COUNCIL AGENDA: 06-21-11
ITEM: 3.7

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: **ISSUANCE OF CITY OF SAN JOSE AIRPORT REVENUE BONDS, SERIES 2011A**

DATE: May 31, 2011

Approved [signature] Date 6/7/11

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

It is recommended that the City Council:

a. Hold a TEFRA ("Tax Equity and Fiscal Responsibility Act") hearing with respect to the proposed issuance by the City of tax-exempt airport revenue bonds and subordinated airport commercial paper notes in an aggregate principal amount not to exceed $320 million pursuant to a plan of financing in order to provide proceeds to finance or refinance all or a portion of the costs of acquisition, construction, equipping, financing, reconstruction, development, and modification of airport facilities that are included in or are consistent with the Airport Master Plan for the Airport.

b. Adopt the Sixteenth Supplemental Resolution (the "Resolution") of the City Council authorizing the issuance of City of San José Airport Revenue Bonds, Series 2011A in one or more series (the "2011A Bonds") in a total aggregate principal amount of not to exceed $300 million to be sold through negotiated sale; approving substantially final forms of Supplemental Trust Agreement, Preliminary Official Statement, Bond Purchase Agreement and Continuing Disclosure Certificate; authorizing the distribution of one or more Preliminary Official Statements and the Final Official Statements; and authorizing and approving other related actions in connection with the issuance of the Series 2011A Bonds.

c. Adopt a resolution authorizing the City Manager to negotiate and execute an Agreement by and among the City, Public Financial Management and Public Resources Advisory Group for financial advisory services in connection with the issuance of the City of San José Airport Revenue Bonds Series 2011A and Series 2011B in an amount not to exceed $420,000.

d. Adopt a resolution authorizing the City Attorney to negotiate and execute an Agreement with Orrick, Herrington & Sutcliffe LLP for bond and disclosure counsel services in connection with the issuance of the City of San José Airport Revenue Bonds Series 2011A and Series 2011B in an amount not to exceed $350,000.

OUTCOME

Approval of the recommendations will allow the issuance of the Series 2011A Bonds to refund a portion of the outstanding City of San José, San José International Airport Subordinated Commercial Paper Notes ("CP") and to refund certain outstanding City of San José Airport Revenue Bonds to the extent such refunding of Airport Revenue Bonds meets the City's Debt Management Policy savings objectives and the requirements stipulated in the Airport's Master Trust Agreement.

EXECUTIVE SUMMARY

This staff report recommends approving the issuance of airport revenue bonds in an amount not to exceed $300 million to refund outstanding tax-exempt CP and, where market conditions are favorable, to current refund certain outstanding airport revenue tax-exempt bonds previously issued in 1998 and 2001. The tax-exempt CP refunding is the first step in a larger financing strategy that will also include the refunding of taxable CP primarily used to fund the construction of the Airport's new consolidated rental car facility (the "ConRAC") planned for later this calendar year. Staff also recommends approval of the financial advisory and legal services agreements related to both transactions on a contingent basis.

This refunding meets several objectives. It complies with the Airport's original plan of finance to refund short-term CP debt, which had been identified as an interim financing vehicle during the construction period of the Airport Master Plan, with long term fixed rate bonds. Refunding of CP Notes mitigates future letter of credit renewal risk and allows the Airport to substantially reduce the size of the CP program at a time when market conditions have made it increasingly difficult and expensive to obtain the credit facilities required to support the CP program. Finally, refunding the Airport Revenue Bonds, Series 1998A (the "1998A Bonds") and/or the Airport Revenue Bonds, Series 2001A (the "2001A Bonds") would achieve economic savings for the Airport in the form of lower debt service.

BACKGROUND

The Airport CP Program

The Airport CP program was established in November 1999, pursuant to its Resolution 69200, 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.

The Airport CP program has been amended and expanded since its inception in November 1999. In particular, in March 2008[1] City Council approved an expansion of the Airport CP program from $450 million to $600 million, primarily to refund the Airport Revenue Bonds, Series 2004A and Series 2004B (the "2004A/B Bonds") that were adversely impacted by disruptions in the financial markets related to auction rate securities. This expansion was accomplished through the creation of three additional series of commercial paper notes: Series D (Non-AMT), Series E (AMT), and Series F (Taxable), secured by a letter of credit issued by Lloyds TSB Bank plc, acting through its New York Branch ("Lloyds"), pursuant to a Letter of Credit and Reimbursement Agreement with a current expiration date of September 7, 2011. A full legislative history of the Airport CP program has been included in Attachment A of this memo.

