



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: February 26, 2009 REPORT NO. 09-017

ATTENTION: Council President and City Council
Agenda of March 9, 2009

SUBJECT: Wastewater System – Sewer Bonds and Sewer Refunding Bonds

REFERENCES: Companion Report – Metropolitan Wastewater System Improvements
Report

REQUESTED ACTIONS:

1. Authorize the issuance by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of the Sewer Revenue Bonds and Sewer Revenue Refunding Bonds (i) in an amount not to exceed \$259 million for the refinancing of the outstanding Subordinated Sewer Revenue Notes, Series 2007 ("2007 Notes"), coming due on May 15, 2009; (ii) in an amount not to exceed \$168 million for the financing of Wastewater System capital improvement projects; (iii) in an amount not to exceed \$900 million to generate debt service savings on outstanding senior Sewer Revenue Bonds in one or more financings by no later than June 30, 2010; and (iv) in an amount not to exceed \$65.1 million to fund the debt service reserve fund requirement for certain outstanding Sewer Revenue Bonds; and the related financing documents. The related financing documents are described in detail in Section J of this report.
2. Authorize the City Attorney to appoint Nixon Peabody, L.L.P. as Bond Counsel in connection with the issuance of the Sewer Revenue Bonds, Series 2009A ("2009A Bonds") and pay an amount not to exceed \$231,000, plus reasonable out-of-pocket expenses not to exceed \$5,000. The fees payable to Bond Counsel shall be contingent upon the closing of the 2009A Bonds and paid out of the proceeds from the 2009A Bonds.
3. Authorize the City Attorney to appoint Hawkins Delafield & Wood, LLP as Disclosure Counsel for the City in connection with the issuance of the 2009A Bonds and pay an amount not to exceed \$250,000, plus reasonable out-of-pocket expenses not to exceed \$5,000. The fees payable to Disclosure Counsel shall be contingent upon the closing of the 2009A Bonds and paid out of the proceeds from the 2009A Bonds.

STAFF RECOMMENDATIONS: Approve the requested actions.

SUMMARY:

I. BACKGROUND

The objectives of the Wastewater System Capital Improvement Program ("CIP") are to meet federal and State requirements and City policy regarding water pollution control, to provide satisfactory levels of service to users of the System, and to maintain the integrity of the System. The City has completed many major projects to the Wastewater System since 1993 following litigation involving violations of the Clean Water Act, the Consent Decree and certain other matters.

While substantial progress has been made in completing the projects, the Metropolitan Wastewater Department ("MWWD") is required to take significant actions annually to inspect, clean, repair, and expand the capacity of its sanitary sewer system to reduce the occurrence of sanitary sewer overflows as set forth in the Consent Decree. Further, the CIP is planned to improve the effluent quality from both water reclamation facilities; perform routine capital rehabilitation and repair, and plan for future capacity requirements. The companion report titled Metropolitan Wastewater System Improvements ("Companion Report") describes the overall CIP in greater detail.

In March of 2007, Council approved 8.75% annual increases for Fiscal Years 2007 and 2008, and 7% annual increases for Fiscal Years 2009 and 2010, commencing on May 1 of each year. These rate increases enable the MWWD is able to continue with upgrades to the sewer treatment system and implement other capital improvement projects to ensure compliance with federal and State requirements and maintain the existing wastewater system.

Since 1993, sewer revenue bonds have been issued for the upgrades to the Metropolitan Treatment System. As of February 15, 2009, the total outstanding principal in long term sewer revenue bonds (Series 1993, 1995, 1997 A&B, and 1999 A&B) is \$893.7 million. Scheduled principal and interest payments over the remaining life of the outstanding bonds are \$1.37 billion (rounded). In the absence of access to the public markets, short term notes were issued via private placements in 2004 and 2007 to continue to finance MWWD's CIP; the 2007 Notes proceeds were also partially used to repay fully the Subordinated Sewer Revenue Bonds, Series 2004 ("2004 Bonds"). The total outstanding principal of the 2007 Notes is \$223.8 million. In addition to the outstanding bond and note obligations, as of February 15, 2009, MWWD presently has 11 State Revolving Fund loans, totaling \$85.9 million. See Attachment 1 for the breakdown of the total outstanding debt.

