THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: November 16, 2011 REPORT NO: 11-152

ATTENTION: Budget & Finance Committee

SUBJECT: 2012 Deferred Capital Improvement Program Bond Authorization

REFERENCE:

REQUESTED ACTIONS:

Forward the bond authorization of lease revenue bonds by the Public Facilities Financing Authority in an amount not to exceed $100 million in net proceeds to City Council for consideration and approval. The City Council will be requested to approve related financing and disclosure documents for the 2012 financing.

STAFF RECOMMENDATION:

Forward the requested action for the City Council's consideration and approval.

SUMMARY:

I. Background

The City's General Fund Deferred Capital Improvement Program ("Deferred CIP") includes capital improvements to streets, sidewalks, facilities, and storm drains. The backlog of capital improvement projects is currently estimated at $800 - $900 million. In March 2009, the City issued $103 million in Deferred CIP General Fund backed lease revenue bonds ("2009 A Bonds") to fund a construction fund of $102.7 million for projects identified in the backlog of capital improvement needs (phase 1). These bonds were refunded as long term bonds in mid 2010 as part of the 2010 Master Refunding lease revenue bond issue.

As of September 30, 2011, from the 2009A Bonds construction fund and earnings, approximately $49.7 million has already been expended and an additional $21.7 million has been encumbered for projects, totaling $71.4 million in utilization of proceeds. Current projections from Public Works indicate that approximately $92.5 million of the original $102.7 million will be expended by the end of April 2012, with $10.8 million in remaining bond proceeds and earnings to be exhausted by December 2012. As contemplated in the FY 2013-2017 Five Year Financial Outlook, dated October 12, 2011 ("Five Year Outlook"), in order to continue the General Fund

Deferred CIP program, the second Deferred CIP bond financing is planned for April 2012 in conjunction with the spend down of the majority of the 2009 bond funds.

II. Discussion

A. Financing Plan and Fiscal Considerations

In February 2012, Debt Management and Public Works will be requesting authorization for long term fixed rate bonds generating up to $100 million in net proceeds. The bond issue size to support the delivery of $100 million in net proceeds is estimated at approximately $107 million based on current market conditions. As contemplated in the Five Year Outlook and Public Works deferred capital planning, the $100 million provides funding for the second phase of Deferred CIP projects, including Streets, Storm Drains, and Facilities.

The financing ordinance requesting the bond authorization, in up to two series and for a total amount of $100 million in net proceeds, establishes the total approval limit. A smaller bond series will be issued in April 2012 drawing from the established bond authorization for $100 million to support the funding needs for the next 12 months for the reasons discussed below.

The upfront bond authorization for $100 million in net proceeds offers needed flexibility and provides certain efficiencies including time savings by eliminating multiple ordinance approval steps; quick ability to execute bond pricings under favorable market conditions due to pre-existing authorization; and eliminates duplication in financing document preparation and counsel expenses for multiple smaller bond series. As such, the April 2012 tranche ("Series 1") is recommended at an issue size of approximately $60 million[1] to finance approximately $55.7 million in additional deferred CIP improvements.

1. April 2012 Bond Issue – Series 1

In April 2012, when the bonds are proposed to be issued for the second phase of the deferred CIP projects, the actual size of the borrowing will be based on the market conditions and the projected encumbrance needs from May 2012 through April 2013. The current cash flow projections from Public Works indicate an encumbrance need of up to approximately $55.7 million for this period.

The recommended approach by series to finance the Deferred CIP needs would also result in not incurring debt service costs for the full $100 million in net proceeds upfront while providing sufficient capital to ensure that there is no slowdown in the execution rate of the projects. This "just in time" borrowing to match the more immediate encumbrance needs results in a lower debt service compared to the estimate of $7.2 million for FY 2013, preliminarily identified in the Five Year Outlook. The issuance of Series 1 in a par amount of approximately $60 million is projected to meet the encumbrance need of approximately $55.7 million. This would result in an annual debt service of approximately $4.0 million commencing Fiscal Year 2013.

[1] The issue size of the bonds includes funding the reserve funds and costs of issuance.

Approximately $30 million allocated in the second phase of the Deferred CIP projects is towards completion of projects started under phase 1 from the 2009 bond issue. If the encumbrances from Series 1 proceeds occur faster than currently projected, an additional series can be executed quickly and efficiently from the pre-existing bond authorization for $100 million in net proceeds. It should be noted that while the pre-approved financing ordinance exists, the City Council still retains the final authority to issue bonds through the authorization of the disclosure document containing the most current City financial information (Preliminary Official Statement) for each series prior to the sale of the bonds. The Preliminary Official Statement is approved via Council Resolution and as such does not have the same level of time delays for the execution of a financing.

