THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	October 6, 2010	REPORT NO:	
ATTENTION:	Budget and Finance Committee		
SUBJECT:	Proposed Fiscal Year 2011 Economic Bond Refundings		
REFERENCE:	City Council of the City of San Diego, May 4, 2010; O-19951		

REQUESTED ACTIONS:

Forward the Proposed Fiscal Year 2011 Economic Bond Refundings to City Council for City Council consideration and approval, including the partial refunding of the Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998A, the partial refunding of the Water Subordinated Revenue Bonds, Series 2002, and the refunding of Community Facilities District No. 2 (Santaluz) – Improvement Area No. 1 Special Tax Bonds Series A of 2000. The City Council will be asked to authorize the issuance of the refunding bonds for the respective transactions, and approve the related financing and disclosure documents.

STAFF RECOMMENDATION:

Forward the requested actions to City Council for City Council consideration and approval.

EXECUTIVE SUMMARY:

I. Background

Due to historically low interest rates, the City was able to execute three economic refundings in Fiscal Year 2010 (the "Fiscal Year 2010 Refundings"). The first refunding occurred in April, 2010 with the refunding of Senior Sewer Revenue Refunding Bonds, Series 2010A in a par amount of $161.9 million. Subsequently, refundings under the Lease Revenue Refunding Bonds (Master Refunding Project), Series 2010A ($167.6 million) and the Water Revenue Refunding Bonds, Series 2010A ($123.1 million) occurred in May and June, 2010. These financings totaled $452.6 million and collectively produced $73.7 million in gross cumulative annual debt service savings and present value cumulative savings of $41.5 million.

At the time the Fiscal Year 2010 Refundings were executed, staff evaluated the feasibility of refunding all or a portion of the Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998A and the Community Facilities District No. 2 (Santaluz)

Improvement Area No. 1 Special Tax Bonds Series A of 2000. At that time, the refundings were not economic. In addition, as described below, although City Council authorized the refunding of the Water Subordinated Revenue Bonds, Series 2002, interest rates were not low enough to produce the required net present value savings for the transaction. (The City's Debt Policy specifies that a refunding should be considered when there will be net present value savings, expressed as a percentage of the par amount of the refunded bonds, of at least 3% for a current refunding, and 4% or above for an advance refunding.[1]) However, due to the recent rally in the tax-exempt market, rates have decreased to a level that would allow the City to move forward with full or partial refundings of these transactions, as described in more detail below. To illustrate the recent interest rate movements in the municipal market, the 20-year Municipal Market Data AAA Index (the "MMD Index," which is a standard index of AAA rated municipal bonds) has declined from 3.73% on July 1, 2010 to the current rate of 3.29% on September 30, 2010.

II. General Fund Refunding Opportunity

Convention Center Refunding Bonds - The proposed Convention Center Refunding Bonds provide for the economic refunding of a portion of the Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998A (the "1998A Convention Center Bonds"). The 1998A Convention Center Bonds were issued in 1998 in a principal amount of $205,000,000 to finance the costs of expanding the San Diego Convention Center. The expanded portion of the facility was substantially completed and opened in August 2001. As of the date of this report, the outstanding principal amount of the bonds is $162,545,000 and the final maturity is April 1, 2028.

Sufficient authorization ($165,000,000) to refund all of the outstanding 1998A Convention Center Bonds through June 30, 2011 will be requested, which would allow the City to conduct a full refunding in a single or multiple refunding if interest rates decrease to a level that would make a full refunding economic. However, under existing market conditions, serial bonds maturing between 2011 - 2020 totaling $73,105,000 can be refunded on an economic basis. Based on rates as of October 1, 2010, the refunding of the 2011 - 2020 maturities is expected to result in net present value savings ranging from $2.7 million - $3.3 million, or 3.7% - 4.6% of refunded debt. This will generate average annual cash flow savings ranging from $363,000 to $444,000 in Fiscal Years 2012 - 2020. The term of the refunding bonds will match the term of the bonds being refunded.

Similar to the 1998A Convention Center Bonds, the Convention Center Refunding Bonds will be issued under a lease revenue bond structure, involving leasing agreements between the City and the Convention Center Expansion Financing Authority. The leased property will be the expanded portion of the Convention Center, the same facility that was financed with, and leased under, the 1998A Convention Center Bonds. The Convention Center Refunding Bonds will be issued under a subordinate lease payment structure, with no debt service reserve fund requirement under the indenture. The lease payments due under the Convention Center

[1] An advance refunding (as opposed to a current refunding) is a defeasance of outstanding debt at least 90 days prior to the date the bonds can be called by depositing cash and/or securities in escrow sufficient to pay all principal and interest payments when due up to, and including, the call date. Generally, following an initial issuance of bonds, an issuer may execute one advance refunding related to that initial issuance.

Refunding Bonds will be subordinate to the lease payments due on the 1998A Convention Center Bonds (senior bonds) that will remain outstanding after the partial refunding is executed (i.e., Series 2010 bondholders will receive bond payments after the bond payment obligations of the Series 1998 are met).

