DATE ISSUED: July 16, 2003 REPORT NO. 03-148

ATTENTION: Honorable Mayor and City Council
Docket of July 21, 2003

SUBJECT: Refunding of Bonds Issued in Connection with the Ballpark and Redevelopment Project

SUMMARY

Issues - Should the City Council:

Adopt an ordinance authorizing: (a.) the issuance of not to exceed $195,000,000 of Lease Revenue Bonds by the Public Facilities Financing Authority of the City of San Diego (the "Authority") to refund the previously issued $169,685,000 Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds, Series 2002 (Ballpark Project) (the "Original Ballpark Bonds"); (b.) a Site Lease between the City and the Authority; (c.) an Amended and Restated Ballpark Facility Lease between the City and the Authority; (d.) an Assignment Agreement between the Authority and the Trustee for the project; (e.) an Indenture between the Authority and the Trustee for the project; (f.) an Escrow Agreement between the City and an Escrow Bank; and (g.) any other actions of the City Manager and his designees that may be necessary to issue refunding bonds in connection with the Ballpark and Redevelopment Project (the "Refunding Ballpark Bonds")?

Manager's Recommendations: Adopt the Ordinance.

Other Recommendations – None.

Fiscal Impact – Based on current market conditions, the average annual lease payment for the Refunding Ballpark Bonds is estimated to be $12.1 million, which is approximately $2.9 million lower than the average annual lease payment for the Original Ballpark

Bonds. The actual annual lease payment amounts will be determined at the time of the bond sale, which is anticipated to occur in October of 2003. These savings will be offset by lower interest earnings generated within the project of approximately $200,000 per year. This results in net project savings of approximately $2.7 million per year. It is recommended that the net project savings of approximately $2.7 million per year be reserved as a solution for the State budget issue.

All related costs of issuance, including, but not limited to, financial advisor, underwriting, bond counsel, trustee fees, and costs to prepare the official statement would be reimbursed from bond proceeds.

BACKGROUND

A. Original Ballpark Project Financing

An ordinance (the "Financing Ordinance") approving the financing documents relating to the issuance of lease revenue bonds to finance the City's contribution to the Ballpark and Redevelopment Project was adopted by the City Council on January 31, 2000. On March 6, 2001, the City Council adopted an ordinance and a resolution that ratified the actions that the City Council had taken earlier when it adopted the Financing Ordinance. Also, on November 20, 2001, the City Council adopted resolutions approving certain additional financing documents that allowed the City to move forward with the issuance of the bonds to finance a portion of its contribution to the project.[1] Subsequently, on February 15, 2002, the City caused the execution and delivery of $169,685,000 Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds, Series 2002 (Ballpark Project) (the "Original Ballpark Bonds").

Annual payments on the Original Ballpark Bonds are paid from, and secured by, the assignment of lease payments made by the City, utilizing a "lease, lease-back" structure. Specifically, under this structure, the City ground leases to the Public Facilities Financing Authority (the "Authority") the Park at the Park and the Ballpark (collectively, the "Ballpark Facility") site, which constitutes Parcel 1 of Parcel Map 18855. Pursuant to the Ballpark Facility Lease, the Authority then leases to the City the Ballpark Facility site and the Ballpark Facility, exclusive of the components owned by Padres L.P. (which is equivalent to up to 30% of the original cost of the Ballpark Facility as set forth in the MOU) (the "Leased Assets"). The lease payments paid by the City are assigned by the Authority, as lessor, to the trustee for the bonds, which is obligated to make bond payments to bond owners. The leasing arrangement is also subject to abatement, which means that the City is not legally obligated to make lease payments if the facility cannot be used; this applies even if the reason the facility can not be used is beyond the control of the City.

B. Impact of Litigation on Original Ballpark Project Financing

When the Original Ballpark Bonds were issued, 16 lawsuits had been filed, each in some way seeking to halt the entire Ballpark Project or otherwise impact elements of it. At that time, in all

[1] Under the existing financing plan, the City's contribution to the Ballpark Project totals approximately $205.9 million, and is composed of cash ($75.5 million) and $130.4 million in construction proceeds from the Original Ballpark Bonds, including the interest earnings on such proceeds.

but five of the cases, the City or the Redevelopment Agency prevailed summarily on the merits, and the decision of the trial court was either not appealed, or was ultimately affirmed on appeal.

