COUNCIL/AUTHORITY AGENDA: 04-26-11
ITEM: SJFA #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: April 13, 2011

Approved

Date 4/14/11

COUNCIL DISTRICT: Citywide

SUBJECT: ACTIONS RELATED TO THE CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE BONDS, SERIES 2008F

RECOMMENDATION

It is recommended that the City Council adopt a resolution to:

a. Approve and authorize the negotiation, execution, and delivery of a First Amendment to Letter of Credit and Reimbursement Agreement, the Fee Letter Agreement, and other related actions in connection with the City of San José Financing Authority Lease Revenue Bonds, Series 2008F in order to allow for the extension of the existing credit facility.

It is recommended that the City of San José Financing Authority Board adopt a resolution to:

a. Approve and authorize the negotiation, execution, and delivery of a First Amendment to Letter of Credit and Reimbursement Agreement and other related actions in connection with the City of San José Financing Authority Lease Revenue Bonds, Series 2008F in order to allow for the extension of the existing credit facility.

OUTCOME

Approval of these recommendations will result in an extension of the Letter of Credit and Reimbursement Agreement providing credit and liquidity support for the City of San José Financing Authority Lease Revenue Bonds, Series 2008F (Land Acquisition Refunding Project) effective May 2, 2011 through May 1, 2014.

BACKGROUND

On May 14, 2008, the City Council and the City of San José Financing Authority Board (the "Authority") approved the issuance of the Authority's Lease Revenue Bonds, Series 2008F (Land Acquisition Refunding Project) (the "2008F Bonds") to refund the Authority's Lease Revenue Bonds, Series 2005A (Taxable) and Series 2005B (AMT) (the "2005 Bonds") which had been negatively impacted by disruptions in the financial markets related to the downgrades of bond insurers. A portion of the proceeds from the sale of the 2005 Bonds were used to purchase approximately 52 acres of real property on Coleman Avenue across from the Norman Y. Mineta San José International Airport and to make certain improvements thereto. The City also purchased an adjacent 23 acres using the proceeds of a HUD loan. The 52 acre bond-financed property and the 23 acre HUD financed property are referred to as the "Airport West property."

In order to provide credit and liquidity support for the 2008F Bonds, the Authority and the City obtained an irrevocable direct-pay letter of credit (the "Credit Facility") issued by Bank of America, N.A. (the "Credit Provider") to support the payment of debt service on the 2008F Bonds and the payment of the purchase price of the 2008F Bonds upon their optional or mandatory tender, as provided in the Credit Facility and the Indenture of Trust, as more fully discussed below. In connection with the issuance and delivery of the Credit Facility, the Authority and the City entered into a Letter of Credit and Reimbursement Agreement with the Credit Provider.

ANALYSIS

Overview

The 2008F Bonds are variable rate lease revenue bonds. The City has leased to the Authority the bond-financed Airport West property pursuant to a Site and Facility Lease, (the "Site Lease"). The Authority subleased the bond-financed Airport West property back to the City pursuant to an Operating Sublease Agreement, which has been terminated, and a General Sublease Agreement (the "Sublease"), which is now in effect, in exchange for the rental payments which pay the principal of and interest on the 2008F Bonds (or reimburse the Credit Provider for drawings on the Credit Facility).

The Authority issued the 2008F Bonds under the Marks-Roos Local Bond Pooling Act of 1985 and pursuant to an Indenture of Trust between the Authority and Wells Fargo Bank, National Association (the "Indenture"). The variable interest rate on the Bonds is established weekly by a remarketing agent.

Under the Indenture, the Trustee is obligated to draw on the Credit Facility to pay debt service on the Bonds, when due, and rental payments made by the City under the Sublease are used to reimburse the Credit Provider for such draws on the Credit Facility or, in the event a bank dishonors a draw on the Credit Facility for whatever reason, to pay debt service on the 2008F Bonds when due. Additionally, the Trustee is obligated to draw on the Credit Facility to provide liquidity support in the event the 2008F Bonds are subject to optional or mandatory tender for purchase and the remarketing agent is unable to find a buyer (i.e., a failed remarketing) or the 2008F Bonds are not remarketed in the case of certain mandatory tenders. A general description of the mechanics of variable rate bonds is attached to this Council Memorandum as Attachment A.

