



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: April 16, 2008 REPORT NO. 08-058

ATTENTION: Council President and City Council
 Agenda of April 21, 2008
SUBJECT: Community Facilities District No. 4 (Black Mountain Ranch Villages)
 Special Tax Bonds Series A of 2008

REFERENCE: None

REQUESTED ACTIONS:

Authorize the issuance of Community Facilities District (“CFD”) No. 4 Special Tax Bonds Series A of 2008 (the “2008 A Bonds”) in a principal amount not to exceed \$13.0 million and the related financing documents to provide CFD funding for eligible district improvements, primarily street improvements and underground utility improvements contained in the Black Mountain Ranch Public Facilities Financing Plan (the “PFFP”), as approved by the City Council. The related financing documents include a Bond Indenture, a Bond Purchase Agreement, a Preliminary Official Statement, and a Continuing Disclosure Certificate.

REQUESTED ACTIONS – Approve the requested actions.

SUMMARY:

I. BACKGROUND:

The Mello-Roos Community Facilities Act of 1982 (the “Mello-Roos Act”) was enacted by the State to help growing areas finance essential public facilities that typically accompany major development projects. The Mello-Roos Act specifically provides for the establishment of a CFD for the purpose of financing certain public improvements and/or services. The City’s Council Policy 800-03, which was in effect at the time Community Facilities District No. 4 (Black Mountain Ranch Villages) (the “District”) was formed in November 2000,¹ allows for utilization of CFDs to finance public facilities required in connection with development.

¹ On November 6, 2007, the City Council passed a resolution to repeal Council Policy 800-03 and to approve a new Special Districts Formation and Financing Policy, which is included within the City’s Debt Policy. The resolution stated that the new Special Districts Formation and Financing Policy would apply only to CFDs and Assessment District formed after the effective date of the resolution. Therefore, in connection with the issuance of the proposed 2008 CFD Bonds, Council Policy 800-03 is still considered operative.

In accordance with the Mello-Roos Act and the Council Policy, and following public hearings and a special election conducted pursuant to the Mello-Roos Act, the City Council adopted the necessary resolutions and ordinance to form the District in 2000. In addition, the City Council authorized the levy of special taxes (“Special Taxes”) on taxable property within the District and the issuance of bonds in an amount not to exceed \$25.0 million, which provides for the acquisition of eligible facilities, the required debt service reserve fund (“DSRF”), and costs of formation and issuance.

In 2002, the City Council adopted resolutions and an ordinance to modify the Rate and Method of Apportionment of Special Taxes (“RMA”) for CFD No. 4 and to increase the bond authorization to an amount not to exceed \$30.0 million. The change to the RMA had the effect of reducing the anticipated overall tax rate to 1.85% and more equitably distributing the tax burden to the various classes of taxable property. The increase to the bond authorization was done to mitigate significant increases in the estimated cost of the facilities subsequent to formation of the district. The resolutions and ordinance were approved following the filing of a written petition, in accordance with the Act, by an owner of more than 25% of the property within the District requesting the modifications, and following a public hearing and special election.

The District was established to assist in the financing of certain public facilities (the “Public Facilities”) required in connection with development of the Black Mountain Ranch area. The geographic boundaries of the District and the public facilities proposed to be financed are primarily within the Black Mountain Ranch Community Planning Area. Provision of major public facilities within this area is generally governed by the PFFP, which provides that public facilities projects that benefit a population larger than the local/adjacent development can be financed by a number of methods, such as Development Impact Fees, Facilities Benefit Assessments, Assessment Districts, and Community Facilities Districts.

The Public Facilities that are eligible 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 Black Mountain Ranch LLC (the “Developer”). The Acquisition Agreement was approved by the City Council in connection with the District formation proceedings in 2000. The facilities included in the agreement and eligible for funding consist primarily of:

- a. Extension and widening of Camino Del Sur (formerly Camino Ruiz), between Camino Del Norte and SR-56, including two wildlife crossings, and associated underground utilities & improvements
- b. Extension and widening of Carmel Valley Road, between Black Mountain Road and Del Mar Heights Road and associated underground utilities & improvements
- c. Sewer Lift Station No. 1, gravity sewer lines, and force mains

It is anticipated that approximately \$10.5 million, representing only a portion of the facilities costs in item “a.” above, will be paid from the proceeds of the 2008 A Bonds.

