

DATE ISSUED: May 11, 2005 REPORT NO. 05-112

ATTENTION: Honorable Mayor and City Council  
Agenda of May 17, 2005

SUBJECT: Naval Training Center - Proposed Issuance of Community  
Facilities District No. 3 (Liberty Station) Special Tax Bonds Series  
A of 2005 in an Amount Not To Exceed \$16.0 Million

REFERENCE: Manager's Report No. 02-096 dated April 29, 2002

**SUMMARY**

**Issues:** - Should the City Council, acting in its capacity as the legislative body of Community Facilities District No. 3 (Liberty Station), approve:

Adoption of a resolution authorizing and approving: (a) the issuance of Community Facilities District No. 3 (Liberty Station) Special Tax Bonds Series A of 2005 (the "CFD Bonds") in a principal amount not to exceed \$16.0 million; (b) the execution and delivery of certain documents required in connection with the proposed bond issuance, including the Bond Indenture and the Private Placement Agreement; and (c) the performance of any other actions of the City Manager, the Deputy City Manager, the City Treasurer, and their designees that may be necessary to issue the CFD Bonds?

**Manager's Recommendation:** Adopt a resolution authorizing and approving: (a) the issuance of Community Facilities District No. 3 (Liberty Station) Special Tax Bonds Series A of 2005 (the "CFD Bonds") in a principal amount not to exceed \$16.0 million; (b) the execution and delivery of certain documents required in connection with the proposed bond issuance, including the Bond Indenture and the Private Placement Agreement; and (c) the performance of any other actions of the City Manager, the Deputy City Manager, the City Treasurer, and their designees that may be necessary to issue the CFD Bonds.

**Other Recommendations:** None.

**Fiscal Impact:** None to the City. In accordance with Council Policy 800-03, all costs related to Community Facilities District No.3 (Liberty Station), have been funded by McMillin – NTC, LLC. The costs related to establishing and administering CFD No. 3 (Liberty Station) and financing public facilities related to the district will ultimately be borne by property owners within the district, via the collection of special taxes, through the term that the CFD Bonds remain outstanding.

## **BACKGROUND**

The Mello-Roos Community Facilities Act of 1982 (the “Mello-Roos Act”) was enacted by the State to help growing areas finance certain essential public facilities that typically accompany major development projects. The Mello-Roos Act provides for the establishment of a Community Facilities District (“CFD”) for the purpose of financing certain public improvements and the provision of certain services, and was amended in order to specifically facilitate military base reuse. The City’s Council Policy 800-03 (the “Council Policy”) allows for utilization of CFDs to finance certain public facilities required in connection with development.

More particularly, the Disposition and Development Agreement or “DDA” between the Redevelopment Agency of the City (“Agency”) and McMillin-NTC, LLC (“McMillin”) related to the development of the Naval Training Center Redevelopment Project (the “Redevelopment Project”) and approved by the City Council and the Agency in June of 2000 gave McMillin the right to pursue CFD formation for the purpose of financing certain public improvements that McMillin is responsible for under the DDA. The DDA states that the “Master Developer intends to finance the Development Cost of the Horizontal Improvements with a combination of debt (including, to the extent approved by the City, Community Facilities District bonds as described in paragraph c.(3) of Section 1.08 of this Agreement) and Master Developer’s equity.” Paragraph c.(3) of Section 1.08 of the DDA further states, the “Master Developer shall have the right to pursue formation of a Community Facilities District or other district in order to finance Horizontal Improvement Development Costs....” The DDA defines Horizontal Improvements as “public improvements and utilities....”, which includes road improvements. Also, in the DDA, “Park Improvements” are defined as Horizontal Improvements.

CFD formation proceedings were conducted in 2002. In accordance with the Mello-Roos Act, the Council Policy, and provisions of the DDA, and following public hearings and a special election conducted pursuant to the Mello-Roos Act, the City Council adopted the necessary resolutions to form Community Facilities District No. 3 (Liberty Station) (the “District”). In addition, the City Council authorized the levy of special taxes (“Special Taxes”) on taxable property interests within the District and the issuance of bonds in an amount not to exceed \$30.0 million (such not to exceed authorization includes amounts to

acquire eligible facilities, as well as amounts to cover the required debt service reserve fund and costs of formation and issuance).