MWWD's current borrowing requirement is anticipated to be an estimated \$145 million in new bond proceeds to pay for approximately 18 months of CIP needs during FYs 2009-2011.

II. DISCUSSION

A. Wastewater System Plan of Finance

The proposed financing plan for the Wastewater System presents several components -- (i) repay the short-term 2007 Notes ("Note Repayment"); (ii) finance the Wastewater CIP construction

("New Money" need) for FYs 2009 – 2011; and (iii) refund outstanding long term sewer revenue bonds if the refunding generates debt service savings to the Wastewater System ("Economic Refunding").

Repayment of the short-term Subordinated Sewer Revenue Notes, Series 2007

The 2007 Notes, in the amount of \$223.8 million, were issued in May of 2007 to finance the construction and renovation of wastewater facilities required by regulatory agencies and to repay \$144.4 million of the then outstanding 2004 Bonds. The 2007 Notes were purchased by Citigroup Global Markets, Inc. and were structured as a two-year obligation, with interest only payments, and principal coming due on May 15, 2009. Proceeds from the issuance of the new Sewer Revenue Bonds will repay the \$223.8 million principal outstanding on the 2007 Notes.

Financing of Wastewater CIP

An estimated \$145 million in net bond proceeds is required to finance Wastewater System's CIP activities during FYs 2009 – 2011. A breakdown of the CIP funding and the projected timeframe of the spending are provided in the Companion Report.

Refunding of Outstanding Senior Bonds

The proposed financing plan seeks the authorization to refund all outstanding Sewer Revenue Bonds, Series 1993, 1995, 1997A&B, and 1999A&B ("Outstanding Senior Bonds"), if economic. All Outstanding Senior Bonds are eligible to be current refunded¹, with the 1999 bonds becoming eligible as of May 15, 2009. Pursuant to the Debt Policy, the Outstanding Senior Bonds, or selected maturities thereof, will only be refunded if the net present value savings is at least 3% of the refunded bonds. As of the week of February 17, 2009, approximately \$557 million of the Outstanding Senior Bonds generate an estimated 7.1% in net present value savings. Due to major municipal market dislocations, the interest rate environment continues to remain very volatile. Staff will continue to monitor the movements in the interest rates and provide updates to the City Council at the Council hearing and if the action is approved, will continue to track the interest rates closely to identify opportunities to refund the Outstanding Senior Bonds to maximize the debt service savings.

The Note Repayment and the New Money need will make up the Sewer Revenue Bonds ("Sewer Bonds") and the Economic Refunding will make up the Sewer Revenue Refunding Bonds ("Sewer Refunding Bonds"). The proposed financing plan contemplates two or more bond offerings, which will begin with Series 2009A to be issued by May 15, 2009. This gives the City necessary flexibility to execute financings taking into account among other things, market demand for the City's bonds, and timing the pricing of the bonds to optimize debt service savings for the refunding bonds. It also enables the City to borrow funds no earlier than the time the proceeds are needed. As stated above, principal on the 2007 Notes is to be repaid by no later than May 15, 2009. MWWD currently projects that by June 2009, additional bond proceeds will be necessary to maintain the necessary rehabilitation required by the Consent Decree. Issuing bonds for new construction as close as possible to the start of the construction will allow the City

¹ A current refunding is a redemption of outstanding debt in which the refunding bonds are issued less than 90 days before the redemption date of the refunded bonds.

to minimize the potential of negative arbitrage on the construction fund.² It is currently contemplated that the first tranche of this financing plan, the 2009A Bonds, will include the repayment of the 2007 Note and the New Money need.

Cash Funding the Existing Debt Service Reserve Fund

The financing plan also includes authorization for the cash funding of the reserve requirement for the Outstanding Senior Bonds for up to \$65.1 million. The debt service reserve fund requirement for the Sewer Revenue Bonds, Series 1993, 1995, and 1997 is currently satisfied by a surety policy, specific to these outstanding series, issued by Ambac. No cash funded debt service reserve funds exist for the 1993, 1995 or 1997 bonds. The Series 1999 Bonds have a cash funded reserve in the amount of approximately \$20 million. At the time the City obtained the surety policy for the 1993, 1995 and 1997 bonds, Ambac, similar to most other bond insurers, had a AAA rating from the three major rating agencies, providing a very strong protection to the bondholders for the timely payment of the principal and interest on the bonds.