The current Credit Agreement by and among the City, Authority, and the Credit Provider expires on June 11, 2011. Staff has negotiated an extension through May 1, 2014. In exchange for this extension, the Credit Provider is requiring that the City and the Authority execute a First Amendment to Letter of Credit and Reimbursement Agreement (the "Credit Agreement") with the Credit Provider, and that the City enter into a Fee Letter Agreement with the Credit Provider. Detailed descriptions of the proposed amendments to the Credit Agreement and Fee Letter Agreement are provided in the section below.

The forms of the proposed Credit Agreement and the Fee Letter Agreement will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about April 14, 2011. Staff recommends that the Executive Director of the Authority or the Executive Director's designees (the "Authority Designated Officers") be authorized to execute these agreements as posted, 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 amendments, as posted, on behalf of the City, as applicable, with such modifications as the Authority Designated Officers or the City Designated Officer determines to be desirable or appropriate, upon consultation with the City Attorney.

First Amendment to the Credit Agreement

Pursuant to the Credit Agreement, the Credit Provider will extend the term of the Credit Facility through May 1, 2014. The annual fee payable for the Credit Facility will be increased from 0.60% to 1.10% of the commitment amount or to approximately $750,000 per annum, representing an increase of approximately $350,000 per year. The commitment is equal to the outstanding principal on the bonds plus 34 days of interest calculated at 12 percent (the "Commitment"). This increase in the annual fee has been factored in the Proposed FY 2011-12 Budget and the Five-Year Forecast.

Under the Fee Letter Agreement in the event that the long-term general fund debt ratings of the City are downgraded by one or more rating agency, the annual commitment fee shall increase pursuant to the following table: In light of the City's current bond ratings, it is anticipated that the rate for the annual fee will be at Level 1.

Level	Moody's Rating	S&P Rating	Fitch Rating	Facility Fee Rate
Level 1:	Aa2 (or higher)	AA (or higher)	AA (or higher)	1.10%
Level 2:	Aa3	AA-	AA-	1.25%
Level 3:	A1	A+	A+	1.40%
Level 4:	A2	A	A	1.55%
Level 5:	A3	A-	A-	1.70%
Level 6:	Baa1	BBB+	BBB+	1.90%
Level 7:	Baa2	BBB	BBB	2.20%
Level 8:	Baa3	BBB-	BBB-	2.30%
Level 9:	(lower than Baa3)	(lower than BBB-)	(lower than BBB-)	Default Rate

Although the fee increase proposed by the Credit Provider is significant compared to the fee currently paid under the original Credit Agreement, it is consistent with both the fees being paid by other similarly-rated large California municipalities for similar credit facilities on similar financing programs and with recent renewals on other City credit facilities. The long-term relationship between the City and the Credit Provider and the City's strong credit ratings has allowed the City to negotiate a favorable fee structure. This fee increase has been expected given the severe financial market disruption that began in late summer 2008 and continues to affect the credit market environment. Over the past three years, the financial services and banking industries have transformed and consolidated significantly which has led to a tightening of credit standards, reduced credit capacity, and more stringent capital adequacy requirements for banks. All of these factors have lead to a shrinking supply of credit and an increase in the cost of utilizing credit.

The First Amendment to the Credit Agreement and the Fee Letter Agreement include amended and/or additional terms and covenants which are summarized below.

In the event any of the 2008F Bonds fail to be remarketed, then the Credit Provider provides the funds to purchase these bonds from the bondholders and they become Credit Provider Bonds. The City's payments to the Authority for the lease of the bond-financed Airport West property are then subject to the interest rates specified in the Credit Agreement. The City also is responsible for paying to the Credit Provider the principal of Credit Provider Bonds on a shorter schedule than the amortization schedule for the 2008F Bonds. This provision is to encourage the

City and the Authority to find other sources of financing to purchase the Credit Provider's bonds from the Credit Provider. The purchase of the Credit Provider Bonds typically is accomplished through a refunding as was the case in 2008. The terms Base Rate, Draw Rate, Term Loan Rate and Default Rate all become applicable when the Credit Provider owns the 2008F Bonds. The term loan amortization period is the length of time permitted for the principal of the Credit Provider Bonds to be paid to the Credit Provider, and for the 2008F bonds this period of time is three years.