Two of the cases remaining at the time the Original Ballpark Bonds were issued caused some uncertainty over the validity and the tax-exempt status of the bonds. As a result of the pendency of these two cases, the City's co-bond counsel, Orrick, Herrington & Sutcliffe LLP ("Orrick") and Webster & Anderson, issued a qualfied bond opinion regarding the validity and tax status of the Original Ballpark Bonds.

The effects of the uncertainty regarding the validity of the Original Ballpark Bonds were mitigated to a large extent by the use of municipal bond insurance, which guarantees the payment of debt service on the bonds in the event the City cannot pay for any reason. Ambac Assurance Corporation ("AMBAC"), one of the major bond insurers in the municipal finance arena, agreed to provide bond insurance on the Original Ballpark Bonds (subject to certain conditions). The insurance premium paid to AMBAC was a non-refundable premium, paid at the time of issuance, and reflected the heightened risk the insurer was taking. However, AMBAC agreed to roll the policy over into a subsequent bond issue without additional charge if, and when, the City refunded the Original Ballpark Bonds.

The Original Ballpark Bonds were sold through a contract of purchase with Merrill Lynch & Co. ("Merrill Lynch") involving an initial purchase of the bonds by Merrill Lynch, and, subject to certain restrictions, Merrill Lynch could subsequently place the Original Ballpark Bonds with a limited group of institutional investors, all of which were willing to take the risk of the outcome of the litigation (the "Tax-Exempt/Limited Placement Structure"). Although these investors were willing to accept the risk that the Original Ballpark Bonds might be deemed invalid, a premium above tax-exempt interest rates was required due to the additional risk of taxability or loss in bond value. (While municipal bond insurance mitigated most of the pricing impacts due to bondholder security issues raised by the outstanding litigation, it could not mitigate the impact of tax status uncertainty.) However, under the Tax-Exempt/Limited Placement Structure, Merrill Lynch assumed the risk of claims against the City and related persons from loss in value or taxability and this indemnity covered claims made by owners of the bonds as well as the Internal Revenue Service.

As a result of the circumstances described above, the interest rates on the Original Ballpark Bonds were considerably higher than the City’s traditional tax-exempt interest rates. Another factor that increased the interest rates on the Original Ballpark Bonds is that the bonds were issued with an optional refunding feature that allows the bonds to be called at par three years after the issuance date (i.e., on or after February 15, 2005). Tax-exempt lease revenue bonds are more typically issued with a ten-year call protection.

C. Litigation Update

The Court of Appeal found in favor of the City on all matters that have been litigated to date and no appeal has been taken to the California Supreme Court. The decision of the Court of Appeal is binding with respect to all but one plaintiff. That plaintiff has not taken any further action to pursue his claim for over one year. Orrick is of the opinion that none of the preceding matters has any bearing on the validity of new bonds ("Refunding Ballpark Bonds") that would be issued to redeem the Original Ballpark Bonds. Consequently, assuming that no further lawsuits are filed, Orrick has agreed to issue an unqualified bond opinion on the Refunding Ballpark Bonds.

DISCUSSION

A. Financing Vehicle for Refunding Bonds

As stated above, since the principal issues related to the litigation have been addressed by the courts, and assuming no new litigation is filed, the City's refunding bond counsel, Orrick, has determined that it can issue an opinion that would be unqualified as to the tax-exempt nature of interest on the Refunding Ballpark Bonds. Based on the foregoing, and on current market conditions, it is proposed that the City move forward with the issuance of Refunding Ballpark Bonds, which would bear a lower interest rate than the Original Ballpark Bonds. Under the proposed refunding plan, the proceeds of the Refunding Ballpark Bonds would be placed in an Escrow Fund, including any interest earned, to be used to redeem the outstanding Original Ballpark Bonds at a redemption price of 100% (par value), plus accrued interest, on or after February 15, 2005. Monies in the Escrow Fund would also be used to make any financing payments due on the Original Ballpark Bonds prior to redemption.