Since 2008, due to the sub prime market exposure, Ambac's financial position has drastically declined. Ambac's current corporate ratings are "Baa1" by Moody's and "A" by Standard and Poors, and it is unknown if the firm's financial position will improve. Ambac's downgraded ratings are indicative of the increased risk to the surety policy on the outstanding series. Due to both the deteriorated ratings of Ambac, and more generally the deterioration of other bond insurers and surety providers, the surety policy cannot be transferred over to the refunding bonds and staff does not recommend seeking a new surety policy for the refunding bonds. If Ambac's financial condition deteriorates further or it is unable to honor the existing surety policy, contract requirements and the prevailing market conditions at the time of the pricing of the 2009A Bonds, may require that the City replace the outstanding surety policy by cash funding the reserve requirements for the Series 1993, 1995, and 1997 to be able to successfully market and price the 2009A Bonds. The authorization for the cash funding of the reserve requirement will be utilized to either cash fund the reserve fund for refunding bonds or to replace the surety policy on the Outstanding Senior Bonds if and when necessary.

B. City Council Approval Process

This staff report describes the overall financing plan and the proposed structure of the Sewer Bonds and Sewer Refunding Bonds. The City Council is currently requested to approve all legal documents required for the Sewer Bonds and Sewer Refunding Bonds; documents that must be approved via ordinance, and are subject to a 30 day referendum period. Section J describes the specifics of each document.

The 2009A Bonds will be issued in a public offering and the financing is to be executed by no later than May 15, 2009, which is the repayment date on the outstanding 2007 Notes. Staff will be requesting the City Council to authorize the Preliminary Official Statement (POS) for the 2009A Bonds separately in the second week of April 2009. The POS for subsequent issuances

² Proceeds for new construction are held in the Acquisition Fund for no more than the time needed to complete the construction projects for which the bonds are issued. In most interest rate environments, the rate the City can expect to earn on these funds is less than the expected interest expense on the bonds, resulting in negative arbitrage.

beyond the 2009A Bonds will be brought to the City Council for approval via resolution prior to the sale of each series of bonds. Preparing the disclosure document for each financing tranche closer to the issuance date will enable the City to provide most current information to prospective investors. Staff will also provide market updates and the outlook for the refunding savings each time a POS associated with the remaining components of the financing plan is brought to the City Council.

C. Summary of Key Terms of Sewer Bonds (2009A Bonds)

- Issuer - The Public Facilities Financing Authority of the City of San Diego
- Underwriting Syndicate - Banc of America Securities, LLC (Book-running Senior Manager); Citigroup Global Markets, Inc. and Siebert Brandford Shank & Co., LLC (Co-Senior Managers); Fidelity Capital Market Services and Wedbush Morgan Securities (Co-Managers)
- Lien Structure - Senior Lien (1.20x coverage of Net System Revenues to Debt Service)
- Market - Public
- Par Amount – \$412.6 million (estimate)
- Final Maturity- 2039
- Debt Service Reserve Fund – cash funded

D. Summary of Key Terms and Conditions of Sewer Refunding Bonds

- Issuer - The Public Facilities Financing Authority of the City of San Diego
- Underwriting Syndicate - Citigroup Global Markets, Inc (Book-running Senior Manager); Banc of America Securities, LLC and J.P. Morgan Securities Inc (Co-Senior Managers); Fidelity Capital Market Services and Wedbush Morgan Securities (Co-Managers)
- Lien Structure - Senior or Subordinate. To be determined prior to issuing POS.
- Market - Public
- Principal - subject to market conditions; outstanding principal of existing Senior Bonds as of February 15, 2009, is \$893.7 million
- Final Maturity – the final maturity of the refunding bonds to match existing final maturities of the respective refunded bonds, plus an additional year.
- Debt Service Reserve Fund – cash funded

E. Financing Schedule and Key Milestones

Sewer Bonds and Sewer Refunding Bonds

March 9/10, 2009	Introduction of the financing ordinance
March 23, 2009	Approval of the financing ordinance (30-day referendum period begins)
	Disclosure Practices Working Group (“DPWG”) to review and approve POS for Sewer and Sewer Refunding Bonds
Week of March 30, 2009	Docket POS for City Council Authorization
Week of April 13, 2009	Receive credit ratings
	Approval of the resolution authorizing POS
April 23, 2009	End of 30-day referendum period

