



# Memorandum

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

**FROM:** Julia H. Cooper  
David Sykes

**SUBJECT:** SEE BELOW

**DATE:** June 1, 2012

Approved

Date

6/5/12

**SUBJECT: ISSUANCE OF CITY OF SAN JOSE FINANCING AUTHORITY  
COMMERCIAL PAPER PROGRAM FOR CONVENTION CENTER  
IMPROVEMENTS**

## RECOMMENDATION

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

1. Conduct a public hearing concerning the approval of the issuance by the City of San José Financing Authority of commercial paper notes in order to finance certain public capital improvements of the City, consisting of additional projects related to the expansion and renovation of the San José McEnery Convention Center (the "Convention Center").
2. Adopt a resolution to approve the issuance of commercial paper notes pursuant to the previously established commercial paper program designated as "City of San José Financing Authority Lease Revenue Commercial Paper Notes" to provide financing for additional projects related to the Convention Center Expansion and Renovation Project in an amount not to exceed \$10 million and to state the City Council's determination that there will be significant public benefits accruing from such financing.

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

1. Adopt a resolution to approve the issuance of City of San José Financing Authority Commercial Paper Notes to provide financing for the additional projects related to the Convention Center Expansion and Renovation Project in an amount not to exceed \$10 million.

## **OUTCOME**

Approval of these recommendations will allow the issuance of commercial paper notes to fund the financing requirements of additional projects related to the Convention Center Expansion and Renovation Project (the "Project").

## **BACKGROUND**

### **Commercial Paper Program**

The Commercial Paper ("CP") Program utilizes a lease revenue financing structure. Under this program, the City of San José Financing Authority (the "Authority") is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. Although the maturity of a CP Note may not exceed 270 days, the Authority may issue additional CP Notes to pay off the maturing notes instead of repaying the principal and interest owed on the maturing CP Notes.

The CP Notes are 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") and are additionally secured by a pledge of lease revenues from various City assets. The current LOC expires on January 27, 2013. On May 30, 2012, CalSTRS indicated to the City that it does not intend to renew the LOC on the CP Program after January 2013. Finance Department staff is examining its various options to find a replacement LOC or reduce the size of the CP Program.

The City has leased to the Authority various City-owned facilities pursuant to a Site Lease (as amended, the "Site Lease"). The 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 Site Lease and Sublease are the Tech Museum, the Animal Care Center, Fire Station No. 1, and the South San José Police Substation.

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. 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 an LOC issued by the Banks, pursuant to the Letter of Credit and Reimbursement Agreement among the Banks, the City and the Authority (as amended, the "Letter of Credit Agreement"). Per the terms of the Letter of Credit Agreement, the Banks are separately, not jointly, responsible for payments on all draws made on the LOC, with State Street Bank obligated for 75% and CalSTRS obligated for 25% of all payments.

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 in Attachment A.

### **Convention Center Expansion and Renovation Project**

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 properties within the CCFD calculated as a percentage of taxable hotel revenues collected by such hotels. The CCFD special tax is levied annually and collected monthly through the same process as used for general City transient occupancy tax collections.

On December 14, 2010, City Council authorized the City Manager to negotiate and execute a contract with Hunt Construction for the Project in an amount not to exceed \$117 million, and established a City-controlled contingency in the amount of \$3 million, subject to the completion of the related bond financing and appropriation actions. Refer to Manager's Budget Addendum #40 regarding the San José McEnery Convention Center Expansion and Renovation Project Update dated May 17, 2012 (MBA #40) for more information on the Project.

On April 12, 2011, the City of San José issued \$107.4 million of special hotel tax bonds and the Authority issued \$31.0 million in lease revenue bonds for a total of \$138.4 million to finance the costs of the Project.

### **ANALYSIS**

As described in MBA #40, staff has identified \$10 million in additional projects to be funded at the Convention Center as part of the Project beyond those identified as part of the \$120 million contract with Hunt Construction. To provide financing to enable construction of the additional projects, staff recommends that the City Council and the Authority Board authorize the issuance of CP Notes in an amount not to exceed \$10 million. It is projected that the CP Notes, if authorized, would be repaid over a period not to exceed seven (7) years.

### **Source of Repayment**

The City would repay any CP Notes issued for these purposes, including interest and all associated fees, from the revenues from the Convention and Cultural Affairs Fund (Fund 536). In the event revenues are insufficient, repayment of the CP Notes could be made first from the CCFD special tax revenues, if available, and then from any legally available funds of the City.

The Convention and Cultural Affairs Fund accounts for the costs of managing the Convention Center and other various convention/cultural facilities. In March 2011, the City Council established a goal for the Convention and Cultural Affairs Fund of having at least \$1.5 million in fund balance at the end of the Convention Center Expansion and Renovation Project. Based on most recent projections developed by City Administration and Team San José ("TSJ"), as reviewed by CSL, the City's industry advisor, the Convention and Cultural Affairs Fund has capacity to support this repayment and meet the minimum fund balance goal of \$1.5 million. The issuance of commercial paper, and resulting debt payments, for the additional projects was assumed in the development of the 2012-2013 Proposed Operating Budget, as included in the Source and Use of Funds Statement for the Convention and Cultural Affairs Fund.