The District was established for the purpose of financing certain public facilities (the “Public Facilities”) required in connection with McMillin’s development of the Redevelopment Project. McMillin’s overall fiscal obligation with respect to public improvements required in connection with the Redevelopment Project is currently estimated to total \$81 million; however, of this overall fiscal obligation, costs associated with improvements anticipated to be financed through the District are limited to approximately \$20.8 million, as specified in the DDA.

The Public Facilities to be financed through the District, and the terms of acquisition, are described in the Purchase and Finance Agreement (the “Acquisition Agreement”) between the City and McMillin, which was approved by the City Council in connection with the District formation proceedings in 2002, and are listed below.

- a. Rosecrans Street and Lytton Street improvements;
- b. improvements to Rosecrans Street and Nimitz Boulevard;
- c. improvements to Harbor Drive at Lee Street;
- d. construction of the 46-acre regional park as required of McMillin pursuant to the terms of the DDA and related agreements, including related demolition of existing structures; and
- e. improvements to Laning Road.

The Special Taxes are levied in accordance with the rate and method of apportionments (the RMAs) that were also approved in connection with the District formation proceedings. The Special Taxes may be used to pay either debt service on the CFD Bonds, or to directly fund the Public Facilities. At the time the District was formed, it was anticipated that tax-exempt bonds would be issued in two series. The first series of bonds would be issued when sufficient development had occurred to support that series of bonds, and the second series of bonds would be issued later in the development process assuming development continued to occur as planned.

## **DISCUSSION**

### **I. Proposed Bond Issuance – Private Placement Structure**

The Financing Team for the CFD Bonds includes staff of the City Treasurer’s Office, the City Attorney’s Office, and the Auditor’s Office, as well as outside consultants such as bond and disclosure counsel, a financial advisor, and an underwriting team. Following the establishment of the District, and as property developed within the District, the Financing Team prepared documents, including the official statement, related to a proposed public offering of a first series of bonds (i.e., a sale of bonds to the general public, and which involves an official statement containing material information relevant to potential buyers of the bonds) in an amount not to exceed \$16.0 million to be issued in 2004. However, although the CFD Bonds are not obligations of the City (i.e., the bonds

are secured by Special Taxes levied upon property within the District, and are not secured by City funds or revenues), certain matters affecting the City have impacted a possible public offering of the CFD Bonds at this time.

Specifically, the City's bond and disclosure counsel for the CFD Bonds and the City's general disclosure counsel have each advised the Financing Team that although the CFD Bonds are not obligations of the City, any adverse information regarding the City's financial condition or any adverse developments regarding the pending investigations being conducted by the Securities and Exchange Commission, the U.S. Attorney's Office, the FBI, the District Attorney's Office, and the City Attorney could have a negative impact on the value of the CFD Bonds in the secondary market. Counsel further advised that until the City is in a position to provide current financial information to the marketplace the CFD Bonds should not be publicly offered.

Given the conclusion that a public offering of the CFD Bonds should not currently be pursued, the Financing Team discussed and analyzed an alternative method of sale, which would involve placement of the bonds by the underwriting team (the "Placement Agent") with a limited group of qualified institutional buyers (a "Private Placement"). A Private Placement structure such as the one contemplated, and described more fully below, generally carries a higher interest rate than a public offering due primarily to restrictions that are placed on the types of investors that can purchase the bonds and due to restrictions placed on the resale of the securities in the secondary market. However, based on certain factors, also described more fully below, the Financing Team determined that proceeding with a Private Placement in the near term was preferable to waiting until it could proceed with a public offering.