Sewer Bonds (POS & Pricing)

Week of April 27, 2009	Distribute final changes to the POS to the City Council after DPWG review
Week of May 4, 2009	Print and distribute Sewer Bonds Preliminary Official Statement Bond pricing Distribute the Official Statement to the City Council after DPWG review
Week of May 11, 2009	Print and distribute Sewer Bonds Official Statement
May 15, 2009	Sewer Bonds closing and receipt of proceeds Subordinated Sewer Revenue Notes, Series 2007 principal due

Sewer Refunding Bonds (POS & Pricing)

The Sewer Refunding Bonds will follow a similar schedule with the key milestones to be based on market timing and optimal savings to the City.

F. Financing Team

The City's Financing Team for the Sewer and Sewer Refunding Bonds consists of the Chief Financial Officer, Debt Management, MWWD, the Comptroller's Office, the City Attorney's Office, and outside consultants, including Montague DeRose and Associates LLC as independent Financial Advisor, Nixon Peabody, LLC as Bond Counsel, Hawkins Delafield & Wood LLP as Disclosure Counsel, Malcolm Pirnie, Inc. as Feasibility Consultant, and Bank of New York Mellon as Bond Trustee.

Financial and Legal Services

Montague DeRose and Associates, LLC (the "Financial Advisor") is serving as the independent financial advisor. The Financial Advisor entered into a contract with the City effective February 21, 2008. Under the agreement (C-14498), the Financial Advisor is authorized to provide financial advisory services to MWWD in an amount not to exceed \$85,000 for financial advisory services related to the bond issuances through FY 2009. In addition to the fees, Montague will be reimbursed for all approved out-of-pocket expenses not to exceed \$7,500.

The City Attorney's Office has identified Nixon Peabody, LLC to serve as bond counsel. Nixon Peabody, LLC has proposed to provide such service for Series 2009A element for a fee in an amount not to exceed \$231,000. Out of pocket expenses are not to exceed \$5,000. The bond counsel fee is contingent upon the successful closing of the Series 2009A Bonds.

Hawkins Delafield & Wood LLP serves as the disclosure counsel. Hawkins Delafield & Wood LLP has proposed to provide such service for a fee in an amount not to exceed \$250,000 for the Series 2009A element. Out of pocket expenses are not to exceed \$5,000. The disclosure counsel fee is contingent upon the successful closing of the Series 2009A Bonds.

Malcolm Pirnie, Inc. was engaged as the feasibility engineer by MWWD through a competitive selection process. The total current contract value for the feasibility engineer is \$156,745. The feasibility engineer investigates the status of the Metropolitan Wastewater System to analyze its impact on the security of the proposed 2009A Bonds. Malcolm Pirnie, Inc. will provide a Feasibility Report, an independent engineering, institutional, operational, and financial analysis of the Wastewater System. This Feasibility Study will be included as an Appendix to the Preliminary Official Statement.

Bank of New York Mellon was selected through a competitive RFP process as the trustee for the Sewer and Sewer Refunding Bonds. Bank of New York Mellon will receive \$3,775 in acceptance and first year administration fees for each series of the Sewer Bonds and the Sewer Refunding Bonds.

The financial and legal services presented above are specific to the 2009A Bonds. Agreements to provide services for the subsequent bond issuances within the financing plan will be prepared separately at a future date.

Sewer Bonds and Sewer Refunding Bonds Underwriting Syndicate

In Spring of 2008, a Request for Proposals (RFP) was issued to solicit proposals from firms qualified to serve as senior managers (lead manager/book-running manager) and co-managers. The City received proposals from 25 firms, 17 of which wished to serve as Senior Manager or Co-Manager and 8 firms as a Co-Manager only. After evaluating each proposal and conducting interviews for the senior manager selection, the following underwriter syndicates were formed:

(i) Underwriter syndicate selected for the Sewer Bonds

Senior Bookrunning Manager - Banc of America Securities LLC.

