THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: March 29, 2006 REPORT NO. 06-033

ATTENTION: Council President and City Council
Docket of April 4, 2006

SUBJECT: Tobacco Settlement Revenue Securitization

REFERENCE Memorandum to the Budget and Finance Committee, Tobacco Settlement Revenues - TSR Securitization Financing Plan, dated March 17, 2006
Report to the City Council, Report No. 06-012, dated February 1, 2006
Independent Budget Analyst Report, Report No. 06-3, dated February 1, 2006
City Manager's Report No. 05-190, dated September 8, 2005

<u>REQUESTED ACTION(s):</u>

(1) Should the City Council approve the financing plan as outlined in this report to leverage approximately $10.1 million in annual employee retirement pick-up savings by depositing the City's anticipated tobacco settlement revenues for CY 2006 into the San Diego City Employees' Retirement System (the "Pension System") and securitizing an equivalent amount of the City's tobacco settlement revenues, starting with the anticipated receipts for CY 2007, to generate up to $100 million for the Pension System?

(2) Should the City Council adopt a resolution to establish a nonprofit public benefit corporation (described as a Special Purpose Entity in previous reports), the City of San Diego Tobacco Settlement Revenue Funding Corporation (the "Corporation"), with a governing body (the "Board of Directors") consisting of the City's Chief Financial Officer, the City's Chief Operating Officer, and an independent director (Merlyn Brown), and approving certain actions in connection therewith in order to facilitate the securitization transaction?

(3) Should the City Council approve an ordinance (a) approving the form and authorizing the execution and delivery of the Sale Agreement between The City of San Diego (the "City") and the Corporation; (b) approving and acknowledging the form of the Declaration and Agreement of Trust between the Corporation and a Delaware Trustee to be named therein; (c) approving and acknowledging the form of the Indenture between the Corporation and an Indenture Trustee to be named therein; (d) approving and acknowledging the form of the Bond Purchase Contract between the Corporation and

Citigroup Global Markets Inc.; (e) approving and acknowledging the form of the Continuing Disclosure Undertaking of the Corporation; (f) approving and acknowledging the form of the Preliminary Offering Circular; (g) approving a Final Offering Circular; and (h) authorizing, acknowledging and approving certain other documents and actions as may be necessary to complete the securitization transaction?

STAFF RECOMMENDATION:

(1) Approve the financing plan as outlined in this report to leverage approximately $10.1 million in annual employee retirement pick-up savings by depositing the City's anticipated tobacco settlement revenues for CY 2006 into the Pension System and securitizing an equivalent amount of the City's tobacco settlement revenues, starting with the anticipated receipts for CY 2007, to generate up to $100 million for the Pension System.

(2) Adopt a resolution to establish a nonprofit public benefit corporation (described as a Special Purpose Entity in previous reports), the City of San Diego Tobacco Settlement Revenue Funding Corporation (the "Corporation"), with a governing body (the "Board of Directors") consisting of the City's Chief Financial Officer, the City's Chief Operating Officer, and an independent director (Merilyn Brown), and approving certain actions in connection therewith in order to facilitate the securitization transaction.

(3) Approve an ordinance (a) approving the form and authorizing the execution and delivery of the Sale Agreement between The City of San Diego (the "City") and the Corporation; (b) approving and acknowledging the form of the Declaration and Agreement of Trust between the Corporation and a Delaware Trustee to be named therein; (c) approving and acknowledging the form of the Indenture between the Corporation and an Indenture Trustee to be named therein; (d) approving and acknowledging the form of the Bond Purchase Contract between the Corporation and Citigroup Global Markets Inc.; (e) approving and acknowledging the form of the Continuing Disclosure Undertaking of the Corporation; (f) approving and acknowledging the form of the Preliminary Offering Circular; (g) approving a Final Offering Circular; and (h) authorizing, acknowledging and approving certain other documents and actions as may be necessary to complete the securitization transaction.