As discussed in the memorandum dated July 23, 2007 related to the Series 2007 Airport Revenue Bonds[2], the plan of finance called for the Airport CP program to serve as an interim financing vehicle for construction of Phase 1 of the Airport Development Program ("Phase 1" projects). The memorandum also indicated an expectation that some or all of the commercial paper notes issued to fund Phase 1 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.

<u>Phase 1 of the Airport Development Program</u>

Construction of the Phase 1 projects was substantially complete earlier in fiscal year 2010-11. The Phase 1 projects included nine new gates and approximately 366,000 square feet of new terminal space; design and construction of the new Terminal B; improvements to the existing Terminal A, including new ticketing facilities, a new in-line baggage system that serves both Terminals A and B and security checkpoint, lobby concessions and other improvements; the phased demolition of Terminal C; design and construction of the ConRAC; realignment and improvement of existing terminal roadways; parking improvements; airfield projects, including noise mitigation and the reconstruction of Taxiway Y; and other improvements, including construction of a new belly freight facility and an aircraft rescue and fire fighting facility. The Phase 1 projects also include design of certain Phase 2 projects, but under the Airline Lease Agreement the commencement of construction of the Phase 2 projects is contingent upon satisfying specified activity-based triggers. All of these projects have been financed, in part, with bond proceeds and CP note proceeds.

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[1] Council Agenda 3/25/2008, Item #6.4
[2] Council Agenda 8/14/2007, Item #3.9

ANALYSIS

Proposed Financing Strategy

The Airport currently has approximately $417 million of CP notes outstanding, of which approximately $130 million were issued on an AMT basis to refund the 2004A/B Bonds and approximately $233 million were issued on a taxable basis for the construction of the ConRAC. An additional $54 million of CP notes were issued for other purposes not related to the 2004A/B Bonds and the ConRAC. The proposed financing strategy would refund a large portion of the outstanding CP and refund certain outstanding Airport Revenue Bonds to the extent that economic savings are realized in two or more series of bonds (2011A and 2011B Bonds).

The 2011A Bonds will be issued in summer 2011 and will convert approximately $130 million of AMT CP notes to long-term fixed rate bonds and refund certain outstanding bonds for economic savings. The AMT CP notes are currently supported by letters of credit with JP Morgan, Bank of America, Citibank and Wells Fargo Bank with termination dates ranging from one to three years. Upon closing of the 2011A Bonds, the CP capacity supported by the aforementioned letters of credit will be released to allow for a reallocation of the CP notes currently secured by the Lloyds letter of credit. This reallocation provides the Airport with the flexibility to terminate the Lloyds letter of credit on or prior to September 7, 2011 without a prepayment penalty.

Staff anticipates that the issuance of the 2011B Bonds will occur later in the 2011 calendar year. The purpose of the 2011B Bonds will be to refinance approximately $225 million of taxable CP notes issued to fund the construction of the ConRAC. Following the 2011A and 2011B refundings, approximately $15 million of private activity non-AMT CP, $19 million of AMT CP and $20 million of taxable CP not associated with the ConRAC will remain outstanding. Staff is currently evaluating the appropriate size of the CP program after completion of the 2011A and 2011B refundings. Specific recommendations regarding the issuance of the 2011B Bonds and the CP program size will be forthcoming in a separate memorandum dedicated to these topics later in this calendar year.

Plan of Finance

This section provides a description of the 2011A Bonds, including a summary of the estimated sources and uses of funds, and discusses the additional bonds tests that are a prerequisite to the issuance of the 2011A Bonds.

Description of the 2011A Bonds

The 2011A Bonds are being issued to refund CP notes originally issued to refund the 2004A/B Bonds, current refund certain outstanding 1998A and 2001A Bonds to the extent they provide sufficient economic savings, make a cash deposit to the General Account of the Bond Reserve Fund, and pay the costs of issuing the 2011A Bonds.

The 2011A Bonds will be issued pursuant to a Seventh Supplemental Trust Agreement (and potentially an Eighth Supplemental Trust Agreement) to the Master Trust Agreement (which, together with prior Supplemental Trust Agreements, is referred to in this memo as the "Trust Agreement"), as described below.