Co-Senior Managers - Citigroup Global Markets, Inc. and Siebert Brandford and Shank

Co-Managers - Fidelity Capital Markets and Wedbush Morgan Securities

(ii) Underwriter syndicate selected for the Sewer Refunding Bonds

Senior Bookrunning Manager - Citigroup Global Markets, Inc.

Co-Senior Managers - Banc of America Securities, LLC. and JP Morgan Securities, Inc.

Co-Managers - Fidelity Capital Markets and Wedbush Morgan Securities

The syndicate members were identified based on the investment banking experience and the banking team's qualifications as presented in the proposals and verified through reference checks, knowledge of the City's Wastewater System, firm's financial capacity to underwrite and current financial condition, the strength of the institutional and retail distribution networks, and marketing outreach capabilities.

G. Document Preparation Due Diligence

Consistent with the Kroll Report recommendations, the financing documents for the proposed Sewer Bonds and Sewer Refunding Bonds would be distributed to the City Council offices two weeks prior to the City Council hearing.³ As with all the City bond financings, staff will inquire

³ Report of the Audit Committee of the City of San Diego, August 8, 2006.

with the City Council offices and the Independent Budget Analyst's Office one-on-one briefings after docketing the proposed financing item and will be prepared to meet with the Council staff and the Independent Budget Analyst to review the financing plan and address questions.

The POS for the 2009A Bonds is being developed in accordance with the DPWG Controls and Procedures. It will be reviewed by the DPWG during the week of March 23, 2009 after which appropriate certifications from DPWG, the Mayor, the City Attorney, and the Chief Financial Officer will be provided to the City Council prior to the Council hearing on the offering document. The audit opinion for the FY 2008 CAFR is anticipated in late March; the POS will be submitted for City Council review in conjunction with the FY 2008 CAFR review by the City Council in mid-April.

H. Credit Ratings

The City will request credit ratings for the Sewer Bonds and the Sewer Refunding Bonds from the three rating agencies. The request for ratings for the 2009A Bonds is anticipated to occur in late March 2009. The request process will entail providing the bond documents and offering statement in their final form, making in depth presentations and responding to all the questions from the rating agencies. The DPWG will review the ratings materials prepared by staff with assistance from the financial advisor, underwriters, and the disclosure counsel. Ratings on the 2009A Bonds will be requested by the City prior to the release of the POS which is currently anticipated in late April 2009.

On May 15, 2008, Standard & Poor's reinstated the City's credit rating. The Wastewater System Obligations were given a credit rating of A+ underlying rating (stable outlook). The Standard & Poor's report cited the Wastewater System's good projected financial performance, strong cash reserves, approved rate increases, stable service area economy and customer base as support for the rating. On March 27, 2008 Fitch changed the City's credit outlook to positive. Fitch currently rates the Wastewater Obligations at BBB+ with a positive outlook. Moody's last rated the Wastewater Obligations in 2005 with an A3 rating with a negative outlook. With the planned presentations to the rating agencies, it is expected that the bond ratings will be returned at least to the levels which existed in 2003.

I. Legal Structure

The Public Facilities Financing Authority of the City of San Diego (the "Authority"), established pursuant to a Joint Exercise of Powers Agreement, dated May 14, 1991, between the City and the Redevelopment Agency of the City, is the issuing authority. The Authority was established to serve as a financing vehicle for certain of the City's facilities and projects. The Authority served as the issuing entity for the 1993, 1995, 1997A&B and 1999A&B Sewer Revenue Bonds, and the 2004 Bonds as well as the 2007 Subordinated Sewer Revenue Notes.

Under the terms of the Master Installment Purchase Agreement (MIPA), the Authority assists the City in funding the CIP of the Wastewater System. The City acts as an agent of the Authority to construct, acquire, and install the Project. The City purchases components of the Project from the Authority with installment payments from the net system revenues of the Wastewater Department. The installment payments are assigned to the trustee towards debt service payments for the bonds issued by the Authority on behalf of the City.

J. Financing Documents for Council Action

A brief description of the financing documents follows:

(i) Documents Pertaining to the Sewer Bonds and Sewer Refunding Bonds

The **Financing Ordinance** authorizes the issuance of the Sewer Bonds and Sewer Refunding Bonds, the approval of the form of the operative legal documents described below and any other actions of the Mayor or his designees that may be necessary to issue the bonds.