The subordinate structure became necessary due to the structuring limitations pertaining to the existing legal structure of the outstanding 1998A Convention Center Bonds. Under the Additional Bonds provisions set forth in the 1998A Convention Center Bonds Indenture, a one-half year debt service reserve fund would need to be established for any refunding bonds issued on a parity basis to the 1998 Convention Center Bonds. The 1998A Convention Center Bonds currently meet the one-half year debt service reserve fund requirement with an Ambac surety policy; there is no cash reserve for the 1998A Convention Center Bonds. Purchase of a similar surety or cash funding of the debt service reserve fund for the Convention Center Refunding Bonds is not economic for refunding purposes. Due to the projected economic benefits from refunding select maturities of the 1998 Convention Center Bonds, the partial refunding is proposed under a separate indenture which provides flexibility to the City to establish new bond terms separate and distinct from the 1998 Convention Center Bonds legal structure, including a subordinate repayment feature and no debt service reserve fund requirement. There is no business or economic advantage to the City in conducting a refunding with a debt service reserve fund requirement. *A refunding with a debt service reserve fund requirement would not generate necessary present value savings; therefore, a refunding that includes a debt service reserve fund requirement is not recommended.*

Due to the junior nature of the lease structure, coupled with the absence of reserve fund protection for bondholders, it is expected that the 2010 Refunding Bonds will be rated lower by the credit rating agencies than the 1998A Convention Center bonds, which are currently rated A+, A-, and A2 by Fitch, Standard & Poor's, and Moody's, respectively. Even with lower ratings due to the weaker credit quality and correspondingly higher interest rate, the refunding of the outstanding bonds is still expected to be economic and produce estimated net present value savings ranging from 3.8% - 4.7% of the refunded debt.

III. Water Revenue Bonds Refunding Opportunity

Water Revenue Refunding Bonds - In May, 2010, Ordinance O-19951 was approved by City Council authorizing the economic refunding of the Water 1998 Certificates of Participation and the Series 2002 Water Subordinated Revenue Bonds, subject to market conditions. This authorization approved the related financing documents and approved the execution of the refunding through June 30, 2011. In June, 2010, the Public Facilities Financing Authority Water Revenue Refunding Bonds, Series 2010A were successfully priced with a par amount of $123.1 million. The 2010A bonds refunded all of the outstanding 1998 Certificates ($141.3 million). However, since interest rates had been moving up and the municipal markets were very volatile the month before pricing, none of the 2002 bonds could be advance refunded concurrent with the Series 1998 Certificates.

Due to the recent decline in interest rates, approximately $100.0 million became eligible to be refunded on an advance refunding basis. Based on rates as of October 1, 2010, the present value savings under a subordinate lien structure are estimated to be 4.13%, above the savings threshold requirement of 4% for an advance refunding generating cumulative debt service savings of $5.4

million for the Water Utility and net present value savings of approximately $4.0 million over the remaining life of the refunded bonds. This will generate average annual cash flow savings of an estimated $361,000 in Fiscal Years 2013 - 2027. The term of the refunding bonds will match the term of the bonds being refunded.

IV. Conduit Financing - Special District Refunding Opportunity

Community Facilities District No. 2 (Santaluz) Improvement Area No. 1 ("CFD No. 2") - In October 2000, the City issued Community Facilities District No. 2 (Santaluz) Improvement Area No. 1 Special Tax Bonds Series A of 2000 in the amount of $56,020,000 (the "2000 Special Tax Bonds"). The bonds were a conduit issuance, executed to fund certain public infrastructure facilities within or serving the district. The facilities include portions of Camino Del Sur, Carmel Valley Road, water and sewer facilities, a 25 million gallon reservoir, and a Community Park. The facilities were substantially completed in fiscal year 2004, and all facilities have been acquired by the City. The 2000 Special Tax bonds are solely secured by special taxes levied upon approximately 1,000 parcels of property located within the district. The special taxes are levied and collected annually via property tax bills.

It is anticipated that approximately $48.8 million of Special Tax refunding bonds (the "CFD No. 2 Special Tax Refunding Bonds") will be issued in December 2010 or January 2011 to execute a full refunding of the 2000 Special Tax Bonds. Assuming an investment grade rating, under current market conditions, the refunding bonds would generate net present value savings over the remaining term of the bonds (through 2030) of approximately $3.6 million, representing 7.4% of the refunded bonds. The average annual savings to district taxpayers would be approximately $265,000 through 2030. This represents an average reduction of $263 annually for each of the District property owners. The maturity date of the refunding bonds would not be extended.

CITY COUNCIL AUTHORIZATION

At this time, it is expected that the financing authorization and legal documents related to the Convention Center Refunding Bonds will be presented to City Council on October 19, 2010, and that the Preliminary Official Statement (POS) for the transaction will be reviewed by the Disclosure Practices Working Group ("DPWG"), and then docketed separately to be authorized via resolution in early November. This timing would ensure the POS is current, and approved by City Council closer to the date the POS will be released to the market. The POS for the Water Revenue Refunding Bonds is expected to be brought forward to City Council in November, to be approved via resolution, following DPWG review. The financing authorization, legal documents, and POS for the CFD No. 2 Special Tax Refunding Bonds are expected to be docketed for City Council consideration in December 2010 or January 2011.

FISCAL CONSIDERATIONS:

The subsequent pricing and closing of the economic refunding bonds would be subject to favorable market conditions and the fulfillment of the City's net present value savings requirements for economic refundings. As described above, under current market conditions, the proposed economic refundings would produce substantial annual debt service savings and reduce funding requirements for the General Fund and Water Utility, and produce annual savings for the special taxpayers within CFD No. 2.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

The Debt Management Department presented potential economic refundings to the Budget and Finance Committee in December 2009, and in March, April, and May 2010, various refunding action items were presented to the City Council. The refundings ultimately resulted in substantial debt service savings for the Sewer, General Fund, and Water Utility and ratepayers from the refundings conducted in the first half of 2010.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

See above.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Business entities involved in the proposed financings include investment banks, financial advisors, bond and disclosure counsels and trustees. The selected firms will be identified in the Reports to City Council that are issued when the financing and legal documents are docketed for City Council action.

Respectfully submitted,

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