SUMMARY:

BACKGROUND

On September 12, 2005, Report No. 05-190 (CMR 05-190), titled: "*Options to Increase the Funded Ratio of the San Diego City Employees' Retirement System"* was presented to the Mayor Pro Tem and City Council. This analysis, developed by a working group comprised of representatives from Financial Management, City Treasurer, City Auditor and Comptroller, Risk Management, Real Estate Assets, and Human Resources departments, described results of the research performed by the working group, discussed several funding scenarios, and presented proposed funding options to increase the funded ratio of the "Pension System over a three (3) year phased period. The potential funding strategies included revenue securitization (proposed target amount of $100 million) utilizing the employee pick-up savings/labor concessions (estimated at $17.5 million for FY06), sale of City property, pension obligation bonds, re-engineering city services, analysis of a pension tax, and possible transferring of the City's

Retirement and Disability program administration to the California Public Employees' Retirement System.

On February 6, 2006, the City Council provided conceptual approval for the proposed transaction described within the Report to the City Council No. 06-012 titled: *"Pension Solutions"* and approved Council Resolution No. 30122, authorizing the Mayor to proceed with the implementation of the financing. This proposal focused on a revenue securitization transaction as the first step to increasing the funding ratio of the Pension System and presented the option to leverage approximately $10.3 million in annual employee pick up savings by using an equivalent amount of the City's tobacco settlement revenues (TSRs) starting with CY 2006 TSR receipts to generate up to $100 million for the Pension System. The conceptual plan included the creation of a nonprofit public benefit corporation to establish a "true sale" of the TSRs and effectuate the transaction. City Staff advised the City Council that a financing plan and the required legal documents to establish the nonprofit public benefit corporation and execute the securitization transaction will be brought before the City Council for the required approvals.

On March 17, 2006, a Memorandum to the Budget and Finance Committee providing the TSR securitization financing plan was forwarded to the Budget and Finance Committee members in anticipation of the discussion of this topic at the scheduled March 29, 2006, Budget and Finance Committee meeting. The memorandum illustrated the importance of leveraging the employee offset savings with respect to the negotiated labor agreements, most specifically the International Association of Fire Fighters Local 145 (in effect through June 30, 2006).

DISCUSSION

In attempting to identify the potential first step to infuse funding into the Pension System, above and beyond the required annual contribution, the following criteria were observed: adhering to the stipulations within certain negotiated FY 2006 labor contracts as to leveraging the achieved employee offset savings before the end of the FY 2006, the City's inability to access more traditional debt instruments, and the potential economic benefit to the City from transferring additional funds into the Pension System.

Employee Offset Savings

A three year labor agreement was reached with the Municipal Employees Association (MEA) and the American Federation of State, County and Municipal Employees Local 127 (Local 127) for Fiscal Years 2006-2008, a one year labor contract was agreed upon with the International Association of Fire Fighters Local 145 (Local 145) and the Deputy City Attorney Association (DCAA), and the terms unilaterally imposed by the City on the San Diego Police Officers Association (POA) for FY 2006. The labor agreements and the imposed terms on POA resulted in the reduction of City "pick-up" of the employee pension contribution and a negotiated salary reduction for Local 127. The reductions and pension contributions provided by the employees are projected to provide the City with expenditure savings of approximately $17.5 million (General Fund and Non-General Fund) in FY 2006.

It is critical to leverage the employee offset savings within the terms of the respective contracts (3 years and 1 year respectively). Terms within the agreement with Local 145 (1 year contract) indicates that if the employee offset savings are not leveraged within the contract term, end of FY 2006, the funds must be deposited into the Employee Contribution Rate Reserve and be used to defray the pension contribution obligation of the bargaining unit. The inability to fulfill the agreement with Local 145 will require the re-opening of the contract negotiations for MEA and Local 127 even though these two groups are under 3 year agreements due to the language in the agreements requiring that if any other labor group had a lesser concession (which would be the case if the funds from the Local 145 agreement were returned), it would trigger the re-opening of their contracts.

TSRs

The Master Settlement Agreement ("MSA"), entered into in November 1998, resolved certain cigarette smoking-related litigation between what were then the four largest United States tobacco manufacturers, 46 states and six other U.S. territories (collectively the "Settling States"). In exchange for a release from past, present and future smoking-related claims, the cigarette manufacturers agreed to make payments to the Settling States. For additional background and potential risks related to the future receipts of TSRs, refer to the Report to Council No. 06-012.