The 2011A Bonds will be issued in up to three series as the City of San José Airport Revenue Bonds, Series 2011A-1 (the "2011A-1 Bonds"), the Series 2011A-2 (the "2011A-2 Bonds), and potentially the Series 2011A-3 Bonds (collectively, the "2011A Bonds") in the not to exceed aggregate principal amount of $300 million. Federal tax law permits the issuance of tax-exempt bonds for either governmental purposes (non-AMT) or for specified private purposes that are "qualified" as tax-exempt subject to the Alternative Minimum Tax ("AMT"). The 2011A-1 Bonds are subject to the AMT, and the 2011A-2 Bonds are non-AMT bonds. In order to comply with IRS regulations, the AMT bonds may need to be issued as two different series with different bond sale dates. In the event such that a separation in bond sale dates is required, the 2011A-1 and 2011A-2 Bonds will be designated as AMT bonds issued pursuant to a Seventh Supplemental Trust Agreement, and the 2011A-3 Bonds will be designated as the non-AMT bonds, and the 2011A-1 Bonds issued pursuant to an Eighth Supplemental Trust Agreement. For simplification purposes of this memo, the 2011A Bonds will be referred to only as the 2011A-1 Bonds (AMT) and the 2011A-2 Bonds (non-AMT) and in aggregate the 2011A Bonds.

The portion of the 2011A Bonds associated with the refunding of the 2004A/B Bonds will have a final maturity date of March 1, 2034. The principal amortization of the 2011A Bonds will be structured to mirror the original amortization of the 2004A/B Bonds.

Security

The principal of and interest on the 2011A Bonds, and all of the City's Airport Revenue Bonds, are secured solely by the General Airport Revenues and certain other funds held or made available under the Master Trust Agreement, after Maintenance and Operation Costs are paid. The City is not obligated to pay debt service on the Bonds except from the General Airport Revenues and such other funds held or made available under the Master Trust Agreement. The General Fund of the City is not liable, and the credit or taxing power of the City is not pledged, for the payment of the principal of, premium, if any, or interest on the 2011A Bonds. The 2011A Bonds are not secured by a legal or equitable pledge of, or charge, lien or encumbrance upon, any of the property of the City or any of its income or receipts, except the General Airport Revenues. The owners of the 2011A Bonds have no right to compel the exercise of any taxing power of the City.

The Master Trust Agreement generally defines General Airport Revenues as meaning all revenues, income, receipts and moneys derived by the City from the operation of the

Airport. General Airport revenues also includes all interest, profits or other income derived from the deposit or investment of any moneys in the General Revenue Fund or any account therein established under the Master Trust Agreement.

In addition to General Airport Revenues, the City also anticipates applying a portion of its PFC revenues to pay a portion of the debt service on the 2011A Bonds.

Potential Refundings of Airport Revenue Bonds

As stated above, the 2011A Bonds may include up to two economic refunding components: a current refunding of all or a portion of the outstanding maturities of the 1998A Bonds and the 2001A Bonds. Incorporating a refunding with a larger, longer-dated bond issuance creates certain efficiencies: it reduces costs of issuance and streamlines the administration of the Airport debt portfolio.

The Council-adopted Debt Management Policy specifies a minimum of 3% net present value savings for a refunding to be considered economically viable and provides for consideration of refundings below the 3% threshold on a case-by-case basis. While at present, all of the 1998A Bonds and a portion of the 2001A Bonds can be refunded to achieve the 3% savings threshold, staff will continue to monitor these bonds for refunding potential up to the anticipated bond pricing during the week of July 11, 2011. The final refunding amount will be determined closer to the pricing date and may deviate from the 3% savings threshold in view of the operational efficiencies of refunding all maturities at the same time as a part of the larger 2011A Bond financing.

> ***Current Refunding of 1998A Bonds*** - A current refunding is a refunding in which the refunding bonds are issued not more than ninety (90) days before the redemption date upon which the outstanding bonds become due or are callable. The proceeds of the 2011A Bonds used to refund the 1998A Bonds, of which \$6.54 million are outstanding, will be applied to such refunding on the closing date. The current financing schedule calls for the 2011A Bonds to close the week of July 25, 2011.
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> ***Current Refunding of 2001A Bonds*** - The proceeds of the 2011A Bonds used to refund the 2001A Bonds, of which \$131.34 million are outstanding, will be applied to such refunding on the closing date. At present, approximately \$60.4 million of the 2001A Bonds appear to be economic refunding candidates. As with the potential refunding of the 1998A Bonds, staff will continue to monitor the 2001A Bonds for refunding savings through the anticipated bond pricing date.