The **Supplement to the Master Installment Purchase Agreement**, supplementing the Master Installment Purchase Agreement dated as of September 1, 1993, between the City of San Diego and the Public Facilities Financing Authority of the City of San Diego documents the sale of certain components of the City's Wastewater System by the Authority to the City and provides for installment payments by the City to pay the debt service on the Sewer Bonds and Sewer Refunding Bonds. A new supplement to the MIPA will be executed with each financing tranche.

The **Indenture** between the Authority and the Bank of New York Mellon ("Trustee") provides for the issuance of the 2009A Bonds and set forth terms, including the specific rights, responsibilities, and obligations of each party with respect to the issuance of the 2009A Bonds. The **Supplemental Indenture** between the Authority and the Trustee provides for the issuance of each subsequent financing tranche.

The **Continuing Disclosure Certificate** detail the City's ongoing obligation to file annual reports and material event notices with the Nationally Recognized Municipal Securities Information Repositories for the benefit of the bondholders for each financing tranche.

The **Bond Purchase Agreements (BPA)** between the City, Authority, and Underwriters' representative sets forth the price and the terms and conditions under which the Underwriters will purchase from the Authority the Sewer Bonds and Sewer Refunding Bonds. The Underwriters' representatives for the Sewer Bonds and the Sewer Refunding Bonds are Banc of America Securities LLC. and Citigroup Global Markets, Inc. respectively.

The **Escrow Agreement** between the City, the Authority, and the Trustee provides for the deposit of moneys in the escrow account to refund all or a portion of the Outstanding Senior Bonds in the event Sewer Revenue Refunding Bonds are issued prior to the redemption date of the Outstanding Refunding Bonds. The agreement sets forth the manner in which funds are to be invested pending their expenditure and a schedule of payments to be made with respect to the Outstanding Senior Bonds to being refunded.

III. FISCAL CONSIDERATIONS

Estimated Sources and Uses of Bond Proceeds (Preliminary and Subject to Change)

The presentation of the Sources and Uses of Funds below provides the most likely financing scenario under current market conditions. As discussed in Section II.A, the actual size of the economic refunding of Outstanding Sewer Bonds will depend on the available interest rates when the Sewer Refunding Bonds are sold to investors.

Sewer Bonds (Citi Note Repayment and New Money)

Based on the interest rates as of February 11, 2009, the estimated True Interest Cost is 6.02%. Staff will provide updated estimates to the City Council at the time of the Council hearing.

Estimated Sources of Funds

Par Amount of Sewer Bonds	\$ 412.6 million
Discount ¹	(\$ 12.4 million)
TOTAL	\$ 400.2 million

Estimated Uses of Funds

2007 Notes Repayment	\$ 223.8 million
New Money	\$ 145.0 million
Deposit to Reserve Fund	\$ 29.1 million
Costs of Issuance ²	\$ 2.3 million
TOTAL	\$ 400.2 million

¹ The Sewer Bonds are sized to permit discount bonds, that is, bonds are sold at a price below par value of the bonds; this reflects current market conditions and investor preferences.

² Costs of Issuance include legal fees, consultant costs, underwriting fees, feasibility engineer fees, rating agency fees, and certain other expenses related to the issuance of the bonds. The estimated Costs of Issuance are detailed in Attachment 2. The financial and legal services presented above are specific to the 2009A Bonds. Costs of issuance associated with subsequent financing tranches will be funded from the respective bond proceeds.

Sewer Refunding Bonds

As noted earlier, as of the week of February 17, 2009, approximately \$557 million of the Outstanding Senior Bonds generate an estimated 7.1% in net present value savings. More generally, refunding \$100 million of eligible maturities of Outstanding Senior Bonds that generate 3% in net present value savings are estimated to result in annual debt service savings of approximately \$290,000. Staff will continue to monitor the movements in the interest rates to identify opportunities to refund the Outstanding Senior Bonds to maximize the debt service savings.

City Council Authorization Parameters

The legal documents authorize the issuance of the Sewer Bonds for the repayment of the 2007A Notes (\$223.8 million) and issuance for New Money (\$145 million in net proceeds). Issuance of Sewer Refunding Bonds is authorized in an amount not to exceed \$900 million to refund all or portions of the Outstanding Senior Bonds if economic. The financing ordinance also authorizes the cash funding of reserves for the Sewer Revenue Bonds, Series 1993, 1995, and 1997 either in the context of the refunding of the Outstanding Senior Bonds or on a stand alone basis, if needed to replace the Ambac surety policy.