The Refunding Ballpark Bonds would be issued utilizing the same lease, lease-back structure described above with respect to the Original Ballpark Bonds. The lease payments made by the City to the Authority for the use of the Ballpark Facility would be made pursuant to the Amended and Restated Ballpark Facility Lease. As described above, the lease payments paid by the City are assigned by the Authority, as lessor, to the Trustee for the bonds, which would be obligated to make financing payments to bond owners.

Consistent with provisions of the original lease, the provisions of the Amended and Restated Ballpark Facility Lease would require the City to budget and make lease payments in each year it has use of the Leased Assets. Although the City would not have use of a significant portion of the Leased Assets while construction of the Ballpark Project is being completed, it will have use of the Ballpark Facility site. For the portion of the Leased Assets that may be occupied (i.e., the Ballpark Facility site), the City began making interest payments approximately six months after the issuance of the Original Ballpark Bonds. The interest payable with respect to the portions of the Leased Assets that the City would not have use of during construction, plus a four month period following the anticipated project completion date of April 2004, must be funded with the proceeds of the bond issuance (i.e., with capitalized interest).

The bonds would be insured by AMBAC. As described above, AMBAC provided bond insurance on the Original Ballpark Bonds, and agreed to roll the policy over into a subsequent bond issue without additional charge when the City refunds the Original Ballpark Bonds.

B. Bond Issuance Size

Based upon current estimates, the bond issuance size is approximately $180.0 million. The bond proceeds would fund the Escrow Fund (as described above, the Escrow Fund would provide funds to redeem the Original Ballpark Bonds and would be used to make financing payments due on the outstanding bonds prior to redemption), a required debt service reserve fund ("DSRF"), capitalized interest, and the costs to issue the refunding bonds. The estimated par value of the Refunding Ballpark Bonds ($180.0 million) is greater than the par value of the Original Ballpark Bonds ($169.7 million) due to the need to provide funds for financing payments due on the Original Ballpark Bonds prior to redemption and the costs to issue the refunding bonds.

Based on current market conditions, the par value of the Refunding Ballpark Bonds is also impacted by "negative arbitrage." Specifically, negative arbitrage occurs when the interest rate on the Escrow Fund is less than the interest rate on the refunding bonds. This circumstance requires that the par value of the refunding bonds be increased to compensate for the lower investment earnings on the Escrow Fund in order to ensure sufficient funds are available to make financing payments due on the Original Ballpark Bonds prior to redemption.

C. Surety Bond

The Original Ballpark Bonds structure reflected a forward commitment, provided by AMBAC, for a surety bond covering one-half of the DSRF requirement (the DSRF requirement is equivalent to the maximum annual debt service on the bonds). (The financing documents approved for the Original Ballpark Bonds and for the proposed Refunding Ballpark Bonds authorize the use of a surety for some or all of the DSRF.) A surety bond policy is a commitment issued by a municipal bond insurance company that is deposited in the DSRF in lieu of cash, and, like a DSRF, offers security for a bond issue. The surety provides that, in the event a required financing payment is not made on a timely basis, monies would be advanced by the bond insurer to make the payment. The monies advanced are then repaid by the issuer to the bond insurer.

AMBAC has agreed to transfer its surety commitment (approximately $7.5 million, based on 50% of the DSRF for the Original Ballpark Bonds) to the Refunding Ballpark Bonds, which would allow the City to fulfill its remaining commitment to the Ballpark and Redevelopment Project. The ordinance that the City Council would approve through the actions requested would authorize the City Manager to take the actions necessary to execute a Guaranty Agreement between the City and AMBAC underwhich the City would agree, subject to City Council appropriation, to reimburse AMBAC for any draws made on the surety bond policy.

D. Annual Lease Payment Savings

Under current market conditions as of June 27, 2003, the overall estimated bond interest rate (the "interest rate") on the Refunding Ballpark Bonds is approximately 4.89%, and the estimated average annual lease payment would be approximately $12.1 million. By contrast, the comparable interest rate and the average annual lease payment on the Original Ballpark Bonds are 7.66% and $15.0 million, respectively. (The actual interest rate and average lease payment amounts for the Refunding Ballpark Bonds would be determined at the time of the bond sale, and could be greater than, or less than, the estimated figures provided above.) This is an estimated savings of approximately $2.9 million per year. These savings will be reduced by lower interest earnings of approximately $200,000 per year in the project. This is due to lower interest rates, and lower cash balances in the project. The resulting net project savings is $2.7 million per year.