General Account of the Bond Reserve Fund

The City anticipates that the 2011A Bonds will be secured by the General Account of the Bond Reserve Fund ("General Account") for the City's outstanding Airport Revenue

Bonds. The General Account serves as a "common reserve" for all of the Airport's outstanding Airport Revenue Bonds except for the Series 2004 Bonds and the Series 2007 Bonds. It is presently projected that the required deposit to the General Account from the proceeds of the 2011A-1 Bonds will be an amount equal to 10% of the proceeds of such bonds, or approximately $14.6 million.

It should be noted that the Reserve Requirement in the General Account is presently satisfied, in part, by a $4.25 million surety bond from Ambac Indemnity Corporation and a $6.6 million surety bond from National Public Finance Guaranty Corporation ("NPFG"), as successor to MBIA Insurance Corporation. The ratings of NPFG and Ambac were reduced or withdrawn subsequent to the deposit of the respective surety bonds to the General Account. The Master Trust Agreement does not require that the rating of any surety bond held in the General Account be maintained after the date of deposit.

The NPFG surety bond expires on March 1, 2016 and the Ambac surety bond expires on March 1, 2018. If no additional Bonds are issued and no additional amounts are deposited in the General Account prior to such dates, on each such date the City would have to make a deposit to the General Account from accumulated Airport surplus funds or provide a Qualified Reserve Surety to replace the amount of each of the expiring surety bonds. The City will also be obligated to replenish the General Account prior to the expiration dates of the surety bonds in the event of a non-payment or cancellation under either surety bond, including upon the liquidation of a surety bond provider. A detailed discussion on the status of the surety bond providers is included in the draft Official Statement for the 2011A Bonds. This document will be posted on the City's Agenda Services website on or about June 10, 2011.

Estimated Sources and Uses

The estimated sources and uses of funds for the 2011A Bonds are shown in the table below. It should be noted that the total estimated par amount shown below is less than the not to exceed authorization of $300 million because not all of the Airport Revenue Bonds, Series 1998A and 2001A currently meet the City's refunding savings criteria. As noted above, staff will continue to monitor the 1998A and 2001A Bonds for refunding savings through the anticipated bond pricing date.

City of San José
Airport Revenue Bonds, Series 2011A
Estimated Sources and Uses of Funds[1]

	2011A-1 (CP Refunding)	2011A-1 (1998A Refunding)[2]	2011A-2 (2001A Refunding)[2]	Total
Sources of Funds:				
Par Amount of Bonds	$144,315,000	$6,045,000	$56,465,000	$206,825,000
Premium	1,122,000	264,000	4,512,000	5,898,000
Prior Interest Account	-	124,000	-	124,000
Prior Principal Account	-	318,000	-	318,000
Total Sources of Funds	**$145,437,000**	**$6,751,000**	**$60,977,000**	**$213,165,000**
Uses of Funds:				
Refund Commercial Paper	$129,578,000	-	-	$129,578,000
Deposit to Refunding Escrow	-	6,691,000	60,447,000	67,138,000
Debt Service Reserve Fund	14,432,000	-	-	14,432,000
Underwriters' Discount	794,000	33,000	311,000	1,138,000
Costs of Issuance[3]	633,000	26,000	220,000	879,000
Total Uses of Funds	**145,437,000**	**6,750,000**	**60,978,000**	**213,165,000**

(1) Preliminary; subject to change.
(2) Refunding reflects candidates currently meeting City's savings threshold. Total par amount of refunding bonds issued will depend on interest rates and savings available at the time of sale.
(3) Includes bond counsel fees and expenses, financial advisor fees and expenses, rating agencies fees, trustee fees and expenses, and printing costs. Does not include municipal bond insurance premium, if any.

Conditions for Issuance of Additional Airport Revenue Bonds

Under the Master Trust Agreement, the City is authorized to issue additional bonds conditioned upon certain tests being met. A summary of the City's outstanding airport revenue bonds, and review of Council's prior approval of Airport bond issuances, may be found in Attachment B of this memorandum.

The 2011A-1 Bonds are proposed to be issued under the prospective additional bonds test, which requires that, for the longer of (i) the next five fiscal years or (ii) the three fiscal years following the fiscal year in which the bond-funded project is estimated to be completed, net General Airport Revenues plus other funds available for the payment of airport revenue bonds are projected to be at least equal 125% of annual debt service on all outstanding airport revenue bonds after the 2011A-1 Bonds are issued.