City TSRs – Allocations

It is estimated that the City will receive approximately $10.3 million in April 2006, its annual share of the MSA settlement. See the Budget and Finance Committee memorandum for the meeting of March 29, 2006 for historical and future TSR projections. As previously noted, the loss of TSRs due to the securitization will be substituted dollar for dollar by the employee offset savings or salary reductions achieved during the most recent labor negotiations. The budgetary appropriations are anticipated to be discussed in April/May of this year, with the budget to be presented to the City Council for approval in May/June.

The securitizing of the TSRs is a separate decision from the discussion and decisions that have to occur in conjunction with future budgets regarding the recommended uses and appropriation of the backfilled revenues (which are dollar for dollar replacement of TSRs used for securitization). The decisions, either to fund the programs that were historically receiving those funds or to fund alternative programs that more closely meet the City Council's current priorities, should be fully separated from the present decision to authorize the securitization of TSRs and accepting the proposed financing plan.

CY 2006 TSR Payment

The current projection for CY 2006 TSR payment is approximately $10.3 million. However, it is possible that this amount could be reduced by approximately 18%, or roughly $1.8 million to approximately $8.5 million, if an "NPM Adjustment" is made to the April 2006 payment due from the three largest cigarette manufacturers. These manufacturers have indicated that they are seeking such an adjustment due to market share loss for calendar year 2003 allegedly attributed to cigarette manufacturers not participating in the MSA ("Nonparticipating Manufacturers" or "NPMs"). To trigger the NPM Adjustment, however, an independent economic consultant must make a determination that the provisions of the MSA were a significant factor contributing to the market share loss and, in the case of the City, it must be proven that the State of California has not diligently enforced its Model Statute. On or about March 2, 2006 the Brattle Group (the independent consultant selected to make the determination) announced their preliminary decision that the provisions of the MSA were a significant factor contributing to the market share loss for 2003. The parties to the proceeding have a right to submit additional information and arguments to the Brattle Group before it reaches its final decision, which is expected before the April 2006 payment is due. The Settling States, including California, have reserved the right to commence an enforcement action for compliance with the MSA and send notice of the intent to commence such action to the Original Participating Manufacturers or "OPMs". At this point in time, it is uncertain whether the Brattle Group's final decision will be unchanged from their preliminary determination, and if an NPM Adjustment is made, whether MSA payment amounts will be withheld from the amounts due to California. It is also uncertain whether the participating manufacturers will seek or be entitled to additional NPM adjustments that could affect the City's TSRs in future years.

TSR Securitization Financing Plan

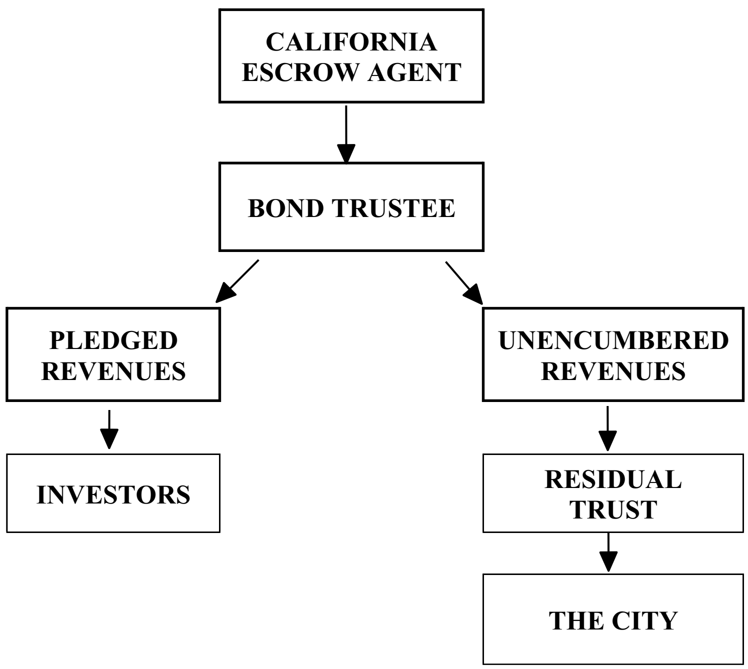
The City will securitize a pledge of a fixed amount of up to $10.1 million (equal to the City's CY 2005 TSR receipts) in annual future TSR receipts and use the upfront proceeds (after paying the financing costs and funding a debt service reserve fund) in conjunction with a contribution of TSRs received in CY 2006 to reduce the City's outstanding pension fund liability. The City will sell the right to receive the TSRs to the Corporation in exchange for an upfront payment. The Corporation will issue bonds to generate the upfront payment to the City, dedicating the pledged TSRs to the corresponding debt service for these bonds. The Corporation will receive the gross proceeds from the investors from the sale of the bonds and will forward the net proceeds (after paying for the upfront financing costs, finding a debt service reserve fund and capitalizing the first interest payment) to the City to complete the transaction.