The Placement Agent, Stone & Youngberg and E. J. De La Rosa & Co., Inc. has estimated that, based on current market conditions, it could place the CFD Bonds under the proposed structure at a rate that is approximately 0.28% higher than if a public offering could be executed. Comparatively, the Placement Agent has estimated that interest rates for non-rated land based securities, such as the CFD Bonds, could increase by 0.45% to 0.55% over the next nine months, which is the estimated time-frame to implement a public offering (such time-frame to issue a public offering could not be constructed with any certainty, and would necessarily be dependent on the release of the 2003 and the 2004 Comprehensive Annual Financial Reports ["CAFRs"]). It is unknown when the CAFRs will be released. Also, under a public offering, the appraisal for the CFD Bonds, which is a key piece of disclosure for land based securities, and other disclosure previously drafted would need to be updated, and it is not advisable to proceed with such updates until there is more certainty with respect to the timing of the CAFRs.) The City's Financial Advisor, Fieldman, Rolapp, & Associates, believes the Placement Agent has based its estimate of future market conditions on valid assumptions.

In addition to possibly being more cost-effective than waiting to issue a public offering, there are other benefits to proceeding with a Private Placement at this time as described below:

- a) Phase 1 Park Completion - McMillin and Agency staff have indicated that the first phase of the regional park improvement that would be reimbursed with the CFD Bonds could be commenced and completed sooner if the proceeds of the CFD Bonds are available in the near future. It is understood that there is strong community support that the park be commenced and completed as soon as possible. To this end, it is anticipated that a companion item to the proposed CFD Bonds will be docketed for City Council consideration. The companion item would involve an amendment to the NTC Park Improvement Agreement, and would address the commitment by McMillin to accelerate the schedule set forth in the DDA for commencement and completion of a first park phase contingent upon the sale of the CFD Bonds in the near future.
- b) Reallocation of Limited Resources to Other City Financings - Due to limited staff resources, and the significant number of City financings that have been placed on hold, a prioritization of these financings is necessary. If the City can execute the Private Placement, it could reallocate limited existing staff resources to other financing and refunding activities that have been put on hold due to the delay in the CAFRs.

Based on the market analysis described above, the possibility of having a completed park phase earlier, and the ability to reallocate limited staff resources to other important City financings and refundings, it is recommended that the City proceed with a Private Placement of the CFD Bonds in an amount not to exceed \$16.0 million.

## **II. Method of Sale**

Under the Private Placement structure, on the day of the bond issuance, the Placement Agent would sell the CFD Bonds to a limited group of investors. The bond offering period would remain open until all the CFD Bonds are sold. It is possible that the purchasers of the CFD Bonds could include the Placement Agent. Also, under the proposed structure, the Securities and Exchange Commission (“SEC”) rules that require preparation of a disclosure document, or official statement, in connection with a primary offering would not apply. Specifically, the SEC rules do not apply to primary offerings of bonds that are issued in authorized denominations of \$100,000 or more if such bonds are sold to no more than 35 investors each of whom the participating underwriter, or Placement Agent, believes (a) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and (b) is not purchasing the bonds for more than one account or with a view to distributing the securities (i.e., to reselling the bonds in the secondary market).

The Financing Team for the CFD Bonds is proposing an even more conservative approach than would be required under the SEC rules, and is structuring the offering in

denominations of \$250,000 or more, limiting the placement of the CFD Bonds to no more than 15 investors, and requiring that the Bonds be placed with Qualified Institutional Buyers as defined under Rule 144A of the Securities Act of 1933 (the “Securities Act”). In general, Qualified Institutional Buyers include large insurance companies, banks, and investment companies that own and invest on a discretionary basis at least \$100 million in securities of issuers.

Each investor would also be required to sign an Investor Letter acknowledging, among other things that: it is a Qualified Institutional Buyer as defined by the Securities Act; it has sufficient knowledge and experience in financial and business matters--including the purchase and sale of bonds issued pursuant to the Mello-Roos Act--to evaluate the risks and merits of the CFD Bonds; it understands that the CFD Bonds are not obligations of the City and are not secured by funds and revenues of the City; and it is acquiring the CFD Bonds for investment and not with a view to resell the CFD Bonds. The Investor Letter would also provide that the Qualified Institutional Buyer acknowledge that, while the Bonds are limited obligations of the District and are not payable from any funds or revenues of the City, it is possible that a significant negative development with respect to the City’s financial condition or pending investigations could reduce the value of the Bonds in the secondary market. Each Qualified Institutional Buyer would also acknowledge, under the Investor Letter, that it could only transfer or sell the CFD Bonds to another Qualified Institutional Buyer and that such new buyer must deliver an executed Investor Letter to the Trustee, and the transfer must not result in more than 15 bond owners overall with respect to the CFD Bonds.