For the purposes of the 2011A Bonds, this forecast period will be through fiscal year 2017, or the next five fiscal years. In conjunction with the issuance of the 2011A Bonds, the Airport's feasibility consultant, Ricondo & Associates ("Ricondo), has prepared a report setting forth a projection of estimated net General Airport Revenues and other funds available for the payment of airport revenue bonds, among other matters. The City will deliver to the Trustee a certificate setting forth the annual debt service on all bonds subject to the lien of the Master Trust Agreement (including the 2011A Bonds), and the projections of net general airport revenues and other available funds provided by Ricondo, which demonstrate that these projected revenues equal at least 125% of the annual debt service for each corresponding fiscal year through fiscal year 2017. Based on the Ricondo report, estimated debt service coverage is expected to range from 155% to 183% within the projection period of fiscal years 2012 through 2017.

Pursuant the Master Trust Agreement, the City is also authorized to issue additional bonds for the purpose of refunding outstanding Airport Revenue Bonds without meeting an additional bonds test, so long as (i) the proceeds are used solely to pay or defease the refunded Airport Revenue Bonds and to pay the costs of issuance, accrued interest, and reserve costs of the refunding Airport Revenue Bonds and (ii) the annual debt service for the refunding Airport Revenue Bonds in each year is less than or equal to the annual debt service for the refunded Airport Revenue Bonds in each year the refunding bonds are to be outstanding. So long as the bonds issued to refund the 1998A Bonds and the 2001A Bonds are delivered simultaneously with the 2011A Bonds issued to refund outstanding CP, the City expects to show compliance with the prospective additional bonds test described in the preceding paragraph for all 2011A Bonds. However, if the bonds issued to refund the 1998A Bonds and/or the 2001A Bonds are delivered on a different date, it is possible that the additional bonds test described in this paragraph that applies only to refunding bonds would be used.

Feasibility Report, Use of Unspent Bond Proceeds

In connection with the issuance of the 2011A Bonds, Ricondo, has prepared a report which sets forth findings, assumptions, and projections of the air traffic and financial analysis for the Airport. This report is included as Appendix B of the Official Statement. Ricondo's projection of debt service coverage discussed above is based on a number of assumptions and projections, including the growth of enplaned passengers, from 4,107,394 in FY 2010 to 4,195,000 in FY 2017.

In preparing the financial projections, Ricondo worked with Airport staff and Bond Counsel to incorporate certain assumptions relating to the allowable uses of unspent bond proceeds associated with Airport Revenue Bonds, Series 2007A and 2007B. Based on Bond Counsel advice and information provided by Airport staff, Ricondo has assumed that a portion of the unspent bond proceeds associated with the 2007A bonds (currently estimated at $62 million) and certain other Airport funds will be applied towards future principal payments due on the 2007A bonds. Similarly, the unspent bond proceeds associated with the 2007B bonds (currently estimated at $28 million) are assumed to be applied towards future principal and interest on the 2007B bonds. This represents a conservative assumption for the purpose of calculating certain financial projections, including cost per enplanement and debt service coverage ratios. However, it should be noted that staff is currently working with Bond Counsel to evaluate other legally allowable uses of unspent bond proceeds associated with the 2007A and 2007B bonds and the 2004 Bonds, including the potential of reimbursing various Airport capital expenses that have previously been paid with Airport revenues.

Sale Parameters

Staff recommends that the 2011A Bonds will be sold within certain parameters as described below. The Sixteenth Supplemental Resolution sets forth these parameters.

Principal Amount: The aggregate not-to-exceed principal amount is $300,000,000, which represents the approximately $145,000,000 principal amount that will be required to refund the outstanding commercial paper, plus the principal amount needed to refund the approximately $138,000,000 of 1998A Bonds and 2001A Bonds currently outstanding. While not all of the 1998A and 2001A Bonds currently are refundable within the City's savings parameters, the higher not-to-exceed amount will permit the City to refund any of these bonds that meet its savings criteria at the time of sale.

True Interest Cost: The not-to-exceed true interest cost of the 2011A Bonds is 8.50%, which is approximately 1.70% higher than current market rates.

Underwriters' Discount. The not-to-exceed total compensation to underwriters is 0.6% of the par amount of the 2011A Bonds.