Concurrently with the securitization, as mentioned above, the City will also transfer the TSRs received in CY 2006 to the Pension System to ensure that the total contribution to the Pension System from the current and future TSRs will be $100 million. It is expected that the April 2006 payment will be approximately $10.3 million and therefore the bond issue will be targeted to produce approximately $90 million in net proceeds for transfer to the pension system. This transfer of $100 million is above and beyond the City's annual Employer Contribution requirement (Annual Required Contribution) for FY 2007. In the event that the City's April 2006 TSRs are lower than the projected $10.3 million, then the amount of bonds to be issued under the financing plan will be increased proportionately so that the total contribution to the Pension System is $100 million. For securitization sizing purposes, the cash contribution portion toward the pension funding from CY 2006 TSR payment was assumed to be $8.5 million (figure conservatively assumes possible projected NPM adjustment).

The securitization transaction will be structured to ensure that the sale of the TSRs to the nonprofit public benefit corporation is a "true sale". This structure will insulate the pledged TSRs from the City's estate in the event of a City bankruptcy and alleviate the City from the risk that the stream of tobacco revenues secured by the bonds is not sufficient to generate enough monies to pay debt service with respect to the bonds when due.

In order to effectuate a "true sale", the City, per the Sale Agreement (between the City and the Corporation), will sell 100% of the TSRs starting with CY 2007 to the Corporation with the binding agreement that any TSR amount received in excess of the pledged $10.1 million will be returned to the City, as an annual residual, soon after the annual TSR payments are made by the State each April. These residual funds would be available for budget allocation in the next succeeding fiscal year beginning each July 1. The transaction, as originally described in the Report to Council No. 06-12, anticipated using the CY 2006 TSRs to fund all or a portion of the debt service reserve fund (the "DSRF"). However, after further legal review by Bond Counsel, it was determined that a "true sale" would be better established if the CY 2006 TSRs were deposited directly to the Pension System, rather than applying the funds to the DSRF. The DSRF will now be funded with bond proceeds.

As noted above, the City will be selling 100% of its future TSRs to the corporation. The Trustee for the bonds will be required to allocate all TSRs it receives from the California Escrow Agent to one of two sub-accounts: Pledged Revenues and Unencumbered Revenues. The first TSRs received each year up to $10.1 million will be deposited into the Pledged Revenue sub-account. All TSRs in excess of the $10.1 million going to the Pledged Revenues sub-account will be deposited in the Unencumbered Revenues sub-account and immediately sent to a residual trust, of which the City is the beneficial owner. The residual trust will then immediately forward the Unencumbered Revenues to the City. The Unencumbered Revenues will not be available to the bondholders and they are expected to be forwarded to the City within a business day or two of the Trustee's receipt of the annual TSRs.



Due to the proposed use of the proceeds to fund the Pension System, taxable bonds will be issued and, based on market conditions as of the week of March 6, 2006, a total bond size of approximately $107.8 million is anticipated to produce net proceeds of $91.5 million. The proposed bonds are expected to have a final maturity of CY 2024 (19 years). Although the financing plan estimates a final maturity of the tobacco bonds, the revenue will be pledged until the bonds are fully paid. Unanticipated actions delaying or suspending the MSA payments may cause the anticipated final maturity of the bonds to be extended.