The Special Taxes are levied in accordance with the RMA approved in connection with the District formation proceedings. The Special Tax receipts may be used to pay debt service on the 2008 A Bonds, and/or to directly fund the Public Facilities. As of March 18, 2008, \$2.2 million of Special

Tax receipts have been used as partial payment for certain facilities included in item “a.” above. The par amount of the 2008 A Bonds is anticipated to be \$12.2 million, which is expected to provide \$10.5 million in net acquisition proceeds, which will be used to make additional payments on these facilities.

II. DISCUSSION

A. Method of Sale - Negotiated Public Offering

The proposed 2008 A Bonds would be issued as a public offering. Due to the nature of the security for land secured bonds, such as the 2008 A Bonds, and because such bonds are typically non-rated, most land secured bond sales in the State of California utilize a negotiated sale method. CFD bonds are typically non-rated because they are usually not considered investment grade (BBB- or above) due to the fact that the bonds are secured solely by the Special Tax revenues (versus a General Fund pledge of a municipality), and are often issued while development is still occurring.

With a negotiated sale, the underwriter is selected early in the financing process and the terms and price of the bonds are negotiated with the issuer. As a member of the Financing Team, the Underwriter assists with structuring the financing, participates in the review of financing documents and the development of the disclosure documents (the preliminary official statement [“POS”] and the official statement [“OS”]). Also, with input from the City and its Financial Advisor, the Underwriter identifies appropriate investors, pre-markets the bonds, and schedules and conducts the bond sale.

Due to the factors described above (i.e., the nature of the security for the bonds, and the non-rated status of the bonds), the proposed financing was developed using a negotiated sale method. The negotiated sale method would give the Underwriter adequate time to pre-market the 2008 A Bonds to appropriate investors, which should result in lower interest rates than if the bonds were sold on a competitive basis. Land secured bonds are not appropriate investments for all investors. The Underwriter has advised that it has controls in place to ensure that the 2008 A Bonds are purchased by appropriate investors who understand the special risks of land secured bonds such as the 2008 A Bonds, and that it will comply with all suitability requirements of the SEC and Municipal Securities Rulemaking Board.

B. Issuance Size

In 2002, City Council approved a \$30 million maximum overall bond authorization for the District to provide for the acquisition of eligible facilities, the required debt service reserve fund, and costs of formation and issuance for one or more series of bonds. This proposed issuance is anticipated to total \$12.2 million, and would represent the first of two expected issuances, the second of which is anticipated to occur at some point in the future, when development of the overall project is further along.

The following table specifies the estimated sources and uses of proceeds of the 2008 A Bonds:

Sources and Uses of Bond Proceeds*

<u>Estimated Sources:</u>	
Par Amount of the 2008 Bonds:	\$ 12,255,000
 <u>Estimated Uses:</u>	
Public Facilities/Acquisition Fund	\$10,552,000
Deposit to Debt Service Reserve Fund	896,000
Costs of Issuance**	<u>807,000</u>
 TOTAL:	 \$12,255,000

* Preliminary; subject to change.

** Costs of Issuance include legal fees, financial advisor, mortgage study and other consultant fees, Underwriter's discount, staff costs, and other expenses related to the issuance of the bonds. Also includes costs incurred to form the District of approximately \$270,000, which were funded by the Developer, and which will be reimbursed from bond proceeds.

C. Acquisition Funds

The use of acquisition funds is guided by the Acquisition Agreement (such Acquisition Agreement was approved by City Council in 2000 as part of the District formation actions). To date, as referenced above, the City has acquired street improvements to Camino Del Sur between San Dieguito Road and Paseo Del Sur. Pursuant to the RMA that was approved in connection with the formation proceedings, the City has levied Special Taxes on developed property within the District beginning with Fiscal Year 2003/2004. Partial payment of \$2.2 million for the above referenced improvements was made to the Developer from Special Tax receipts, and the estimated \$10.5 million of acquisition funds from the 2008 A Bonds will be used to make additional payments on these improvements.

Operations and Maintenance Costs – Camino Del Sur

The General Services Department is issuing a separate Report to City Council outlining the estimated operations and maintenance costs associated with the street improvements to Camino Del Sur between San Dieguito Road and Paseo Del Sur.

D. Repayment of the Bonds – Special Taxes

Debt service on the 2008 A Bonds would be payable from Special Taxes levied on taxable property within the District over the term of the 2008 A Bonds, in accordance with the RMA approved by the City Council in 2002. The 2008 A Bonds are not general or special obligations of the City, and are not backed by the full faith, credit, nor the taxing power of the City. The 2008 A Bonds are special limited obligations of the District payable solely from Special Taxes collected from owners of taxable property within the District.