Base Rate:	Higher of: (i) Prime Rate plus 1.50%; (ii) Fed Funds Rate plus 3.00%; or (iii) 7.50%.
Draw Rate:	Base Rate for draws outstanding between the draw date and 90 days. Base Rate plus 1.00% for draws outstanding between 91 days and thereafter.
Term Loan Rate:	Base Rate plus 1.00% for draws outstanding 91 days and thereafter.
Default Rate:	Base Rate plus 3.00%.
Term Loan Amortization:	Any unreimbursed draw on the Letter of Credit will be amortized over a three-year period; however, lease payments may not exceed the maximum annual lease payment under the Sublease.

Other significant terms of the Credit Agreement or Fee Letter Agreement are outlined below.

Most Favored Nation:	If the City or Authority enters into a similar credit facility on any bonds payable from the General Fund within six months of May 2, 2011, or at anytime on the Series 2008 ABCDE Bonds, with terms or covenants more restrictive than included in the Series 2008F Reimbursement Agreement, then these more restrictive terms and covenants would also apply to the Series 2008F Reimbursement Agreement.
Pricing Parity:	If the City or the Authority enters into a similar credit facility on any bonds payable from the General Fund within six months of May 2, 2011, or at anytime on the Series 2008 ABCDE Bonds with higher pricing terms, the higher pricing will also apply to the Series 2008F Reimbursement Agreement.

Governing Law:	As is common in many banking agreements, the law governing the agreements and the Bank's obligations is New York law. The law governing the ability of the City and the Authority to enter into the agreement is California law.
Early Termination Fee:	If the Credit Facility is terminated at the request of the City or the Authority prior to the expiration of its term for any reason other than a down grade of the short term ratings of the Bank below "A-1" by S&P, "P-1" by Moody's or "F-1" by Fitch, then City shall pay to the Credit Provider an early termination fee equal to the difference between what the City would have paid in facility fees for three years and what the City paid in facility fees through the early termination date.

Staff also recommends that the Designated Officers each be authorized to enter into one or more extensions of the Credit Agreement on substantially same terms and conditions, provided that the annual fees for each extension do not exceed 2.50% of the Commitment.

Airport West Option Agreement

On December 14, 2010, the City entered into an amendment to the Amended and Restated Option Agreement for the Airport West Property ("Option Agreement") with a potential developer for the purchase of the entire Airport West property. The Option Agreement allows the developer to purchase the Airport West property in phases. The Option Agreement allows the developer to make option payments to reserve exclusive negotiation rights with City for the future purchase of the Airport West property. The revised non-refundable payment schedule for the option periods approved by the City Council is as follows:

Payment Due Dates	Option Periods	Amount
December 21, 2010	January 1 – December 31, 2013	$2,000,000
December 22, 2013	January 1 – December 31, 2014	1,000,000
December 22, 2014	January 1 – December 31, 2015	2,000,000

In the event the developer exercises its option to purchase the property prior to the expiration of the Credit Facility on May 1, 2014, then pursuant to the terms of the Credit Agreement discussed above, the City will be subject to the Early Termination Fee.

As discussed above, a portion of the proceeds from the sale of the 2005 Bonds was used to purchase approximately 52 acres of the Airport West property. An additional 23 acres of the Airport West property was financed with a HUD loan and is not subject to the terms of the Credit Agreement. The current proposal for the soccer stadium is for construction to occur on the HUD financed portion of the Airport West property. The developer may purchase the soccer site separately from the bond-financed portion of the Airport West Property the HUD financed portion of the Airport West Property. Any sale or other arrangement involving the HUD financed portion of the Airport West property is not subject to the terms of the Credit Agreement, specifically the Early Termination Fee.