The following tables illustrates the proposed $10.1 million in TSRs pledged annually to generate an anticipated $91.5 million in net proceeds with the residual amounts of TSR receipts (Unencumbered Revenue) flowing to the City annually. This financing plan estimates a final bond maturity of CY 2027 based on an amortization needed to obtain investment grade ratings on the bonds. However, as shown in the table, this "rated" amortization shows debt service below the $10.1 million pledged to the bonds each year. The bonds will be structured and sold to investors with a "turbo" feature that will allow the Corporation to use the rated debt service coverage to accelerate payment of bond principal. Assuming the future MSA payments are as expected, the bonds would be repaid by CY 2024 ("expected" amortization). Any fluctuations in the projected TSRs (adverse or beneficial) would first affect the residual amount of TSRs expected to flow to the City as the residual amounts are subordinate to the annual pledged amount for the securitization. Based on market conditions as of the week of March 6, 2006, the cost of borrowing for this financing plan is estimated to be 6.87%.

SIZING SUMMARY (Estimated)

Issuance Date	June 2006
Par Amount	**$ 107.8 million**
Gross Proceeds	$ 107.8 million
Cost of Issuance*	$ 2.2 million
Debt Service Reserve	$ 10.1 million
Capitalize Interest	$ 3.8 million
Issuer Operating Expenses	$ 0.2 million
Net Proceeds to Fund the Pension System	**$ 91.5 million**
Structured Final Maturity	**CY 2027**
Planned Final Maturity	**CY 2024**

*Cost of Issuance includes underwriters' fees, legal fees, rating agencies fees, printing costs, and certain other expenses related to the issuance of the bonds.
Source: Citigroup Global Markets

TRANSFER TO PENSION SYSTEM

Proceeds from TSR securitization	$ 91.5 million
Cash contribution – CY 2006 TSRs(1)	$ 8.5 million
Total transfer to Pension System	$ 100.0 million

(1) See CY 2006 TSR payment discussion on page 5.

Actuarial Valuation
The summary findings of the actuarial valuation for the Fiscal Year ending June 30, 2005 were presented by the Pension System Actuary to the Retirement Board on March 17, 2006. Based on the summary valuation results for the fiscal year ending June 30, 2005, presented to the Pension System Board by the Pension System actuary on March 17, 2006, the funding ratio was 68.2% on an actuarial basis. Assuming a $100 million transfer to the Pension System from executing the proposed financing plan, the actuarial assets as of June 30, 2005, will be enhanced by $100 million to $3.083 billion from $2.983 billion resulting in the funding ratio change from 68.2% to 70.4%. Note that this calculation does not take into consideration any actuarial changes to the liability base or the actuarial experience for the period commencing July 1, 2005.

Benefits of the $100 Million Transfer to the Pension System

The current cost of amortizing the outstanding Unfunded Actuarial Accrued Liability (UAAL) is equal to the Pension System current assumed investment return rate at 8.00%. Based, on market conditions as of the week of March 6, 2006, the estimated cost of borrowing for this transaction is 6.87%. Below is a hypothetical comparison to illustrate the potential cash flow benefit from the proposed transaction based upon the expected debt service schedule presented in page 9.

Alternative 1 below assumes that the City pays for a $100 million unfunded liability, as of June 30, 2006, on a pay-as-you-go ("PAYGO") basis over several years. The annual payments are based on the Gleason Settlement methodology for FY 2008, and from FY 2009 through FY 2023, annual payments reflect a level percentage of payroll at 4.25% inflation and a 15-year fixed term. The annual remaining balance is subject to 8.00% interest. Under this hypothetical scenario, annual payments would start at approximately $6.2 million in FY 2008 and increase to approximately $16.5 million by FY 2023 (final year of payments). This alternative results in an average annual payment of approximately $12.2 million and total payments of $194.5 million.

