COUNCIL AGENDA: 11-06-12
ITEM: 3.4

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 REFUNDING BONDS, SERIES 2012A**

DATE: October 19, 2012

Approved

Date 10/22/12

RECOMMENDATION

Adopt the Eighteenth Supplemental Resolution (the "Resolution") of the City Council authorizing the issuance of City of San José Airport Revenue Refunding Bonds, Series 2012A (the "2012A Bonds") in a total aggregate principal amount of not to exceed $49,140,000 to be sold through a private placement with Banc of America Public Capital Corp; approving substantially final forms of the Ninth Supplemental Trust Agreement and Bond Purchase Agreement; and authorizing and approving other related actions in connection with the issuance of the 2012A Bonds.

OUTCOME

Approval of the recommendations will allow the issuance of the 2012A Bonds to refund all of the outstanding City of San José Airport Revenue Refunding Bonds, Series 2002A (the "2002A Bonds") to the extent such refunding of the 2002A Bonds meets the City's Debt Management Policy savings objectives and the requirements stipulated in the Airport's Master Trust Agreement.

BACKGROUND

The 2002A Bonds reached their first optional redemption date on September 1, 2012. Since the 2002A Bonds could not be advance refunded, the City did not have the opportunity to refund these bonds for savings prior to summer 2012 (within 90 days of the first optional redemption date). Given the amount of 2002A Bonds outstanding (less than $50 million) and the short final maturity (March 1, 2018), this transaction appeared to be a good candidate for a direct loan or private placement with a commercial bank. As compared to publically sold transactions, direct loans/private placements can provide lower financing costs, can typically be effected using streamlined documentation, generally have lower up-front fees, and do not require the cost or process of applying for credit ratings.

Given the characteristics of the 2002A Bonds and the current market opportunity for a direct loan/private placement product, the City approached three of its existing or former credit bank partners (Citibank, Bank of America, and JPMorgan) that have recently provided direct-pay letters of credit to the Airport's Commercial Paper Program. The banks were chosen based on their familiarity with the Airport, as well as their current lack of credit exposure to the Airport due to the termination or expiration of the credit facilities. Of these three banks, two provided the City with term sheets for a direct loan/private placement structure – Bank of America, through its affiliate Banc of America Public Capital Corp ("BAPCC"), and JPMorgan. The interest rate indication and terms offered by BAPCC were materially better than those offered by JPMorgan, and further, provided better refunding savings than a comparable public sale of refunding bonds. Based on these factors, the City moved forward with BAPCC as the recommended Purchaser of the 2012A Bonds.

ANALYSIS

The proposed 2012A Bonds would refund the $49,140,000 million of outstanding 2002A Bonds to the extent that economic savings are realized. Based on the current market pricing, the City estimates refunding savings of approximately $5 million, or approximately 10% of the par amount of 2002A Bonds refunded. Such estimated savings are well above the City's savings objectives.

Plan of Finance

This section provides a description of the 2012A 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 2012A Bonds.

Description of the 2012A Bonds

The 2012A Bonds will be issued in one series as the City of San José Airport Revenue Refunding Bonds, Series 2012A in the not to exceed aggregate principal amount of $49,140,000, which is the outstanding principal amount of the 2002A Bonds.

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"). However, prior to the enactment of the Tax Reform Act of 1986 (the "TRA"), bonds issued for private purposes were not subject to the AMT. The TRA provided for a number of transitional rules that permitted private activity bonds issued prior to the TRA to continue to be treated as non-AMT bonds, so long as certain tests were met, including: (1) the final maturity of the bonds is not extended; (2) the weighted average maturity of the refunding bonds is equal to or lesser than the weighted average maturity of the refunded bonds; and (3) the par amount of bonds issued for refunding purposes is equal to or lesser than the par amount of bonds

being refunded. Accordingly, since the 2002A Bonds were issued to refund pre-TRA bonds, the 2012A Bonds are being structured to meet these three tests to permit them to retain non-AMT tax treatment.

The 2012A Bonds are being issued to refund the $49,140,000 outstanding 2002A Bonds, to the extent they provide sufficient economic savings. Costs of issuance will be paid from Airport revenues.

The 2012A Bonds will be issued pursuant to a Ninth Supplemental Trust Agreement to the Master Trust Agreement (which, together with prior Supplemental Trust Agreements, is referred to in this memo as the "Master Trust Agreement"), as described below.

The 2012A Bonds will mature on March 1, 2018, the current final maturity of the 2002A Bonds, and will amortize to provide substantially level debt service savings.

Security

The principal of and interest on the 2012A 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 (referred to as "Other Available Funds"), after Maintenance and Operation Costs are paid. The City is not obligated to pay debt service on any outstanding Airport debt 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 2012A Bonds. The 2012A 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 owner of the 2012A Bonds has 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.

