THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: October 12, 2011 REPORT NO: 11-334

ATTENTION: Budget and Finance Committee

SUBJECT: Bond Refundings

REFERENCE:

REQUESTED ACTIONS:

Forward the two bond refundings to City Council for consideration and approval in accordance with the timelines established for the bond refundings. The City Council will be requested 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 for City Council's consideration and approval.

EXECUTIVE SUMMARY:

I. Background

In the fall of 2010, Debt Management was working on the economic refunding of the Subordinated Water Revenue Bonds, Series 2002 ("Water 2002 Bonds") and the Community Facilities District No. 2 (Santaluz) Improvement Area No. 1 ("CFD No. 2") Special Tax Bonds. These refunding transactions were put on hold until the Fiscal Year 2010 Comprehensive Annual Financial Report ("FY 2010 CAFR") was available. In addition, the municipal market experienced a challenging environment with rising interest rates and waning investor demand toward the end of the fourth quarter of 2010 and through mid 2011.

Commencing in the second quarter of 2011, interest rates have fallen significantly making both the Water 2002 Bonds and CFD No. 2 Special Tax Bonds once again candidates for economic refundings. The Federal Reserve has stated that interest rates will remain low until at least mid-year 2013 due to global economic conditions and at the last Federal Open Market Committee (FOMC) which concluded on September 21, 2011, committed to selling approximately $400 billion of short term treasury securities (1-3 years) and buying $400 billion of longer term Treasury Notes and Bonds over the next 7-8 months that is anticipated to further drive down long term interest rates. To illustrate the recent shift in interest rates movements on the long end, the 20-year Municipal Market Data AAA Index (the "MMD Index," which is a standard index of

AAA rated municipal bonds) was 4.33% in December 2010, which was the proposed time the 2002 Water Refunding Bonds would have been priced had the transaction gone forward in 2010. Since that time, current 20-year MMD rates have fallen to 3.38% on October 3, 2011, representing 95 basis points or a 0.95% percent decline in long term interest rates. It must be noted that market remains very volatile. While Municipal Bond nominal yields are at or near all-time lows, other factors including investor demand (both retail and institutional), new issue calendar of municipal bonds coming to market, outflows or inflows to municipal bond funds and proposed fiscal policy in Washington can impact actual yields, and as a result impact the refunding opportunities.

With the drop in interest rates and the release of the auditor's opinion for the FY 2010 CAFR on August 31, 2011, staff has resumed work on the economic refunding transactions. In fall 2010, staff was also working on a partial refunding of the Series 1998 Convention Center Expansion Bonds. The current favorable interest rate environment still does not support an economic refunding due to marketing and structuring limitations that are unique to these bonds. Opportunities to conduct the refunding will continue to be assessed. Following is the discussion on the two proposed refundings related to the outstanding Water 2002 Bonds and the CFD No. 2 Special Tax Bonds:

II. Water Revenue Bonds Refunding

Water 2002 Bonds

In 2002, the Public Facilities Financing Authority of the City of San Diego issued the Subordinated Water Revenue Bonds, Series 2002 in the amount of $286.9 million. The proceeds of the Series 2002 Bonds were used to finance the upgrade and expansion of the infrastructure of the Water System, fund the debt service reserve fund, prepay, on an advance refunding basis, a portion of the Series 1998 Certificates and pay certain costs of issuance of the Series 2002 Bonds.

In fall 2010, staff was preparing the refunding of the Water 2002 Bonds as an advance refunding which required funding an escrow account until the bonds are eligible to be called. The Water 2002 Bonds become callable starting May 2012. Under current circumstances, it is more economic to conduct the refunding as a current refunding closer to the bond call date. This produces higher net present value debt service savings.