In Alternative 2, the proposed tobacco securitization, the City would receive $100 million in FY 2006 to reduce the unfunded liability through the execution of the securitization. The $100 million transfer would be derived from the direct contribution of the CY 2006 TSRs ($8.5 million) and the estimated net tobacco bond proceeds of $91.5 million. The City pledge of $10.1 million annually until the tobacco bonds are completely paid off (expected to be CY 2024) would be comparable to the annual payment of Alternative 1. (In CY 2024, actual debt service is expected to be less than $10.1 because the debt service reserve fund originally funded with tobacco bond proceeds will be used to pay debt service in the final year, rather than settlement revenues.)

	Alternative 1	Alternative 2
	Hypothetical PAYGO	Proposed Tobacco Securitization
Amount of UAAL Financed	$100,000,000	$100,000,000
Assumed Interest Rate	8.00%	6.87%
Average Annual Payment Amount	$12,200,000	$ 10,000,000 (1)
Anticipated Final Payment	CY 2023	CY 2024
Total Payments	$194,500,000	$183,500,000
Difference	$11,000,000	

(1) Average annual payment slightly less than pledged $10.1million due to cash contribution (CY 2006 TSRs) only in FY06, no pledged revenue for FY 2006.

The potential cashflow benefit that can be derived from the tobacco bond financing in terms of reducing net UAAL payments is estimated to be approximately $11 million.

The following table illustrates the debt service for the TSR securitization on the "rated" and "expected" basis with the final maturity on an "expected" basis estimated to be realized in 19 years.

PROJECTED DEBT SERVICE SCHEDULE

Calendar Year	TSRs sold for Tobacco Bond	Rated Debt Service[1]	Expected Debt Service[2]
2006	$0[3]	$4,000,000	$4,000,000
2007	$10,100,000	$7,400,000	$10,400,000
2008	$10,100,000	$9,800,000	$10,400,000
2009	$10,100,000	$9,800,000	$10,400,000
2010	$10,100,000	$9,800,000	$10,400,000
2011	$10,100,000	$9,800,000	$10,400,000
2012	$10,100,000	$9,800,000	$10,400,000
2013	$10,100,000	$9,800,000	$10,400,000
2014	$10,100,000	$10,000,000	$10,400,000
2015	$10,100,000	$10,000,000	$10,300,000
2016	$10,100,000	$10,000,000	$10,300,000
2017	$10,100,000	$9,900,000	$10,300,000
2018	$10,100,000	$10,000,000	$10,300,000
2019	$10,100,000	$10,000,000	$10,300,000
2020	$10,100,000	$10,000,000	$10,300,000
2021	$10,100,000	$10,100,000	$10,300,000
2022	$10,100,000	$10,100,000	$10,300,000
2023	$10,100,000	$10,100,000	$10,200,000
2024	$10,100,000	$10,100,000	$13,400,000
2025	$10,100,000	$10,100,000	$0
2026	$10,100,000	$10,100,000	$0
2027	$10,100,000	$9,900,000	$0

(1) Financing plan estimates a final bond maturity of CY 2027 taking into account the coverage requirement to obtain credit ratings on the securitization. Debt service reflects lower figure than the TSRs sold.
(2) Turbo Redemption includes amount of TSRs sold for Tobacco bond plus Capitalized Interest Account withdrawals plus earnings on TSRs and Debt Service Reserve less any Operating Expenses of the SPE plus release of Debt Service Reserve in 2024.
(3) Cash Contribution of CY 2006 TSR Receipts to Pension System

PROJECTED ANNUAL RESIDUAL AMOUNTS TO CITY

Calendar Year	Total Projected City TSRs*	TSRs pledged for Tobacco Bond	Projected Annual Unencumbered Amounts to City
2006	$10,391,000	$10,100,000	$291,000
2007	$10,385,000	$10,100,000	$285,000
2008**	$11,242,000	$10,100,000	$1,142,000