2. Deferred CIP Projects

The projected encumbrances from May 2012 through April 2013 are for the following projected Deferred CIP projects:

Streets	$15.2 million
Facilities	26.0 million
Storm Drains	14.5 million
Total	**$55.7 million**

Source: Public Works

The projects under each of the categories are capitalizable and hence eligible to receive tax exempt bond proceeds. The proceeds from a tax-exempt issue cannot be used for maintenance improvements such as slurry sealing and painting. The bonds will be issued as serial bonds with the final maturity corresponding to a 30 year term. Under the IRS regulations for tax-exempt bonds, the weighted average life of the bonds will not exceed 120% of the weighted average remaining aggregate useful life of all the projects funded by the bonds. Prior to the issuance in April 2012, to ensure compliance with the IRS guidelines, the Bond Counsel for the transaction will work closely with Debt Management, Public Works, and City Comptroller, conduct the calculations, and certify to the eligibility and useful life criteria under Tax Certificate for the bonds.

3. Financing Framework

The Public Facilities Financing Authority of the City of San Diego (the "Authority") will be the issuer of the bonds. In 2010, the City issued 2010 A Master Refunding Lease Revenue Bonds ("2010 A Refunding Bonds") to refund 2009 A Bonds. When the 2010 A Refunding Bonds were issued, a Master Site Lease and a Master Facilities Lease (together the Master Lease), and a Master Indenture were prepared to allow for future Deferred CIP bonds to be issued through supplements to each of these documents. The Master Lease involves lease agreements between the City and the Authority of existing City-owned General Fund properties (the "Leased Properties"). Using a Master Lease and Master Indenture structure provides for lower costs, stronger credit, and more diversity in the Leased Properties.

4. Pledge of Assets

The Deferred CIP projects include a variety of projects such as streets and storm drains, which does not make them eligible to be pledged assets in a lease revenue bond transaction. Hence the short term 2009 A Bonds (now paid off) and the 2010 A Refunding Bonds were structured as asset transfer transactions, lease transactions where the Deferred CIP assets were substituted with other essential assets of the City. The Leased Properties for the 2010 A Refunding Bonds included the San Diego Police Headquarters, Northwestern Division Police Station, Rose Canyon Operation Center and several Mission Bay land sites. Similar to the 2010 A Refunding Bonds, the Series 1 will need to be based on lease agreements between the City and the Authority of unencumbered Leased Properties. Essential assets, necessary for core operations of the City or revenue generating, will be considered as strong assets by the rating agencies and investors in a lease revenue bond offering. Debt Management staff is working with the Real Estate Assets Department ("READ") to identify unencumbered assets to be included in the Leased Properties for the bond authorization and will be present a list of properties in conjunction with the financing ordinance in February 2012.

The Leased Properties will be appraised for current market value through a combination of internally conducted appraisals by READ and through appraisals performed by outside firms retained by READ to establish a fair rental value. As legally required under the lease financing structure, the maximum annual debt service payable by the City on the lease revenue bonds would not be in excess of the combined annual fair rental value of the Leased Properties. Title reports will be obtained for all the properties, establishing that the assets are not already encumbered and are free and clear of liens.

B. Time Line for the City Council Approvals and Financing Implementation

In order to execute Series 1 in April 2012 (in a par amount of approximately $60 million), the City Council authorizations are expected to occur as follows:

February 2012	Introduction & approval (2 readings) of the Financing Ordinance authorizing the issuance of the bonds and approval of the financing documents. 30 Day Referendum Period after approval of the financing ordinance.
March 2012	Approval of the disclosure document (Preliminary Official Statement)
April 2012	Pricing of Series 1 and execution of the Bond Purchase Agreement
	Bond Closing and delivery of $60 million for 2012 Deferred CIP execution

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

- FY 2013-2017 Five Year Financial Outlook (October 12, 2011).

- Report from the Department of Public Works, Engineering and Capital Projects to Budget and Finance Committee on Deferred Capital Bond #1, Status and Changes to Project List (November 2, 2011).
- Report from the Independent Budget Analyst (#11-63) to Budget and Finance Committee on Deferred Capital (November 2, 2011).

  Debt Management regularly monitors the spend down of all bond proceeds under its Formal Compliance Monitoring Program. Pursuant to IBA's recommendation #3, Status of the Deferred Capital Program, semi-annual reporting specific to the spend down of bond proceeds will be provided to the City Council.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: N/A

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Business entities involved in the bond authorization include investment banks, advisors, bond counsel, disclosure counsel and trustee. The selected firms will formally be identified in the Reports to City Council that are issued when the financing ordinance and legal documents are docketed for City Council action.

Respectfully submitted,

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