Financing Schedule

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

City Council:	April 26, 2011
Document closing:	May 3, 2011

EVALUATION AND FOLLOW-UP

This memorandum presents a recommendation for 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 and rating agency fees) and other related costs are estimated to be approximately $32,500 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 that will also be paid from Airport operating funds.

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).