Based on rates as of October 6, 2011, bonds totaling approximately $211.4 million could be current refunded at the same subordinate lien level generating cumulative cash flow service savings of an estimated $24 million for the Water Utility and net present value savings of approximately $17.7 million or 8.39% over the remaining life of the refunded bonds. The refunding is estimated to generate average annual cash flow savings of $1.1million in Fiscal Years 2013 - 2033. The term of the refunding bonds will match the term of the bonds being refunded.

Proposed Refunding Timeline

Debt Management is developing the legal documents and Financing Ordinance to bring to the City Council for review and approval by January 2012 and the Preliminary Official Statement ("POS") for approval via resolution in March 2012. This timing would ensure the POS is current with Fiscal Year 2011 financials, and approved by City Council closer to the date the POS will

be released to the market. The proposed 2012A Subordinated Water Refunding Bonds are expected to be priced in March, with closing planned for early May 2012, and outstanding bonds refunded by August 1, 2012. A bond closing 90 days prior to call date of August 1, 2012, is deemed a current refunding under IRS regulations and to reduce the interest risk it is advantageous to complete the current refunding as soon as the tax laws permit.

III. Conduit Financing - Special District Refunding

CFD No. 2 Special Tax Bonds

In 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"), and in 2004 issued CFD No. 2 (Santaluz) Improvement Area No. 1 Special Tax Bonds Series A of 2004 in the amount of $5,000,000 (the "2004 Special Tax Bonds"). The bonds were conduit issuances, 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 and 2004 Special Tax Bonds are secured solely 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 $53 million of special tax combined refunding bonds (the "CFD No. 2 Special Tax Refunding Bonds") will be issued in December 2011 to execute a full refunding of the 2000 and 2004 Special Tax Bonds. Depending on market conditions at the time of pricing the bonds, it is possible that only the 2000 Special Tax Bonds could be economically refunded, in which case the refunding bonds par amount would be reduced. Presently, both series are eligible for full refunding. Staff will be seeking authorization to issue subsequent series to refund any remaining bonds if the market fluctuates between now and the pricing of the first series.

The refunding bonds will be offered as a current refunding requiring a minimum of 3% net present value savings in debt service compared to the outstanding bonds. Assuming an investment grade rating of BBB+, under current market conditions, the refunding bonds would generate net present value savings over the remaining term of the bonds (through 2030) of approximately $4.0 million, representing 7.9% of the refunded bonds. The average annual savings to district taxpayers would be approximately $323,000 through 2030 starting tax year 2013. This represents an average reduction of approximately $323 annually for each of the District property owners. If only the 2000 Special Tax Bonds could be economically refunded, the average annual savings to district taxpayers would be approximately $310,000, which represents an average reduction of approximately $310 annually for each of the District property owners. In either case, the maturity date of the refunding bonds would be unchanged.

Refunding Timeline

Debt Management is preparing to take the legal documents, POS, and the Financing Resolution to the City Council for review and approval in November 2011. The CFD No. 2 Special Tax Refunding Bonds are targeted to be priced by December 2011.

CITY COUNCIL AUTHORIZATION

At this time, it is expected that the legal and financing documents for the CFD No. 2 Special Tax Refunding and the Subordinated Water Refunding Bonds would be docketed and brought to the City Council in November 2011 and January 2012, respectively. The POS for the 2012A Subordinated Water Refunding Bonds will be reviewed by the Disclosure Practices Working Group ("DPWG"), and then docketed separately to be authorized via resolution in early March 2012.

FISCAL CONSIDERATIONS:

The 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 and cash flow savings and reduce funding requirements for the 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 for the Series 1998 Convention Center Expansion Bonds, CFD No. 2 Special Tax Bonds and Water 2002 Bonds to the Budget and Finance Committee on October 13, 2010. These refunding transactions were forwarded for City Council approval by the Budget and Finance Committee. On October 19, 2010, the financing ordinance and the legal documents for the Convention Center Refunding Bonds were introduced at the City Council.

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,

Lakshmi Kommi
Debt Management Director

Mary Lewis
Chief Financial Officer