The financing ordinance authorizes only the legal documents that are necessary to issue the Sewer Bonds and Sewer Refunding Bonds. The offering statements for the Sewer Bonds (2009A Bonds) and Sewer Refunding Bonds will still require subsequent approval, via resolution of the City Council and the Authority.

The not to exceed True Interest Cost requested in the financing ordinance for the Sewer Bonds is as follows:

2007A Notes Repayment	10.00%
New Money	10.00%

Consistent with the City's Debt Policy, Outstanding Senior Bonds will be refunded only if they generate at least 3% in net present value savings.

Debt Management will provide a closing memorandum to the City Council immediately after the sale of the bonds specifying the actual interest rate, proceeds received from the sale of the bonds, actual amount of Outstanding Senior Bonds refunded, and the expected lower debt service payment compared to the Outstanding Senior Bonds.

Interest Rate and Projected Debt Service

In accordance with the Council approved Debt Policy, the Sewer Bonds and Sewer Refunding Bonds will be priced on a fixed rate basis with the interest rate fixed at the time of the pricing for the life of the bonds. The actual interest rate will be set when the bonds are sold and will be based on the public market conditions present at the time of the bond pricing. The debt service payments will be paid semi-annually.

Based on interest rates as of February 11, 2009, the par issuance of the Sewer Bonds is an estimated \$412.6 million. The annual estimated debt service is \$29.1 million with an estimated total debt service of \$871.7 million over a 30 year term. For comparison purposes, at the City Council authorized not-to-exceed interest rate of 10%, the annual debt service on the bonds would be an estimated \$45.1 million with the total annual debt service at \$1.4 billion over a 30 year term.

Revenue Pledge

Under the terms of the financing documents, the Sewer Bonds and Sewer Refunding Bonds are limited obligations of the Authority payable solely from the Installment Payments made by the Wastewater System. The Installment Payments are secured by and payable solely from the Net System Revenue of the Wastewater System. Net System Revenue is the income derived from the operation of the Wastewater System (primarily sewer rates and charges) less the maintenance and operation costs.

Municipal Bond Market

The municipal bond market has shown some improvement beginning January 2009, after the major disruption starting Fall of calendar year 2008. The municipal markets, seen as an opportunity, have spurred interest from various investor classes in general and from retail buyers in particular. The focus on credit quality has resulted in credit spreads reaching a near 10-year high. The interest rate premium on lower rated and lower credit quality bonds have increased significantly. Highly rated bond deals are being successfully completed; examples of successful deals sold in January 2009 in the range of \$120- \$160 million, include San Francisco Unified School District, City of San Antonio, and Maryland and Higher Ed Facilities Authority. The

City's \$157 million Water Bond Issuance was also successfully closed in January 2009. The market is experiencing a historically steep yield curve; higher yields for longer maturities continue to result in strong demand for longer dated bonds. With the flexibility in executing financing in separate tranches in accordance with market conditions, staff expects to be able to successfully execute the proposed 2009A Bonds and subsequently the Sewer Refunding Bonds.

IV. ALTERNATIVES

Do not approve the requested actions necessary to issue the Sewer Bonds and Sewer Refunding Bonds to repay the 2007 Notes and make available additional funds to upgrade and expand the Wastewater System. However, not approving the requested actions essential to repay the short term note will adversely affect the City in meeting its repayment covenants and paying off the Wastewater System's outstanding debt obligations in a timely manner. There is no other viable option to pay off the Note or extend the term of the Note other than through the issuance of long term bond obligations. Also, unless additional bond funds are made available through the proposed offering, there is no viable permanent funding option to continue to undertake the Wastewater System capital projects essential to meet the terms of the Consent Decree; to meet federal and State requirements and City policy regarding water pollution control; to provide satisfactory levels of service to users of the System; and to maintain the integrity of the System. It is recommended that the requested actions be approved to implement a cost effective financing plan in a timely manner in order to address the repayment obligations and meet the ongoing new capital funding needs of the Wastewater System.