By approaching the financing in this manner, the City would be able to proceed with the financing at this time. The Private Placement structure addresses the issue of potential secondary market impacts related to the City investigations or financial condition. Each investor would specifically acknowledge that information regarding the City’s financial condition is not material to the investor given the nature of the security for the CFD Bonds, and the investor’s present intention of acquiring the CFD Bonds for investment and not for resale.

Due to the nature of the security of land secured bonds, such as the CFD Bonds, and the fact that such bonds are typically non-rated, most land secured bond sales in the State occur via negotiated sale (i.e., an underwriter, or Placement Agent, is selected in advance of the bond sale and the terms and price of the bonds are negotiated with the issuer) rather than by competitive sale (i.e., the sale of bonds to the bidder presenting the best sealed bid). It is prudent to place the CFD Bonds on a negotiated basis with the Placement Agent due to the factors described above (i.e., the nature of the security for the bonds, and the non-rated status of the bonds), and also because the bonds would be sold to no more than 15 Qualified Institutional Buyers, would be sold in denominations of \$250,000 or more, and would have limited secondary market liquidity. The negotiated sale method would give the Placement Agent adequate time to pre-market the CFD Bonds to Qualified Institutional Buyers, which should result in a lower interest rate than if the bonds were sold on a competitive basis.

### III. Issuance Size

The maximum overall bond authorization for the District totals \$30.0 million (such maximum authorization includes amounts to acquire eligible facilities--which total approximately \$20.8 million--as well as amounts to cover the required debt service reserve fund and costs of formation and issuance, for one or more series of bonds). It is proposed that a first series of bonds be issued by the District in a principal amount not to exceed \$16.0 million. If the bond issuance is authorized by the City Council, it is anticipated that bond proceeds would be utilized to finance road and park improvements pursuant to the Acquisition Agreement, as more fully described below, to fund a required debt service reserve fund (a "DSRF"), and to fund costs to establish the District and issue the bonds.

The road improvements that would be funded with the CFD Bond proceeds include improvements to Rosecrans Street and Harbor Drive, both of which have been completed. It is understood that McMillin and the Agency currently anticipate that the park improvement would be completed in two phases. It is estimated that the CFD Bond proceeds would fund a first phase of the regional park improvement (Phase 1) (Phase 1 includes, but is not limited to, 18 acres of active and passive turf areas, a children's playground area, a comfort station, paved pedestrian walkways, parking lots, landscape and irrigation, park furnishings, half-width street improvements for perimeter streets, and costs for demolition required at the park site), and a portion of a second park phase (Phase 2), which includes the balance of the 46 acre park with similar elements as Phase 1 (e.g., passive open play turf areas, comfort stations, paved pedestrian walkways, parking lots, landscape and irrigation, park furnishings, benches, picnic tables, and trash receptacles.) The following table specifies the estimated sources and uses of the proceeds of the CFD Bonds:

#### Sources and Uses of Bond Proceeds

##### Estimated Sources:

Bond Proceeds:	\$ 16,000,000
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##### Estimated Uses:

Public Facilities	\$13,296,088
Debt Service Reserve Fund	1,125,573
Costs of Formation and Issuance	<u>1,578,339</u>
TOTAL:	\$16,000,000

Pursuant to the RMAs that were approved in connection with the formation proceedings, the City has levied Special Taxes on developed property within the District, beginning

with the Fiscal Year 2004 tax year. The following table provides more specific information on the anticipated facilities to be acquired with Special Tax receipts collected in Fiscal Years 2004 and 2005, and with the acquisition proceeds of the proposed CFD Bonds:

Sources and Uses of Acquisition Funds

	<b>FY 2004-2005 Acquisition Levy Receipts</b>	<b>Acquisition Bond Proceeds</b>	<b>Total</b>
<i>Estimated Sources of Acquisition Funds</i>			
FY 2004 Levy - Acquisition Receipts	\$381,024	--	\$381,024
FY 2005 Levy - Acquisition Receipts	951,207	--	951,207
Bond Proceeds (Acquisition Fund)	--	13,296,088	13,296,088
<i>TOTAL</i>	<i>\$1,332,231</i>	<i>\$13,296,088</i>	<i>\$14,628,319</i>
<i>Estimated Uses of Acquisition Funds</i>			
Rosecrans/Lytton St. Improvements	\$1,332,231	\$3,769,539	\$5,101,770
Harbor Drive Improvements	--	890,000	890,000
<i>Sub-total Road Improvements</i>	<i>\$1,332,231</i>	<i>\$4,659,539</i>	<i>\$5,991,770</i>
Park – Phase 1	--	7,958,866	7,958,866
Park – Phase 2 (portion)*	--	677,683	677,683
<i>Sub-total Park Improvements</i>	<i>--</i>	<i>\$8,636,549</i>	<i>\$8,636,549</i>
<i>TOTAL</i>	<i>\$1,332,231</i>	<i>\$13,296,088</i>	<i>\$14,628,319</i>

\* Phase 2 cost is estimated to total \$6,820,934, which includes a \$466,729 contribution to the aquatic center. Combined with the Phase 1 cost (\$7,958,866), the park costs total \$14,779,800. To the extent acquisition proceeds from the CFD Bonds are available for Phase 2, McMillin has indicated it would expand Phase 1 to include elements currently included in Phase 2.

As displayed above, approximately 35% (\$4,659,539) of the bond acquisition proceeds are anticipated to be used to acquire road improvements, with the remaining 65% (\$8,636,549) anticipated to acquire park improvements.

A second series of bonds could be issued later in the redevelopment process, assuming an updated feasibility study and appraisal support the issuance of additional bonds, and assuming the City Council subsequently authorizes a second bond issuance. It is anticipated that a second series of bonds would be utilized to finance a small amount of additional road improvements, and the remaining Phase 2 park improvements associated with the District. If a second series of bonds is issued, the financing documents for the



CFD Bonds allow for the release of the restrictions on the resale of the CFD Bonds in the secondary market, at the City Council's discretion.

#### **IV. Repayment of the Bonds – Special Taxes**

As described, debt service on the CFD Bonds would be paid with Special Taxes levied on taxable property interests within the District through the term of the CFD Bonds in accordance with the RMAs approved by the City Council in 2002. The CFD Bonds are not general or special obligations of the City, and are not backed by the faith, credit, nor taxing power of the City. The CFD Bonds are special limited obligations of the District payable solely from Special Taxes collected from owners of taxable property interests within the District.

If there is a shortfall in the amount of Special Taxes available to make a required debt service payment, monies would be withdrawn by the Trustee from the DSRF. The DSRF would be established when the CFD Bonds are issued and would be generally sized in an amount equivalent to the maximum annual debt service on the CFD Bonds. In addition, in the event a parcel is delinquent in the payment of Special Taxes, the District has provided a covenant in the Indenture, as described below, wherein it would diligently pursue foreclosure of such delinquent property if certain delinquency thresholds are reached.

Until the City has issued all the bonds it expects to issue with respect to the District, up to the \$30.0 million maximum authorization, or up until it has acquired all the facilities eligible for reimbursement, Special Taxes would be levied at the Assigned Special Tax Rate (the "Assigned Rate"), as set forth in the RMAs. Such Special Tax proceeds would be used to pay debt service on the CFD Bonds and could be used to pay for facilities directly. Once one of the two factors described occurs (i.e., all bonds have been issued or all eligible facilities have been acquired), the City may levy Special Taxes at less than the Assigned Rate if the revenues generated would be sufficient to make principal and interest payments on the bonds, replenish shortfalls, if any, in the DSRF, and pay administrative costs related to the District. Essentially, because a point in time may be reached wherein the Special Taxes could be levied at less than the Assigned Rate, it is important to strive to issue the CFD Bonds at the lowest interest rate possible. As described above, one factor underlying City staff's recommendation to proceed now with a Private Placement Structure is that this type of structure, if issued in the near term, could result in an interest rate that is lower than what would be expected, based on current forecasts, in early 2006, when the City could reasonably expect it might be in a position to issue a public offering of the CFD Bonds.