Bond Insurance

The City plans to solicit a quote for municipal bond insurance from Assurance Guaranty Corporation ("AGC"), the only remaining viable provider of municipal bond insurance. Depending on AGC's interest in providing insurance, the premium quoted, and the interest cost differential between insured and uninsured 2011A Bonds and the analysis of the net economic benefit of insurance, the City may elect to insure one or more maturities of the 2011A Bonds. The resolution proposes to delegate this decision and negotiation of terms and conditions with AGC to the Director or Assistant Director of Finance.

Bond Financing Documents

There are a number of bond financing documents that require City Council approval to proceed with the issuance of the 2011A Bonds. All of these documents (except the Escrow Agreement) in substantially final form will be posted to the City's agenda webpage on or about June 10, 2011.

Official Statement. The Official Statement is the public offering statement for the issuance of the 2011A Bonds. City staff has worked with Disclosure Counsel in preparing the Preliminary Official Statement for the 2011A Bonds. This document describes the purpose of the 2011A Bonds, activity information on the Airport, and the financial condition of the Airport. Detailed financial and activity information regarding the Airport is included in Appendix A to the Preliminary Official Statement and information regarding the City's pension plans is included in Appendix C. The Preliminary Official Statement also includes, as Appendix B, Ricondo's full report . Investors use all of this information to evaluate the credit quality of the 2011A Bonds. Following the sale of the 2011A Bonds and prior to the closing, Disclosure Counsel will prepare the final Official Statement for the 2011A Bonds.

Staff recommends that the Director or Assistant Director of Finance and the Director of Aviation be authorized to sign the final Official Statement for the 2011A Bonds on behalf of the City and to make such modifications to these documents as may be necessary upon consultation with the City Attorney's Office. Prior to the distribution of the Preliminary Official Statement and the Official Statement to investors, staff will update budget or financial information, as well as other topics included in the Preliminary Official Statements and in Appendix A to reflect the most recent information available to the City to the extent that the updates could affect the deliberations of a reasonable investor in making the decision to purchase the 2011A Bonds.

Staff also recommends that the Director or Assistant Director of Finance and the Director of Aviation 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 purpose of marketing the 2011A Bonds.

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 issuing new debt, it is important that elected officials read through the Preliminary Official Statement, including Appendices A, B and C.

Understanding the following elements of the bond issue is key to Council's 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 facts or 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, facts and events been brought to the attention of staff, bond counsel and other professionals?
- Have such risks, facts and events been disclosed, and if not, what is the rationale for the non-disclosure?

The information to address these areas in the Preliminary Official Statement can be found in the INTRODUCTION section which describes the purpose of the 2011A Bonds and the source of repayment, among other things. More detailed information on these topics and on the risks related to repayment of the 2011A Bonds is provided in the SECURITY FOR THE BONDS; and CERTAIN FACTORS AFFECTING THE AIRPORT as well as in Appendices

A and B. Appendix C which provides detailed information regarding the pension plans is included in order to give investors an understanding of this cost on Airport operations.

If any Council member has any personal knowledge that any of the material information in the Preliminary Official Statement is false or misleading, or that the Official Statement omits to state a fact that would be material to investors, the Council member must raise these issues prior to approval of the distribution of the document.

City staff, bond counsel, and the financial advisors will be available at the Council meeting on June 21, 2011, to address any questions, issues and/or concerns.

Staff recommends that the Director of Finance, Assistant Director of Finance, or their authorized designees ("Authorized Officials") be authorized to execute each of these agreements described below. As modifications may be required prior to the closing, staff also recommends that the Authorized Officials be authorized to execute the final version of each of these agreements as may be modified upon consultation with the City Attorney's Office.

Supplemental Trust Agreement. The Supplemental Trust Agreement contains the terms of repayment of the 2011A Bonds, as well as the responsibilities and duties of the Trustee and the rights of the bondholders in connection with the 2011A Bonds.