2009	$11,387,000	$10,100,000	$1,287,000
2010	$11,520,000	$10,100,000	$1,420,000
2011	$11,660,000	$10,100,000	$1,560,000
2012	$11,797,000	$10,100,000	$1,697,000
2013	$11,933,000	$10,100,000	$1,833,000
2014	$12,064,000	$10,100,000	$1,964,000
2015	$12,192,000	$10,100,000	$2,092,000
2016	$12,344,000	$10,100,000	$2,244,000
2017	$12,496,000	$10,100,000	$2,396,000
2018	$13,497,000	$10,100,000	$3,397,000
2019	$13,653,000	$10,100,000	$3,553,000
2020	$13,805,000	$10,100,000	$3,705,000
2021	$13,973,000	$10,100,000	$3,873,000
2022	$14,140,000	$10,100,000	$4,040,000
2023	$14,314,000	$10,100,000	$4,214,000
2024	$14,488,000	$0***	$14,488,000
2025	$14,678,000	$0	$14,678,000
2026	$14,871,000	$0	$14,871,000
2027	$15,068,000	$0	$15,068,000

*Source: Public Resources Advisory Group. Projections reflect inflation adjustment, per the MSA, and projected decline in tobacco consumption as described in the Global Insight report. Global Insight, an econometric and consulting firm, developed a cigarette consumption econometric model that considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. The complete Global Insight report is attached to the Preliminary Offering Circular as Attachment A.

** Beginning of Strategic payments, CY 2008 – CY 2017.
*** Final year debt service to be funded with debt service reserve fund. No TSR pledge required for the final year debt service.

Financing Documents
In order to conduct the TSR securitization, the documents that the City Council is requested to approve through the requested actions today include the following as described below:

A. The **Resolution** of the City authorizes the formation of the City of San Diego Tobacco Settlement Revenue Funding Corporation (the "Corporation") and other related actions. The Corporation is a nonprofit public benefit corporation formed to purchase the City's tobacco settlement revenues and issue bonds to fund such purchase. The following documents relate to the establishment of the Corporation and the Corporation's approval of financing documents:

1) The Action by Incorporator authorizes Bond Counsel to take the necessary actions

to create the Corporation.

2) The Articles of Incorporation and the Bylaws establish, among other things, the name of the Corporation, its legal basis, its purpose and permitted activities, its directors and officers, and procedures concerning governance and operation.

3) The initial Corporation Resolution ratifies the Action by Incorporator, the Bylaws and the Seal of the Corporation, appoints the officers of the Corporation, and authorizes the acquisition of an IRS Employee Identification Number for the Corporation. Ms. Merlyn Brown was appointed by the Mayor to serve as the independent director of the Corporation.

4) The additional Corporation Resolution approves the financing documents and related actions. (See the description of the financing documents in B below.)

B. The **Ordinance** of the City approving the financing and other actions relates to the following documents:

1) The Indenture is an agreement between the Corporation and the Indenture Trustee that provides for the Corporation's issuance of its bonds, the assignment and pledge to the Indenture Trustee for the benefit and security of the bondholders the revenues and other assets available to pay debt service, and the parties' rights, responsibilities and obligations while the bonds are outstanding.

2) The Series 2006 Supplement is an additional agreement between the Corporation and the Indenture Trustee that addresses the specific details about the Series 2006 Bonds including, among other things, par amounts, coupons, maturity dates and redemption provisions.

3) The Sale Agreement between the City and the Corporation provides for the irrevocable "true sale" by the City of its tobacco settlement revenues to the Corporation for a purchase price of the net bond proceeds and a non-cash component consisting of the beneficial interest in the Residual Certificate (discussed below).

4) The Declaration and Agreement of Trust between the Corporation and another trustee (separate from the Indenture Trustee) provides for the creation of a Delaware statutory trust. The sole asset of the trust is the Residual Certificate which provides for the receipt of the Unencumbered Revenues and any excess Indenture Revenues (not needed for debt service) that are released from the Indenture. The agreement also provides for the City to be the owner of the trust and, as such, provides a mechanism for the Unencumbered Revenues to be returned to the City each year the bonds are outstanding and the excess Indenture Revenues to be returned to the City once the bonds are retired.

5) The Continuing Disclosure Undertaking defines what information related to the bonds and the Corporation will be submitted to a national information repository annually, pursuant to SEC regulation 15c2-12 requiring disclosure of financial

information, material information and certain material events, as defined in the regulation.