## **V. Financing Documents**

The financing documents that the City Council would approve through the proposed actions include the form of the Indenture and the Private Placement Agreement.

- a. The Indenture – The Indenture is an agreement between the District and the Trustee for the CFD Bonds, Wells Fargo Bank, National Association. Generally, it outlines the District’s and the Trustee’s responsibilities and obligations, and the rights of the bondholders, with respect to the CFD Bonds. It also pledges Special Taxes levied within the District to the repayment of the CFD Bonds.

The Indenture includes information regarding the amount of the CFD Bonds, the use of bond proceeds, and the nature of the security for the CFD Bonds (i.e., that the CFD Bonds are not obligations of the City, and are limited obligations of the District). It sets forth the maturities and interest rates on the CFD Bonds, provides that the Trustee would establish and maintain certain funds and accounts with respect to the bond proceeds and the Special Tax receipts, specifies how the funds would be invested, and how the DSRF would be utilized. The Indenture also contains the warranties and covenants of the District including that it would: cause the principal and interest on the CFD Bonds to be paid punctually to the extent Special Taxes are available; levy Special Taxes necessary to pay principal and interest on the CFD Bonds up to the maximum rate prescribed by the RMAs; and commence foreclosure proceedings against any delinquent parcel when certain delinquency thresholds are met. It also describes conditions for the issuance of a second series of bonds, and provides a form of the Investor letter.

- b. The Private Placement Agreement – The Private Placement Agreement is an agreement between the District and the Placement Agent involving placement of the CFD Bonds by the Placement Agent with a limited group of Qualified Institutional Buyers. It specifies the purchase price for the CFD Bonds, the placement fee to be paid to the Placement Agent from the bond proceeds, and certifies terms of the CFD Bonds, such as interest rates and maturities. It also identifies each bond buyer and the principal amount of CFD bonds acquired by each buyer. In addition, it describes the circumstances in which the Placement Agent may cancel its obligation to place the issue, such as changes in the tax treatment of the CFD Bonds, and other events (e.g., a national or international crisis that impacts the national financial markets) that would make it substantially more difficult for the Placement Agent to market the CFD Bonds to investors.

The agreement also specifies documents that the Placement Agent and the District must receive prior to the closing of the bond offering, including the Bond Counsel opinion regarding the validity of the CFD Bonds and the Indenture, and the tax exempt nature of the CFD Bonds, and an opinion of the City Attorney. The opinion of the City Attorney would specify that the formation proceedings were properly executed in the legal manner prescribed by law, all formation documents and financing documents to which the City or District are a party were duly

authorized and executed, and, to the best of the City Attorney's knowledge, there is no lawsuit or proceedings threatened against the City or the District that would restrict the issuance of the CFD Bonds, the collection of Special Taxes, or the validity of the formation proceedings.

Under the Private Placement structure, there would be no annual continuing disclosure obligations of the City; however, the Private Placement Agreement includes a form of Developer Continuing Disclosure Agreement (the "DCDA"). The DCDA provides that McMillin and certain affiliates of McMillin, as described in the DCDA, must provide continuing disclosure information on an annual basis to the secondary market. The agreement further provides that after the filing of the first report this obligation would terminate if McMillin and its affiliates are responsible, in the aggregate, for less than 20 percent of the annual Special Taxes levied in the District, and not less than 95% of the Public Facilities to be acquired with the CFD Bond proceeds have been completed.