Escrow Agreements. To the extent either or both of the 1998A Bonds and 2001A Bonds are refunded, the City may need to enter into an Escrow Agreement with the Trustee (The Bank of New York Mellon Trust Company, N.A.) for each refunded series. As this document may not be necessary, a draft is not posted to the agenda webpage. The Escrow Agreement(s) sets forth the responsibilities of the Trustee, as Escrow Agent, with respect to the investment and application of funds in the Escrow Fund with respect to each series of refunded bonds. Each Escrow Agreement will direct Trustee to establish a special fund to be known as the "Escrow Fund" and to deposit a portion of the proceeds from the sale of the 2011A Bonds in separate Escrow Funds established for the 1998A Bonds and the 2001A Bonds, respectively. Each Escrow Fund will be used to redeem the corresponding series of outstanding Bonds on their redemption dates. Any amounts deposited into each Escrow Fund will be invested either in cash, State and Local Government Securities ("SLGS") issued by the U.S. Treasury or in other eligible U.S. securities. Effective May 6, 2011, the SLGS window is closed due to Congress' inaction to raise the federal debt ceiling. It is unclear when the ceiling will be raised and the SLGS window reopened. Should SLGS be unavailable at the time of the refunding transaction, the City likely would invest the escrow funds in other eligible U.S. securities.

Bond Purchase Agreement. The Bond Purchase Agreement is a contract between the City and the underwriters as the purchasers of the 2011A Bonds. The Bond Purchase Agreement specifies the representations and warranties of the City, the documents to be executed at closing, and the conditions that allow the purchaser to cancel the purchase of the 2011A

Bonds. The City will be entering into Bond Purchase Agreement with Citigroup Global Markets Inc. as the Senior Manager and representative of the underwriting team, which includes Bank of America Merrill Lynch and Goldman Sachs. The underwriters will be paid a takedown for the 2011A Bonds in a not to exceed amount of $4.50/$1,000 of the par amount issued. The City will reimburse the senior managing underwriter for its expenses, including underwriters' counsel.

Continuing Disclosure Certificate. This Certificate is executed by the City for the benefit of the bondholders and in order to assist the participating underwriters to comply with Securities and Exchange Commission Rule 15c2-12(b)(5). In executing this document, the City commits to notify certain parties if certain listed events occur and to file annually an update to certain information contained in the Official Statement.

Financing Team

The financing team participants consist of:

City's Co-Financial Advisors:	Public Financial Management Public Resources Advisory Group
Bond and Disclosure Counsel:	Orrick Herrington & Sutcliffe LLP
Book-Running Senior Manager:	Citigroup
Co-Manager	Bank of America Merrill Lynch
Co-Manager	Goldman Sachs
Airport Consultant:	Ricondo & Associates
Trustee:	The Bank of New York Mellon Trust Company, N.A.

Professional Contracts

Financial Advisory Services Agreement

Staff recommends that the Council adopt a resolution authorizing the City Manager to negotiate and execute the financial advisory services agreement with Public Financial Management ("PFM") and Public Resources Advisory Group ("PRAG") in a not to exceed amount of $420,000 for all related services performed through June 2012 for the proposed issuance of Airport Revenue Bonds, Series 2011A and 2011B, payable from bond proceeds contingent on the successful closing of the bonds as follows:

- $150,000 upon the issuance of AMT bonds to refund a portion of the Airport's outstanding AMT CP Notes;
- $50,000 upon the issuance of economic refunding bonds;

- $175,000 upon the issuance of taxable bonds to refund a portion of the Airport's outstanding taxable CP Notes associated with the ConRAC;
- An additional $25,000 if the taxable refunding is completed after December 31, 2011 but on or before June 30, 2012 and requires significant additional work and/or material document redrafting, as agreed to by the parties; and
- Up to $20,000 for reimbursable expenses actually incurred.

The terms outlined above are consistent with the multi-year Airport general financial advisory services agreement approved by City Council in February 2007 with PFM (as successor to Fullerton & Friar) and PRAG. Both PFM and PRAG have extensive experience working on Airport financial matters, and have acted as financial advisor on previous Airport bond transactions. The retention of these firms will provide a level of continuity that is needed for this transaction given the growing complexity of the Airport's debt portfolio and continued limited City staffing resources.

Bond Counsel Agreement

The City Attorney's Office is recommending that the City Attorney be authorized to negotiate and execute an agreement with Orrick, Herrington & Sutcliffe LLP for bond and disclosure counsel services for the 2011A Bonds and 2011B Bonds in an amount not to exceed $350,000 with $250,000 payable upon the closing of the 2011A Bonds and the remaining $100,000 payable upon the closing of the 2011B Bonds. The firm's compensation is contingent on the successful closing of the applicable series of bonds and is to be paid from bond proceeds. Orrick, Herrington & Sutcliffe LLP has previously provided bond and disclosure counsel services related to the City's issuance of Airport debt. Accordingly, they are familiar with the structure of the City's Airport debt portfolio as well as other issues related to the City's issuance of Airport revenue bonds.

