

DATE ISSUED: June 2, 2004 **REPORT NO.** 04-115

ATTENTION: Honorable Mayor and City Council
Docket of June 7, 2004

SUBJECT: Sewer System Interim Financing – Approval of Documents

REFERENCE: City Manager’s Report 01-209, issued October 10, 2001
City Manager’s Report 03-037, issued February 26, 2003
City Manager’s Report 03-120, issued June 11, 2003

SUMMARY

Issue - Should the City Council adopt a resolution approving the form of and authorizing the private placement, on an interim basis, of \$152 million in Non-Transferable Subordinated Sewer Revenue Bonds, Series 2004, which would be sold during the second week of June, 2004?

Manager’s Recommendation– Adopt the resolution.

Other Recommendations- None.

Fiscal Impact– The private placement of \$152 million in Non-Transferable Subordinated Sewer Revenue Bonds at an initial interest rate of approximately two to three percent will result in semiannual debt service payments of approximately \$1.5 - \$2.3 million. The Non-Transferable Subordinated Sewer Revenue Bonds are expected to be retired by a subsequent public offering of long term debt which is expected to occur by December, 2004. All related costs of issuance, including but not limited to bond counsel, financial advisor, trustee, and preparation of documents will be reimbursed from bond proceeds.

BACKGROUND

In October of 2001, the City Council approved increasing all sewer service charges by 7.5% on March 1, 2002, 2003, 2004 and 2005 to ensure continued compliance with the requirements of the Clean Water Act, the Ocean Pollution Reduction Act (OPRA), the State Ocean Plan, the National Pollutant Discharge Elimination System (NPDES) permit, and the federal Stipulated Final Order for Injunctive Relief (Stipulated Order). In connection with approval of the aforementioned service charge increases, the City Council was advised that it would be necessary to issue additional sewer revenue bonds on a periodic basis which, in combination with additional pay-as-you-go funding derived from rates, would provide the required project financial support.

As part of the on-going wastewater project, in June of 2003, the City Council took a series of actions related to the issuance of Sewer Revenue Bonds and/or Subordinated Sewer Revenue Bonds in an amount not to exceed \$1.2 billion, for purposes of (1) financing the fifth phase of the approved wastewater system capital improvements program, and (2) refinancing all or a portion of the previously issued 1993, 1995, 1997 Series A/B and 1999 Series A/B Sewer Revenue Bonds to realize interest cost savings.

Pursuant to those actions, staff proceeded to complete the steps necessary to effect the public sale of the bonds through UBS Financial Services on September 9, 2003. As a result of the discovery of certain errors in the City's FY 2002 Consolidated Annual Financial Report, and the related Annual Financial Report of the Wastewater Utility, as more fully set forth in a Voluntary Report of Information filed by the City in January of 2004, a decision was made not to go forward with that bond issuance.

DISCUSSION

Why Is An Interim Financing Necessary?

As indicated above, the City is under several regulatory obligations which require the construction and renovation of numerous capital facilities on an established schedule. The need to avoid delays in completion of these critical capital projects, coupled with the determination that it would not be prudent to access the public financial markets until the accounting firm of KPMG LLP has completed its audit of the 2003 financial statements (which is not expected to be accomplished by the end of the current fiscal year) has resulted in near-term cash flow pressures which must be, and are best addressed by means of a privately placed interim, or "bridge" financing which will be retired by a subsequent public offering of long term debt, which is expected to occur prior to the end of calendar year 2004.

Assisted by its financial advisors, City staff solicited offers from a total of six financial services firms which were known to possess the financial resources necessary to consummate a private placement transaction under the conditions to be stipulated by the City. Staff received a total of four offers in response to its solicitation, ultimately selecting Bank of America, N. A. as being the most competitive, based on a combination of interest rates, terms and fees.

What Is A Private Placement Financing, And What Is The Nature Of the Private Placement Financing Being Proposed?