## **VI. Bondholder Risk Factors**

The purchase of the CFD Bonds, like most investments, involves risks to the investors. Land based securities, such as the CFD Bonds, are not usually rated by the credit rating agencies, and are generally considered more risky. Thus, land based securities typically command a higher rate of interest than bonds that are obligations of a governmental entity, such as the City. Events could occur that adversely affect the ability or willingness of property owners to pay special taxes. As such, land based securities are not suitable investments for many investors and are typically purchased by sophisticated investors. Following is a discussion of some of the risk factors inherent to land based securities, including the CFD Bonds:

- a. Land Values - The value of the property within the District is a critical factor in determining the investment quality of the bonds. If a property owner is delinquent in the payment of Special Taxes, the District's only remedy is to commence foreclosure proceedings against the delinquent parcel in an attempt to obtain funds to pay the Special Taxes. Reductions in property values due to a downturn in the economy, physical events such as earthquakes, fires or floods, stricter land use regulations, delays in development or other events would adversely impact the security underlying the Special Taxes.
- b. Insufficiency of Special Taxes Due to Ownership by Non-Taxable Entities - If for any reason property within the District becomes exempt from taxation by reason of ownership by a non-taxable entity such as the federal government, Special Taxes may be insufficient to pay all principal and interest due on the CFD Bonds and could result in a default with respect to the payment of such principal and interest. Even if it is determined that a non-taxable entity is legally responsible for the payment of Special Taxes, it could prove difficult to recover delinquencies, if any, from such entities.

c. Hazardous Substances - The presence of hazardous substances on a parcel may result in a reduction in the value of a parcel. In general, the owners and operators of a parcel may be required by law to remedy conditions of the parcel relating to releases or threatened releases of hazardous substances. The effect, should any of the taxed parcels be affected by a hazardous substance, is to reduce the marketability and value of the parcel by the costs of remedying the condition, and this could reduce the willingness of the property owner to pay Special Taxes, or, if any foreclosure proceedings were commenced, could result in insufficient proceeds to provide for recovery of delinquent Special Taxes.

d. Natural Disasters – A natural disaster such as an earthquake, fire, or flood could result in the destruction of, or damage to, taxable property in the District which could result in a substantial reduction in property values in the District and insufficient Special Taxes to repay the CFD Bonds.

In addition to the above risk factors, which are typical for most land based securities, a unique risk factor related to the CFD Bonds pertains to the San Diego County Regional Airport Authority (the “Authority”). Specifically, the redevelopment planning, permitting, and entitlement process for the Redevelopment Project has proceeded pursuant to various federal and state statutes regarding military base closure and reuse. Part of that planning process included the adoption by the City Council of the Precise Plan in September of 2001. During the planning process, City staff worked closely with the staff of the San Diego Unified Port District (the “Port”), which was the operator of Lindbergh Field Airport at that time, and the staff of the San Diego Association of Governments (“SANDAG”), which was the Lindbergh Field Airport Land Use Commission (the “ALUC”) at that time.

In 2002, the Authority was created by the State Legislature as a new agency to serve as both the Lindbergh Field airport operator and the ALUC. In January of 2004, General Counsel for the Authority submitted letters to the City which asserted that the Authority has jurisdiction to review proposed projects for consistency with the Lindbergh Field Comprehensive Land Use Plan (the “CLUP”). In the letters, the Authority claimed that the Precise Plan was not submitted to SANDAG for a consistency determination with the CLUP. The City, however, believes that the Precise Plan was properly submitted to SANDAG as the ALUC. Based upon the foregoing, the City Attorney’s Office is of the opinion that the Precise Plan was deemed consistent with the CLUP by operation of law, pursuant to the Public Utilities Code, and therefore, the Authority does not have any jurisdiction to review development of the property within the District for consistency with the CLUP. The City Attorney’s Office also believes there are other legal arguments to support the City’s position that the Authority does not have jurisdiction to review proposed projects within the District, however, no prediction can be made as to the outcome of litigation on this issue, if any were to arise. The development has continued without any consistency review or any further assertion of jurisdiction by the Authority with respect to the Redevelopment Project, although no assurance can be given that the Authority would not assert jurisdiction in the future.