It is recommended that the net project savings generated from the refunding be reserved as a solution for the State budget issue.

E. Financing Pro Forma

The City's annual lease payments under the Amended and Restated Ballpark Facility Lease would be funded from the same sources allocated for payments due under the Ballpark Facility Lease. Specifically, the City's annual lease payment, and annual operation and maintenance payments of up to $3.5 million (subject to annual upward adjustments in accordance with the San Diego Consumer Price Index for all Urban customers and set-offs for delays in the completion of three hotels, which are the responsibility of Padres L.P.) would be funded, in part, with certain existing revenue in the City's general funds, and certain new revenue in the City's general funds that is anticipated to be generated as a result of the ancillary development component of the Ballpark and Redevelopment Project. A financing pro forma, which depicts the intended funding sources, is included in Attachment A.

F. Financing Documents

The documents that the City Council would approve through the actions requested include the Site Lease, the Amended and Restated Ballpark Facility Lease, the Assignment Agreement, the Trust Indenture, and the Escrow Agreement. These agreements are briefly described below.

1. Site Lease - The Site Lease is the agreement between the City and the Authority under which the City leases the Ballpark Facility site to the Authority.

2. Amended and Restated Ballpark Facility Lease – The Amended and Restated Ballpark Facility Lease is an agreement between the City and the Authority under which the City leases, from the Authority, the Ballpark Facility site and the Ballpark Facility, exclusive of the components Padres L.P. will own (which is equivalent to 30% of the original cost of the Ballpark Facility as set forth in the MOU). The lease payments made by the City will be the equivalent of the financing payments on the Refunding Ballpark Bonds that would be issued by the Authority.

3. Assignment Agreement – The Assignment Agreement is an agreement between the Authority and the Trustee. Under the agreement, the Authority assigns to the Trustee, without recourse, all of its rights to receive lease payments under the Amended and Restated Ballpark Facility Lease.

4. Trust Indenture – The Trust Indenture is the contract between the Authority and a trustee that outlines the parties' rights, responsibilities, and obligations with respect to the issuance of the Refunding Ballpark Bonds.

5. Escrow Agreement – The Escrow Agreement governs the use and investment of funds deposited in the Escrow Account.

G. Schedule

If the City Council approves the actions related to the financing documents for the Refunding Ballpark Bonds, it is anticipated that staff would return to City Council in two weeks for approval of two additional financing documents: the preliminary official statement (the "POS") and the continuing disclosure agreement (CDA). The POS is the bond offering document, which describes the proposed issue to the marketplace, and which provides information about the financial and economic condition of the City. It is used to market the bonds and to fully disclose all facts that would be of interest to potential buyers of the bonds. The CDA is an agreement between the City and the trustee pursuant to which the City is obligated to make secondary market disclosure—including the provision of information regarding the City's fiscal health, and project and financing related information—on an annual basis to comply with federal securities regulations.

If the City Council also approves the actions relating to the POS and the CDA, it is anticipated that the Authority would sell the refunding bonds by competitive sale in mid-October of 2003. The bond closing (receipt of bond proceeds) would occur later that same month.

CONCLUSION

It is recommended that the City Council authorize the issuance of the Refunding Ballpark Bonds in an amount not to exceed $195,000,000. It is also recommended that the City Council approve the related financing documents, and other actions required to implement the issuance of Refunding Ballpark Bonds.

ALTERNATIVES

Do not approve the requested actions necessary to issue the Refunding Ballpark Bonds.

Respectfully submitted,

____________________________ Mary E. Vattimo City Treasurer	____________________________ Approved: Patricia T. Frazier Deputy City Manager

VATTIMO/ELK/JSW

Attachment: Financing Comparison
Ballpark and Redevelopment Project Refunding Pro Forma
(Ballpark and Redevelopment Project – Explanation of Line Items)