Private placement financings do not involve a public offering of the bonds. Rather, the bonds are offered to, and purchased only by knowledgeable, sophisticated investors capable of fully and independently evaluating risk.

As described in the supporting documents, the Authority and the City will enter into a private placement bond purchase agreement with Bank of America, N. A., pursuant to which the Authority will deliver a bond or bonds in the amount of \$152 million to Bank of America, N. A., in return for which it will receive cash in the amount of \$152 million. The Bond may be redeemed at any time by the Authority. Interest on the Bond will be at a variable rate which is set for a stated period of time. The initial rate, which is set for a six-month period, is expected to be approximately two to three percent. Pursuant to the bond purchase agreement, Bank of America, N. A. agrees to retain the Bond in its own investment portfolio, and will not resell the Bond to any third party during the term of the transaction. The Bond will be secured by installment payments to be made by the City exclusively from net system revenues of the Sewer Fund, but will be subordinate in right of payment to the Authority's existing parity (senior) sewer revenue bonds.

As was the case with the four previous public market wastewater debt issuances, proceeds from the Non-Transferable Subordinated Sewer Revenue Bond will be used to fund a part of the Council-approved wastewater capital improvement program consisting of numerous projects, including the repair and replacement of aging and deteriorating components of the Sewer System, upgrades to facilities to meet requirements of the Clean Water Act, OPRA, the State Ocean Plan, the NPDES permit and the Stipulated Order, as well as to meet the needs of current and future residents and commercial customers. Adoption of the resolution will provide cash flow to facilitate the financing of projects pending completion of a larger public market offering through UBS Financial Services prior to the end of calendar year 2004.

Financing Documents

While it is not necessary that the City Council adopt a new bond ordinance because the proposed bond issue is of the type authorized by the 2003 ordinance referenced above, certain new documents specific to this transaction are required. The documents being submitted for approval at this time will enable the Authority to issue the Non-Transferable Subordinated Sewer Revenue Bond, Series 2004, as described above. The Resolution approves the form, execution and delivery of financing documents and certain other actions within the City Manager's purview and limitations which are necessary and in the best interests of the City to issue the bonds. A brief description of the major financing documents follows:

- **Indenture (Subordinated Bonds)** – An agreement between the Authority and Wells Fargo Bank, N. A., as Trustee, the Indenture sets forth the terms and conditions under which the subordinated bonds will be issued, the basis for establishment of funds and accounts, the responsibilities of the Authority and the Trustee, defines events of default

and remedies of holders, conditions governing defeasance and related matters.

- **2004 Supplement to the Master Installment Purchase Agreement of 1993**– This document supplements the master installment purchase agreement of 1993, and provides for the issuance of the Non-Transferable Subordinated Sewer Revenue Bonds, Series 2004, including representations by and between the City and the Authority, a description of the installment payments, conditions governing prepayment, and covenants relating to tax exemption and issuance of additional subordinated obligations.
- **Bond Purchase Agreement**– An agreement between the Authority and Bank of America, N. A., pursuant to which Bank of America, N. A. agrees to purchase the Non-Transferable Subordinated Sewer Revenue Bonds, Series 2004 from the Authority, and the Authority agrees to deliver the bond to the bank. The agreement details the representations, warranties and agreements of the Authority, the City and Bank of America, N. A. in connection with the transaction.

CONCLUSION

It is recommended that the City Council authorize the private placement of Non-Transferable Subordinated Sewer Revenue Bonds, Series 2004, in the amount of \$152 million and approve the related financing documents so that near-term cash flow pressures can be avoided, and ongoing improvements to the wastewater system may proceed without delay.

ALTERNATIVE

Do not approve the requested actions necessary to privately place the Non-Transferable Subordinated Sewer Revenue Bonds. This is not recommended because of its adverse effect on the Metropolitan Wastewater Department's near-term cash flow, and its ability to execute its ongoing capital improvement program.

Respectfully submitted,

Mary Vattimo
City Treasurer

Approved: Patricia T. Frazier
Deputy City Manager

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