If there is a shortfall in the amount of Special Taxes available to make a debt service payment, monies would be withdrawn by the Trustee from the DSRF. The DSRF is established when the

bonds are issued, and will be sized in an amount equivalent to the maximum annual debt service on the 2008 A Bonds. In addition, the District has provided a covenant in the Indenture wherein it would diligently pursue foreclosure on property delinquent in the payment of Special Taxes if certain delinquency thresholds are reached.

E. Value to Lien Ratio

When forming the District, the City required a 4 to 1 value-to-lien ratio for property within the District subject to the Special Tax. This ratio is higher than the minimum ratio (3 to 1) required by the Mello-Roos Act and the Council Policy in effect at the time the District was formed. The value-to-lien ratio is an important factor in evaluating the credit-worthiness of a land secured transaction. It 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 on the property. Requiring a higher value-to-lien ratio reduces the risk that a property owner would become delinquent in payment of 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.

Council Policy No. 800-03 (in effect at the time the District was formed) requires that, where the value-to-lien ratio of a lot or lots is less than 3 to 1, credit enhancements must be provided to the satisfaction of the City. As referenced in the Financing Resolution, a waiver is proposed for one of two parcels within the district upon which special taxes are expected to be levied to repay the bonds and which currently has an assessed value-to-lien ratio of less than 3 to 1. Based on information obtained from the County Assessor's office, this is due to the fact that, effective in tax year 2005, the owner of this parcel received a reduced assessed valuation as a result of the transfer of the property's base year assessed value from the owner's previous residence, as permitted by Article XIII A of the California Constitution, which allows for such a transfer for any person over the age of 55 years. This property now has an assessed value substantially below its sales price. Because the assessed value is artificially low, the parcel has been deemed to provide sufficient security with respect to the payment of special taxes. As such, the Financing Resolution provides for a waiver of the applicable section of Council Policy No. 800-03, requiring additional credit enhancements.

Due to the fact that these bonds are being issued at a time when significant portions of the District have already been developed and sold to end users (e.g., residential homeowners), the estimated overall assessed value-to-lien ratio for the 2008 A Bonds, based on development status of March 1, 2008, is approximately 12 to 1.

F. Pricing of the 2008 A Bonds

Under current market conditions as of March 13, 2008, the estimated True Interest Cost ("TIC") and average coupon rate on the 2008 A Bonds are approximately 7.00% and 6.35%, respectively; the estimated average annual debt service payment would be approximately \$899,000. The maximum TIC established in the Financing Resolution is 7.60%. It is not currently expected that the actual pricing will result in a TIC of 7.60%, however, should that occur, the annual debt service payment would remain at approximately \$899,000, but the par amount of the 2008 A Bonds would be reduced to approximately \$11.6 million. This is due to the fact that the bond sizing is based on the debt service capacity of Special Taxes that will be generated from developed property only, as

defined in the RMA. In addition, the bond sizing is reflective of the industry standard of providing approximately 110% debt service coverage in terms of anticipated Special Tax revenues available to pay debt service. The TIC is a measure of the interest cost of an issue that accounts for the interest rates on the bonds, the time value of money, and the costs of issuance. It is distinguished from the coupon rate (the stated interest rate on a bond) that is paid to the bondholders. The term of the 2008 A Bonds is 30 years, with the final maturity in 2037.

Land based securities, such as the 2008 A Bonds, are usually not rated and are generally considered more risky than securities backed by a governmental entity such as the City. As a result, they command a higher rate of interest than rated bonds that are obligations of a governmental entity. The estimated pricing is based on market conditions for non-rated land secured financings in the State as of March 13, 2008. This particular bond market segment has experienced widening credit spreads relative to more highly rated municipal bonds as well as volatile investor demand in the second half of 2007 and into the first quarter of 2008, due to concerns about the real estate market and the sub-prime mortgage issue. Conditions that exist at the time of the bond sale may differ from current market conditions. The actual pricing will be determined at the time of the sale, and will be dependent upon market conditions that exist at that time.

G. The Financing Team

The Financing Team for the Bond issuance includes staff of the Department of Finance, including the Debt Management Department and the City Comptroller's Office, the City Attorney's Office, and outside consultants, including a financial advisor (Fieldman, Rolapp & Associates), a special tax consultant (David Taussig & Associates), bond and disclosure counsel (Stradling, Yocca, Carlson, & Rauth), the underwriter (UBS Securities LLC), and the underwriter's counsel (McFarlin and Anderson LLP).