While risks do exist with respect to the CFD Bonds, as they do with most investments, City staff has attempted to structure the financing in a manner that strengthens the credit quality of the CFD Bonds. Specifically, the City has required a minimum of 4 to 1 value-to-lien ratio which is higher than the minimum ratio (3 to 1) required by the Mello-Roos Act and the Council Policy for the District as a whole. Notably, it is currently estimated, based on research performed by David Taussig & Associates, Inc., Special Tax Consultant to the District, that the overall assessed value to lien ratio for developed property within the District is 7.37 to 1. The value-to-lien ratio represents the value of the property upon which Special Taxes are levied within the District as compared to the amount of bonds outstanding supported by the Special Taxes, and any other special taxes or assessments levied upon such property. Requiring a higher value-to-lien ratio reduces the risk that a property owner would become unwilling to pay the Special Taxes when due, and increases the likelihood that, if foreclosure proceedings became necessary due to a delinquency in the payment of Special Taxes, the proceedings would result in sufficient proceeds to recover the delinquent taxes. In addition, the first series of bonds has been sized based upon property that has already been developed, or is very near completion. This reduces the bondholder risk relating to the development of property in the District not occurring as planned, which could impact the value of such property.

Although the value-to-lien ratio of the District as a whole is 7.37 to 1, the value-to-lien ratio of certain lots upon which Special Taxes are expected to be levied are below 3 to 1 based on Fiscal Year 2005 assessed values, which reflect property values as of January 1, 2004. These lots are currently under construction, and McMillin anticipates completion of improvements on such lots by September of 2005; when the County Assessor reflects the full improvement values of the lots it is expected that the value-to-lien ratios on these parcels will exceed 3 to 1. The Council Policy provides that where the ratio of a lot or lots is less than 3 to 1, credit enhancements must be provided to the satisfaction of the City. The resolution for this item provides that the CFD Bonds would be issued only if one of the Authorized Officers, as defined in the resolution, certifies in writing that the requirements of the Council Policy regarding value-to-lien ratios have been satisfied for those parcels upon which special taxes are expected to be levied to repay the bonds. In the event that the value-to-lien ratio for any of the parcels described above is still less than 3 to 1 at the time of the issuance of the CFD Bonds, McMillin would provide a letter of credit (LOC) in accordance with the terms of the First Implementation Agreement to the DDA to provide the credit enhancement required by the Council Policy, and such LOC would specify that the LOC would remain in effect until the value-to-lien ratio for such lot or lots is at least 3 to 1, or until the provisions of the First Implementation Agreement have been satisfied, whichever occurs later.

## **VII. SCHEDULE**

If the City Council approves the issuance of the CFD Bonds, it is anticipated that the CFD Bonds would be sold in June of 2005. The bond closing (receipt of bond proceeds) would occur in July of 2005.

## CONCLUSION

It is recommended that the City Council adopt the proposed resolution to authorize the issuance of the CFD Bonds, to approve the related financing documents, and to authorize the performance of any other actions of the City Manager, the Deputy City Manager, the City Treasurer, and their designees that may be necessary to issue the CFD Bonds.

As described above, it is estimated, based on current and forecasted market conditions, that moving forward now with a Private Placement transaction with respect to the CFD Bonds could result in a lower interest rate than waiting to execute a public offering. In addition, it is understood that there is strong community support that construction of the park improvement be commenced and completed as soon as possible. To this end, it is anticipated that a companion item to the proposed CFD Bonds will be docketed for City Council consideration which would outline McMillin's commitment to expedite the park schedule set forth in the DDA if the CFD Bonds can be sold in the near term. Also, after execution of the Private Placement, limited existing staff resources could be reallocated to other pending financings and refundings that are important to the City.

## ALTERNATIVE

Do not approve the resolution to initiate the sale and delivery of CFD Bonds. Based on current and forecasted market conditions, delaying the issuance of the CFD Bonds could result in a more costly financing. Also, McMillin has indicated that if the CFD Bonds are not issued in the near term, it could not accelerate the time-frame set forth in the DDA for completion of the first park phase. Further, the ability to reallocate limited existing staff resources to other significant City financings that are currently on hold due to the delay in the CAFRs would be curtailed.

Respectfully submitted,

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CHARLES E. MUELLER, JR.  
Acting City Treasurer

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Approved: LISA IRVINE  
Deputy City Manager

MUELLER/ELK