Financing Schedule

The current proposed schedule for the issuance of the 2011A Bonds is outlined below. The schedule may be modified if the sale dates for the different series are required to be separated in order to comply with IRS regulations:

City Council:	June 21, 2011
Bond Pricing:	Early July 2011
Closing	Mid/late July 2011

TEFRA Hearing Requirements

Section 147(f) of the Internal Revenue Code requires that, before private-activity bonds may be issued, the City must approve the issuance of such obligations after conducting a public hearing.

This hearing, known as a Tax Equity and Fiscal Responsibility Act ("TEFRA") hearing, is scheduled to be held as part of the action items on the June 21, 2011, Council agenda, and is intended to provide an opportunity for all interested persons to express their views both orally and in writing on the proposed issuance of the 2011A-1 Bonds, which are qualified tax-exempt private-activity Airport revenue bonds. The City most recently held TEFRA hearings on August 14, 2007, in connection with the approval of the 2007 Bonds, which provided long-term financing for the Phase I Airport Master Plan projects, and on March 25, 2008, in conjunction with the expansion of the Airport CP Program from a maximum authorized principal amount of $450 million to $600 million.

The notice for the public hearing is scheduled to be published on or about June 6, 2011 in the *San Jose Mercury News*, states the City's non-binding intent to issue up to $320 million of tax-exempt private activity bonds and commercial paper notes issued to provide proceeds to finance or refinance all or a portion of the costs that are included in or are consistent with the Airport Master Plan.

EVALUATION AND FOLLOW-UP

This memorandum presents a recommendation for the City Council's approval of various actions related to the issuance of City of San José Airport Revenue Bonds Series 2011A and requires no follow-up to the City Council.

As part of its overall financing strategy described above, staff plans to return to Council in approximately the fall of 2011 to request approval to issue the 2011B bonds, which represents a refunding of taxable commercial paper used to finance the construction of the ConRAC parking garage.

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 (bond counsel fees, financial advisor fees, airport consultant fees and rating agency fees) and other related costs are estimated to be approximately $808,000 and will be paid from costs of issuance of the 2011A Bonds.

CEQA

Resolutions No. 67380 and 71451, PP 07-149.

/s/

JULIA H. COOPER
Assistant Director of Finance

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

Attachment A

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.

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")[3], 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 the Series 2004A/B Bonds 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, acting through its New York Branch ("Lloyds"), pursuant to a Letter of Credit and Reimbursement Agreement (the "Agreement").

Attachment A (continued)

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.

On April 26, 2011, the City Council approved an amended and restated letter of credit and reimbursement agreement (the "Amended Agreement") with Lloyds, which provided for the extension of the credit facility for the Series D, Series E and Series F Notes to September 7, 2011 from its previous termination date of May 7, 2011. The Amended Agreement provides aggregate credit support of $140 million to the Airport CP Program.

Attachment B

Summary of Council Approval of Outstanding Airport Revenue Bonds

The City, pursuant to the City Charter and Municipal Code, has the authority to issue Airport Revenue Bonds. Currently, the City has eight outstanding series of Airport Revenue Bonds.

The 1998A Bonds were issued pursuant to Resolution No. 57794, as amended and supplemented, originally adopted by the City Council in 1984 (the "1984 Resolution"). In 2001, the City adopted Supplemental Resolution No. 70532 approving the amendment and restatement of the 1984 Resolution in the form of the Master Trust Agreement dated as of July 1, 2001 (the "Master Trust Agreement") between the City and BNY Western Trust Company, predecessor in interest to The Bank of New York Mellon Trust Company, N.A., as Trustee (the "Trustee").

Under the Master Trust Agreement, the City has issued the 2001A Bonds pursuant to the First Supplemental Trust Agreement, the 2002A Bonds and 2002B Refunding Bonds pursuant to the Second Supplemental Trust Agreement, the 2004C and the 2004D Bonds pursuant to the Fourth Supplemental Trust Agreement, and the 2007A and the 2007B Bonds pursuant to the Fifth Supplemental Trust Agreement. The 2004A and 2004B Bonds which were issued pursuant to the Third Supplemental Trust Agreement were refunded by Airport CP in 2008 as described in the body of the memorandum.