The Underwriter was selected through a competitive process. A Request for Proposals ("RFP") was issued in March of 2005 to solicit proposals from underwriters for the negotiated sale of bonds issued by the District in one or more series. The outcome of this process was to select UBS Securities LLC based on the firm's qualifications.

Pursuant to Council Policy 900-09, UBS Securities LLC has submitted information relating to Community Reinvestment Activities ("CRA"). It is understood that UBS Securities is not a commercial bank and is not subject to the CRA provisions. However, UBS Securities has provided information on its community activities at the City's request. This information is provided under Attachment 1.

The Financial Advisor (Fieldman, Rolapp & Associates), Special Tax Consultant (David Taussig & Associates), and Bond and Disclosure Counsel (Stradling, Yocca, Carlson and Rauth) were also selected prior to the formation of the District in 2000. The City Council passed an Ordinance on September 4, 2007 authorizing contract amendments for these consultants to perform services related to the issuance of the 2008 A Bonds.

H. The Financing Documents

The financing documents that the City Council would approve through the proposed actions include the forms of Bond Indenture, a Bond Purchase Agreement, a Continuing Disclosure Certificate, and a POS.

- a. Financing Resolution – The Financing Resolution authorizes the issuance of the 2008 A Bonds (under certain financing parameters), provides for the approval of the financing documents (described below), and delegates to the Mayor and his designees authority to take actions to issue the 2008 A Bonds.
- b. The Bond Indenture – The Bond Indenture (“Indenture”) is an agreement between the District and the Trustee for the District, Wells Fargo Bank, N.A. that outlines the District’s and the Trustee’s responsibilities and obligations and the rights of the bondholders with respect to the 2008 A Bonds, and pledges Special Taxes levied within the District to repay the 2008 A Bonds.

The Indenture includes information regarding the amount of the 2008 A Bonds, maturities and interest rates on the bonds, and the nature of the bonds (i.e., that the bonds are not obligations of the City, and are limited obligations of the District). The Indenture also provides that the Trustee will establish and maintain certain funds and accounts, specifies how any funds (e.g., DSRF monies) are to be invested, and how the DSRF is to be utilized. It also specifies the covenants of the District including that it will: cause the principal and interest on the 2008 A Bonds to be paid punctually to the extent Special Tax receipts are available; levy Special Taxes sufficient to pay principal and interest on the Bonds up to the maximum rate prescribed by the RMA’s; and commence foreclosure proceedings against any delinquent parcel if certain delinquency thresholds are reached.

- c. The Bond Purchase Agreement – The Bond Purchase Agreement is an agreement between the District and the Underwriter, pursuant to which the District agrees to sell, and the Underwriter agrees to buy, the bonds. It specifies the purchase price for the 2008 A Bonds, and certain terms of the 2008 A Bonds, such as interest rates and maturities. In addition, it specifies the circumstances under which the Underwriter may cancel its obligation to purchase the issue, such as changes in the tax treatment of the 2008 A 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 Underwriter to place the 2008 A Bonds with investors.

The agreement also specifies documents that the Underwriter and the District must receive prior to the closing of the bond offering. These documents include the Bond Counsel opinion regarding the validity of the 2008 A Bonds and the Indenture, and an opinion on the tax exempt nature of the 2008 A Bonds. Also, certain opinions and certificates of the City Attorney and other City and District officials are required. The developer and their legal counsel are also required to provide certain opinions and certificates, and the required forms of these documents are included in the agreement. Such opinions and certificates, among other things, would confirm that all the steps necessary to authorize the execution of the financing documents and the issuance of the 2008 A Bonds have been properly taken.

- d. The Preliminary Official Statement (POS) – The POS describes the bond issue to the marketplace. It provides information that a reasonable investor in these types of securities would need to make an informed investment decision. Specifically, the POS for the 2008 A Bonds includes information about the 2008 A Bonds, sources of repayment of the 2008 A Bonds, the District, and the development and property ownership.

The POS also includes information on risk factors. Land based securities are generally considered more risky than securities backed by a governmental entity such as the City. For example, a downturn in the economy or a natural disaster could result in a reduction in property values and could adversely affect the ability or willingness of property owners to pay the Special Taxes, which are the security for repayment of the 2008 A Bonds. The risk factors section of the POS provides a discussion of certain risk factors that should be considered by potential investors in the proposed 2008 A Bonds.