Financing Team Participants

The financing team participants consist of:

City's Financial Advisor:	Public Resources Advisory Group
Bond Counsel:	Jones Hall, A Professional Law Corporation
Letter of Credit Bank:	Bank of America, N.A.
Bank Counsel:	Fulbright & Jaworski
Trustee:	Wells Fargo Bank
Remarketing Agent:	Goldman Sachs & Co.

Financing Schedule

The current proposed schedule is as follows:

Council approval of amendments to financing documents:	April 26, 2011
Document closing:	May 2, 2011

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the City Council and the Authority's approval of various actions related to the City of San José Financing Authority Lease Revenue Bonds, Series 2008F and requires no follow-up to the City Council.

PUBLIC OUTREACH/INTEREST

The form of the proposed amendment will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about April 14, 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 City Attorney's Office.

COST SUMMARY/IMPLICATIONS

Compensation for professional services (bond counsel, financial advisor and bank counsel) and other related costs will be paid from the FY 2010-11 appropriations for debt service and associated costs. These costs are estimated to be approximately $25,000 for all these services. Any necessary budget adjustments resulting from the Credit Agreement extension will be brought back to Council at a future date.

As discussed above, in the event the developer exercises its option to purchase the 52 acre portion of the property prior to the expiration of the Credit Facility on May 1, 2014, then pursuant to the terms of the Credit Agreement discussed above, the City will be subject to the Early Termination Fee. This amount is estimated at $750,000 per year or an amount equal to the difference between what the City would have paid in facility fees for three years and what the City paid in facility fees through the early termination date. If such an event occurs, staff will conduct analysis to ensure the benefit of the sale of the property and the associated reduced General Fund obligation of the debt service outweighs any cost of paying the Early Termination Fee associated with the Credit Facility.

CEQA

Not a project, File No. PP10-066, Agreements/Contracts (New or Amended).

/s/
JULIA H. COOPER
Assistant Director of Finance

For questions, please contact Arn Andrews, Treasury Division Manager, Finance, at (408) 535-7041.

<u>ATTACHMENT A</u>

TECHNICAL ASPECTS OF

MULTI-MODAL VARIABLE RATE DEMAND BONDS ("VRDBs")

The interest rate on a multi-modal VRDB is established by a Remarketing Agent appointed by the Authority. The rate can be reset as often as daily or can be fixed for longer periods. The most common reset frequency is weekly. Interest reset periods are also referred to as "modes", thus the characterization of the VRDBs as "multi-modal." The Remarketing Agent is required to set the rate based on its impression of current market interest rates. If an investor no longer wishes to hold the VRDB, the investor is permitted to notify the Tender Agent and "put" the bond back to the Authority and "demand" repayment - hence the term "demand bond."

In such an event, the Remarketing Agent will attempt to remarket the bonds so "put" to another investor. If the Remarketing Agent is unable to find a substitute investor, for any reason, the Tender Agent who is the trustee for the 2008F Bonds is authorized to draw on a liquidity facility established by the Authority for this purpose. The liquidity facility is either a letter of credit or a line of credit that provides immediate funding to the Tender Agent to repay the bonds that have been "put" by an investor and the Remarketing Agent has not remarketed. The "put" feature associated with VRDBs is essential to the ability and willingness of investors to purchase the bonds and a liquidity facility is required in order to provide substance to the "put" ability. The City pays a quarterly fee to the bank providing the liquidity facility. In the case of the 2008F Bonds, the liquidity facility is the letter of credit being provided by the LOC bank, which is also providing credit support for the Series 2008F Bonds.

Under the Indenture, the Authority can choose to have the interest on the VRDBs reset with different frequencies. The interest rate modes are (1) daily; (2) weekly; and (3) other terms of varying lengths as selected by the Authority. The Authority can also choose to convert the VRDBs to a fixed interest rate to their maturity.

Each Series of VRDBs can bear interest at a different mode. In order to switch between interest rate modes, the City must give notices to bond investors and other identified parties and satisfy the conditions set forth in the Indenture. Additionally, changing interest rates modes, other than fixing the rate on a series of bonds to maturity, also requires the consent of the bank providing a letter of credit for the particular series of bonds or a new letter of credit. The ability to change interest rate modes provides the City/Authority with the ability to manage its interest rate risk during the term of the bonds.