V. PREVIOUS COUNCIL and/or COMMITTEE ACTION:

The short-term Subordinated Sewer Revenue Notes, Series 2007, were approved by City Council on April 9, 2007.

VI. COMMUNITY PARTICIPATION AND OUTREACH EFFORTS:

In 2007, the Wastewater Department conducted a Proposition 218 noticing process as part of the approval for the rate increases necessary to support the CIP and corresponding bond issuance projections from FY 2009 to FY 2011. Pursuant to Proposition 218, the City provided property owners 45 days advance notice of the Council's formal consideration of rate increases. Notices were mailed to property owners of record and City of San Diego sewer bill customers, advising them that the City Council would hold hearings on February 26, 2007 to consider adoption of the proposed sewer rate increases. The hearings were held as scheduled and the rate increases were subsequently approved by the Council.

VII. KEY STAKEHOLDERS & PROJECTED IMPACTS:

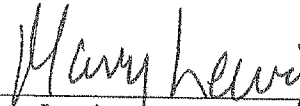
Business entities engaged in the proposed 2009A Bonds transaction are Banc of America Securities, LLC, (Book-running Senior Manager); Citigroup Global Markets, Inc. and Siebert Brandford Shank & Co., LLC (Co-senior managers); Fidelity Capital Market Services and Wedbush Morgan Securities (Co-managers); Hawkins Delafield & Wood LLP (disclosure counsel); Nixon Peabody LLP (bond counsel); Stradling, Yocca, Carlson & Rauth LLP (underwriter's counsel); Bank of New York Mellon (trustee); Malcolm Pirnie, Inc. (feasibility

consultant), and Montague DeRose and Associates LLC (financial advisor). Business entities involved in the Underwriter Syndicate for the subsequent Sewer Refunding Bonds are - Citigroup Global Markets, Inc. (Book-running Senior Manager); JP Morgan and Banc of America Securities, LLC. (Co-senior managers); and, Fidelity Capital Market Services and Wedbush Morgan Securities (Co-managers).

Respectfully submitted,



Lakshmi Kommi
Debt Management Director



Mary Lewis
Chief Financial Officer

Attachments

1. Summary of Outstanding Wastewater Utility Obligations
2. Estimated Costs of Issuance Budget

Summary of Outstanding Senior Bonds
As of February 15, 2009

	Original Issue Size	Principal Outstanding	Remaining Interest Payments	Total Principal & Interest	Final Maturity
1993 Bonds	\$250,000,000	\$167,955,000	\$72,532,198	\$240,487,198	FY 2023 (05/15/2023)
1995 Bonds	\$350,000,000	\$265,540,000	\$128,696,623	\$394,236,623	FY 2025 (5/15/2025)
1997A&B Bonds	\$250,000,000	\$196,800,000	\$114,122,651	\$310,922,651	FY2027 (5/15/2027)
1999A&B Bonds	\$315,410,000	\$263,400,000	\$160,789,789	\$424,189,789	FY 2029 (5/15/2029)
2007 Note	\$223,830,000	\$223,830,000	\$5,595,750	\$229,425,750	FY 2009 (5/15/2009)
State Revolving Fund Loans (11 in total)	\$109,214,104			\$85,880,703	FY 2026 (3/30/2026)

Source: Debt Management and MWW/D

Attachment 2

Estimated Costs of Issuance
Sewer Revenue Bonds (2009A Bonds)

Role	Firm	
Financial Advisor	Montague DeRose and Associates, LLC	\$ 92,500
Bond Counsel	Nixon Peabody LLC	236,000
Disclosure Counsel	Hawkins Delafield & Wood LLP	255,000
External Auditor, FY 07 and 08	Macias Gini & O'Connell LLP	12,000
Feasibility Engineer	Malcolm Pirnie, Inc.	156,745
Credit Rating Fees	S & P, Moody's & Fitch	150,000
Trustee	Bank of New York Mellon	3,775
Printing Costs	TBD	10,000
Electronic Posting of OS	TBD	3,000
Underwriter Discount ¹	2009A Syndicate	1,351,113
Contingency (approx 4%)		37,871
Total Estimated Costs of Issuance (rounded)		\$ 2,308,000

¹Based on market conditions. Includes takedown, underwriter's counsel fees and out-of-pocket expenses.