Appendices to the proposed POS include: A copy of the previously authorized RMA (Appendix A); supplemental economic information relating to the City (Appendix B); a summary of the Indenture (Appendix C); the Continuing Disclosure Certificate of the District (Appendix D); the form of Bond Counsel Opinion (Appendix E); information concerning the Depository Trust Company’s book entry only system (Appendix F); and a copy of the report prepared by Empire Economics, Inc. on Recent Housing Price Trends/Patterns and Mortgage Loan Characteristics – CFD No. 4 (Appendix G).

- e. The Continuing Disclosure Certificate – The Continuing Disclosure Certificate (the “CDC”) is included in the POS, and is a commitment by the District to submit certain information related to the 2008 A Bonds and the District annually to the national information repositories. Such information includes the balance in each fund held by the trustee, including the DSRF and an annual update of the special tax delinquency table provided in the POS. In addition, although a City CAFR is not required or expected for the initial offering and is therefore not included with the POS, SEC rules do require a City CAFR to be filed annually with the bond and District information. The first annual report for the District will be due April 1, 2009.

I. Schedule

The Disclosure Practices Working Group reviewed the proposed financing and the POS on March 26, 2008. Should the City Council approve the Financing Resolution and related financing documents for the 2008 A Bonds, it is anticipated that the 2008 A Bonds would be sold the week of April 28, 2008. The bond closing (receipt of bond proceeds) would occur the week of May 12, 2008.

III. ALTERNATIVES:

Do not approve the resolution to initiate the sale and delivery of Community Facilities District No. 4 (Black Mountain Ranch Villages) Special Tax Bonds Series A of 2008.

IV. FISCAL CONSIDERATIONS:

There is no fiscal impact to the City. In accordance with Council Policy 800-03, all costs related to the formation of the District and the issuance of the 2008 A Bonds have been funded by Black Mountain Ranch LLC and/or will be reimbursed with bond proceeds. The costs related to issuing and paying debt service on the 2008 A Bonds will be borne by property owners within the District, via the collection of the Special Taxes.

V. PREVIOUS CITY COUNCIL ACTIONS:

The City Council previously approved actions relating to the formation of the District and the issuance of Bonds. These actions include:

1. The adoption of resolutions stating the City Council's intent to establish the District, to authorize the levy of Special Taxes, and to have the District incur bonded indebtedness (Resolution Nos. R-293975 and R-293976, adopted October 16, 2000).
2. Following a noticed public hearing and election, adoption of resolutions and an ordinance establishing the District, declaring the necessity to issue bonded indebtedness, and authorizing the levy of special taxes (Resolution Nos. R-294259, R-294260, and R-294261, adopted November 21, 2000, and Ordinance No. O-18905, adopted December 5, 2000).
3. Adoption of a resolution declaring intention to amend and restate the Rate and Method of Apportionment of special tax approved on November 21, 2000 and to increase the indebtedness that the District is authorized to issue to \$30,000,000 (Resolution No. R-296736, adopted June 25, 2002).
4. Following a noticed public hearing and election, adoption of resolutions and an ordinance approving the amended and restated rate and method of apportionment of special tax and authorizing the District to incur bonded indebtedness in an aggregate principal amount not to exceed \$30,000,000 (Resolution Nos. R-296892 and R-296893, adopted July 30, 2002, and Ordinance No. O-19090, adopted September 3, 2002).

VI. COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

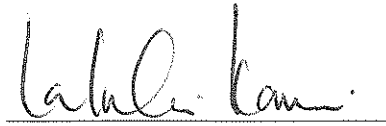
There were no community participation or outreach efforts for this item.

VII. KEY STAKEHOLDERS AND PROJECTED IMPACTS:

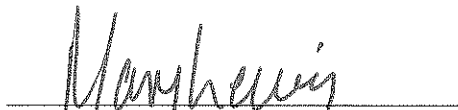
Key stakeholders include Black Mountain Ranch LLC and the special taxpayers in CFD No. 4.

Business entities involved in the transaction are: UBS Securities LLC (the Underwriter); McFarlin and Anderson LLP (Underwriter's Counsel); Stradling, Yocca, Carlson and Rauth (Bond and Disclosure Counsel); Fieldman, Rolapp & Associates (Financial Advisor); David Taussig & Associates (Special Tax Consultant); Wells Fargo Bank, N.A. (Trustee); and Empire Economics, Inc. (Price Trends and Mortgage Study Consultant).

Respectfully submitted,



Lakshmi Kommi
Debt Management Director



Mary Lewis
Chief Financial Officer

Attachment: Community Reinvestment Act Information provided by UBS Securities LLC.