6) The Preliminary Offering Circular (POC) is a document furnished by the Issuer to potential investors. It discloses information which will be material to investors' decisions about whether or not to purchase the Corporation's bonds including, among other things, the structure of the bonds, the security and source of repayment of the bonds, and material risks to the bondholders. Included in the POC in the form of appendices are:

   (1) Appendix A - Global Insight Cigarettes Consumption Report
   (2) Appendix B – Master Settlement Agreement
   (3) Appendix C – MOU, ARIMOU, Consent Decree and California Escrow Agreement
   (4)Appendix D - Proposed Form of Opinion of Bond Counsel to the Corporation
   (5) Appendix E – Summary of Principal Legal Documents
   (6) Appendix F – Book-Entry Only System
   (7) Appendix G – Form of Defeasance Turbo Schedules
   (8) Appendix H – Index of Defined Terms

7) The Contract of Purchase between the Corporation and the underwriters sets forth the final terms, price and conditions upon which the underwriters will purchase the Corporation's Series 2006 Bonds.

Attachment A is a diagram illustrating the flow of funds, securitization structure, and the relationship between the established agreements presented in the financing documents.

ALTERNATIVES

The City Council could decide not to approve the TSR securitization financing plan as presented in this report. However, inability to leverage the employee offset savings within certain contract periods will also result in the re-opening of negotiations for all of the labor agreements.

It is critical to leverage the employee offset savings within the terms of the respective contracts, specifically the agreement with Local 145 by June 30, 2006, otherwise the funds must be deposited into the Employee Contribution Rate Reserve and be used to defray the pension contribution obligation of the bargaining units. The inability to fulfill the agreement with Local 145 would allow for the re-opening of the contracts negotiations for MEA and Local 127 (even though these are currently 3 year agreements) as these current agreements have language such that if any other union had a lesser concession (which would be the case if the funds from the Local 145 agreement were returned), this would trigger the re-opening of their contracts.

FISCAL CONSIDERATIONS:

Any loss of the Tobacco Settlement Revenues (TSRs) to the General Fund from securitizing the revenue stream will be substituted by an equal amount of the annual employee offset savings achieved during the most recent labor negotiations. To eliminate adverse financial impacts on the General Fund from pledging up to $10.1 million in TSRs, for the duration of the securitization term, it is expected and required that the pledged TSRs will be fully substituted by the employee offset savings achieved from the existing labor contracts and all future labor contracts. Lack of employee offset savings to backfill the TSR pledge in any year over the life of the financing will adversely affect General Fund ability to fund the programs listed above or meet other General Fund priorities.

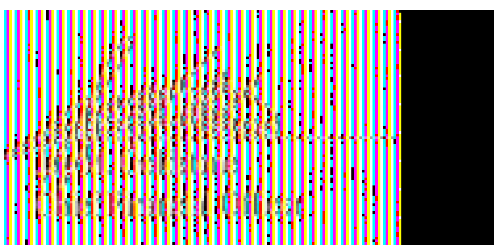
PREVIOUS COUNCIL and/or COMMITTEE ACTION:
On September 12, 2005, the City Manager presented City Manager Report No. 05-190 (CMR 05-190), entitled, “Options to Increase the Funded Ratio of the San Diego City Employees’ Retirement System” to the City Council. The City Council directed the City Manager to proceed with the evaluation of pension solutions, including such solutions to leverage approximately $17 million of estimated employee savings derived from FY 2005 labor negotiations.

On February 6, 2006, the Chief Financial Officer presented Report to the City Council No. 06-012, entitled “Pension Solutions” to the City Council. The City Council authorized and directed to proceed with the proposed securitization transaction and the preparation of financing documents necessary to execute a tobacco securitization in FY 2006, including the formation of a special purpose entity.

On March 29, 2006 the securitization financing plan was presented to the Budget and Finance Committee.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS;
None

KEYSTAKEHOLDERS & PROJECTED IMPACTS (if applicable):
No anticipated affected programs.



Attachment

1. Securitization Structure