Refunding of Airport Revenue Refunding Bonds

As stated above, the 2012A Bonds represent an economic refunding of all of the outstanding maturities of the 2002A Bonds. 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. Based on preliminary results, however, the City anticipates achieving present value savings materially in excess of the 3% savings threshold.

General Account of the Bond Reserve Fund

The 2012A Bonds will be additionally 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, the Series 2007 Bonds, and the Series 2011B Bonds. Since the 2012A Bonds are economic refunding bonds which are anticipated to result in a decrease in annual debt service associated with the 2002A Bonds being refunded, no net deposit to the General Account of the Bond Reserve Fund will be required in conjunction with the issuance of the 2012A Bonds.

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.

Estimated Sources and Uses

The estimated sources and uses of funds for the 2012A Bonds are shown in the table below.

City of San José
Airport Revenue Refunding Bonds, Series 2012A
Estimated Sources and Uses of Funds[1]

	Total
Sources of Funds:	
Par Amount of Bonds	$49,140,000
Airport Funds	200,000
Total Sources of Funds	**$49,340,000**
Uses of Funds:	
Deposit to Redemption Account	$49,140,000
Costs of Issuance	200,000
Total Uses of Funds	**$49,340,000**

[1]Preliminary; subject to change.

Conditions for Issuance of Additional Airport Revenue Refunding Bonds

Under the Master Trust Agreement, the City is authorized to issue additional bonds conditioned upon certain tests being met. Pursuant to the Master Trust Agreement, the City is 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. The City expects to show compliance with the additional bonds test described in this paragraph that applies only to refunding bonds.

Sale Parameters

Staff recommends that the 2012A Bonds will be sold within certain parameters as described below. The Eighteenth Supplemental Resolution sets forth these parameters.

Principal Amount: The $49,140,000 not to exceed principal amount equals the principal amount of the outstanding 2002A Bonds. As discussed above, in order to maintain the current non-AMT tax treatment of the 2002A Bonds, the 2012A Bonds must

meet certain tests, which include issuing 2012A Bonds in a par amount that does not exceed the par amount of 2002A Bonds being refunded.

True Interest Cost: The not-to-exceed true interest cost of the 2012A Bonds is 2.50%, which is approximately 1.0% higher than current market rates.

The interest rate for the transaction will be set according to a predetermined formula based on an index published daily by the Federal Reserve. City staff, in coordination with our Co-Financial advisors, will lock the rate prior to closing with consideration to minimizing interest rate risk as well as interest cost. The City's Co-Financial Advisors on this transaction will confirm the accuracy of the Bank's calculation of the rate at that time.

Bond Financing Documents

There are a number of bond financing documents that require City Council approval to proceed with the issuance of the 2012A Bonds. All of these documents, in substantially final form, will be posted to the City's agenda webpage on or about October 24, 2012.

Ninth Supplemental Trust Agreement. The Ninth Supplemental Trust Agreement contains the terms of repayment of the 2012A Bonds, as well as the responsibilities and duties of the Trustee and the rights of the bondholders in connection with the 2012A Bonds.

Bond Purchase Agreement. The Bond Purchase Agreement is a contract between the City and the purchaser of the 2012A 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 applicable series of bonds.

The City will be entering into Bond Purchase Agreement with Banc of America Public Capital Corp as Purchaser (the "Purchaser"). The Purchaser will not be paid a closing fee in conjunction with this transaction. The City will, however, pay the costs of the Purchaser's Counsel as costs of issuance of the 2012A Bonds.

The Bond Purchase Agreement also includes BAPCC's representations and warranties including among other things, that BAPCC is a "sophisticated investor" and acknowledging that it has done its own due diligence on this transaction in order to make an informed decision to purchase the 2012A Bonds. The bond documents also limit the transfer of the 2012A Bonds to affiliate organizations within Bank of America.

There is no official statement or continuing disclosure certificate required in connection with the issuance of the 2012A Bonds.

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
Purchaser:	Banc of America Public Capital Corp
Trustee:	The Bank of New York Mellon Trust Company, N.A.

Financing Schedule

The current proposed schedule for the issuance of the 2012A Bonds is outlined below.

City Council Approval:	November 6, 2012
Bond Closing:	November 8, 2012

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 Refunding Bonds Series 2012A. Upon completion, staff will prepare an informational memo to Council describing the results of the transaction and the savings generated for the Airport.

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 and financial advisor fees) and other related costs are estimated to be approximately $200,000 and will be paid from Airport revenues.

CEQA

Not a project, File No. PP10-066(e), Services that involve no physical changes to the environment.

/s/
JULIA H. COOPER
Acting Director of Finance

For questions, please contact Arn Andrews, Acting Assistant Director of Finance, at (408) 535-7041.