### **Authorization to Issue Commercial Paper Notes**

It is necessary that Council conduct a public hearing, as required by State law, in order to authorize the issuance of CP Notes. No later than 5 days before the public hearing to be held by the City Council on June 19, 2012, a notice advertising the hearing will be published in the *San Jose Mercury News*.

The public hearing will allow the City Council and Authority Board to hear and consider information concerning the approval of the financing by the Authority and the City for the issuance of CP Notes, the additional projects related to the Convention Center Expansion and Renovation Project, and the significant public benefit of such financing with the Authority as issuer. Under State law "significant public benefit" includes lower costs of financing. Establishing the financing with the Authority as the issuer, rather than the City as the issuer, makes the financing less complicated (because the Authority can issue CP Notes whereas the City would have to issue CP Certificates of Participation) and, accordingly, less costly. Additionally, as no amendments to any of the documents that established the CP Program are necessary, the Authority's issuance of CP Notes to finance the Project is less costly than any other form of financing available to the City.

### **Utilization of the CP Program**

At the time of the City Council/Authority Board's initial approval of the expanded CP Program in November 2005, the Authority was authorized to have up to \$116.0 million in CP Notes outstanding at any time. It was also contemplated that the City Council could at a future date authorize the issuance of CP Notes to provide funding for additional projects.

The amount of CP Notes currently outstanding is \$46.7 million of the total program capacity of \$116.0 million. On a by-project basis, the outstanding amounts of CP Notes are as follows: \$23.5 million for the Central Service Yard Phase II Project, \$3.6 million for the CUBS Project, \$5.5 million for the HP Pavilion Project and \$14.1 million for the Housing Loan. Each project has additional authorization for issuance above the outstanding amount.

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The unused program capacity of \$48.5 million is available for funding additional projects including, but not limited to, those related to the additional projects for the Convention Center Expansion and Renovation Project. This issuance may limit the City and the Authority's ability to fund other capital projects in the future. Examples of potential capital projects that may be considered by Council in the future for use of the CP Program include, but are not limited to, the LED streetlights project, various energy improvements and solar energy projects, technology acquisition and improvements, and other potential capital equipment acquisitions. It should be noted that these projects are provided as examples only and do not represent staff recommendations. None of these projects have been analyzed internally for project feasibility and none have been discussed with Council for further guidance.

### **Risks associated with the CP Program**

The CP Program is subject to the following risks:

- LOC Renewal Risk - Should the Banks decide not to renew the LOC at the end of the current three-year term in January 2013 and no replacement banks are identified, the CP Notes outstanding will need to be repaid in full. The General Fund is ultimately responsible for the repayment of outstanding notes. LOC fees are subject to change at future renewal dates based on market conditions.
- Interest Rate Risk – interest rate for CP Notes may increase significantly depending on the overall financial market conditions.
- Downgrade Risk – the Banks' credit ratings may be downgraded in the future due to changes in the market's perception of the financial health of the Banks. To the extent a downgrade occurs, the CP Notes may become unmarketable.
- Marketability Risk – If there is a lack of market demand for CP Notes, the notes may be tendered back to the Authority and the Authority may not be able to find buyers for these notes.
- The LOC is backed by certain real properties pledged as leased assets by the City and Authority with a total replacement value of approximately \$125 million. If any of the underlying leased assets as described above are no longer available, replacement assets would need to be identified or the CP Program capacity may adversely be impacted. Replacement assets require approval by LOC providers.

### **EVALUATION AND FOLLOW-UP**

This memorandum presents the set of recommendations related to the City Council and the Authority Board's approval of various actions related to the City of San José Financing Authority Lease Revenue Commercial Paper Program and requires no additional evaluation or follow-up to the City Council or the Authority Board.

### **PUBLIC OUTREACH/INTEREST**

The City Council will hold a public hearing on June 19, 2012, 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 CP Notes. The Notice of Public Hearing to be held in conjunction with the approval of the issuance of the CP Notes will be published in the *San José Mercury News* no later than 5 days before the June 19<sup>th</sup> hearing announcing the time and location of the public hearing.

The proposed resolutions of the City Council and the Financing Authority Board will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about June 8, 2012.

- 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, Office of Economic Development, and the City Attorney's Office.

### **COST SUMMARY/IMPLICATIONS**

The CP Notes issued for the identified purposes, including all associated fees and interest, will be repaid (in priority order) from revenues of Fund 536, CCFD Special Tax revenues as available, and then from any legally available funds of the City.

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**CEQA**

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

/s/  
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Acting Director of Finance

/s/  
DAVID SYKES  
Director of Public Works

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

## Attachment A

<b>Date</b>	<b>City Council/City of San José Financing Authority Board Actions</b>
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 ("CUBS").
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.
March 15, 2011	Authorized 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 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. The facilities currently subject to the Site Lease and Sublease are: the Tech Museum, the Animal Care Center, Fire Station No. 1, and the South San José Police Substation.