



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: **April 1, 2009** REPORT NO. **09-047**

ATTENTION: Council President and City Council
Agenda of April 13, 2009

SUBJECT: Wastewater System – Sewer Bonds and Sewer Refunding Bonds
Preliminary Official Statements

REFERENCES: Report to City Council - 09-016, dated February 26, 2009
Ordinance No. O-19841

REQUESTED ACTIONS:

1. Approve the forms and authorize the distribution of two preliminary official statements for the Sewer Revenue Bonds, Series 2009A ("2009A Bonds") and Sewer Refunding Bonds, Series 2009B ("2009B Bonds") and authorize the execution, delivery and distribution of the official statements for the 2009A Bonds and 2009B Bonds.
2. Authorize the City Attorney to appoint Nixon Peabody, L.L.P. as Bond Counsel in connection with the issuance of the 2009B Bonds and pay an amount not to exceed \$50,000, 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 2009B Bonds and paid out of the proceeds from the 2009B 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 2009B Bonds and pay an amount not to exceed \$65,000, 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 2009B Bonds and paid out of the proceeds from the 2009B Bonds.
4. Declare the City's intent to use funds made available from the 2009A Bonds to reimburse itself for eligible capital expenditures relating to the components of the Wastewater System made prior to the issuance of the 2009A Bonds.

STAFF RECOMMENDATIONS: Approve the requested actions.

SUMMARY:

I. BACKGROUND

A comprehensive financing plan for Wastewater System was presented to the City Council on March 9, 2009. The financing plan included the issuance of long term bonds via public offering, in two or more financings, for the refinancing of the short-term Sewer Revenue Notes, Series 2007 ("2007 Notes"), financing of Wastewater Capital Improvements Program (CIP) construction; and the refinancing of outstanding long term sewer revenue bonds ("Outstanding Senior Bonds"), if economical. The financing ordinance approving the issuance of Sewer Revenue Bonds and Sewer Refunding Bonds, in two or more financings, was introduced on March 9, 2009, and was adopted by the City Council on March 24, 2009 (O-19841).

As indicated by staff on March 9, 2009, the 2009A Bonds will include (i) the takeout of the outstanding 2007 Notes in an amount of \$223.8 million; and (ii) the financing of the Wastewater System capital improvement projects in an amount totaling \$145 million. It is currently anticipated that the refunding of approximately \$51 million of Outstanding Senior Bonds that produce at least a 3% net present value savings would also be included in the 2009A Bonds.

As of March 25, 2009, a total of approximately \$454 million in outstanding bonds were eligible for refunding yielding a net present value savings of 3.0%. The 2009B Bonds are expected to be issued to economic refund approximately \$403 million of the Outstanding Senior Bonds, 2-3 weeks after the 2009A Bonds.

II. DISCUSSION

A. Preliminary Official Statement

Staff is presenting two **Preliminary Official Statements (POS)** for the 2009A and 2009B Bonds respectively, for City Council consideration. The Preliminary Official Statements include detailed descriptions of the 2009A and 2009B Bonds, the Wastewater System's financial data and a summary of the pertinent Wastewater System, regulatory, and financial issues. Each POS includes the following appendices:

- Excerpts from the Fiscal Year 2008 CAFR¹
- The Engineer's Feasibility Study
- Summary of the Principal Legal Documents
- Form of Bond Counsel Opinion
- Form of the Continuing Disclosure Certificate

B. Engineer's Feasibility Study

In anticipation of the Sewer Revenue and Sewer Revenue Refunding Bonds, the Wastewater Department engaged the engineering firm, Malcolm Pirnie, Inc. to complete an independent engineering and financial feasibility study on the planned bond offering. The feasibility study is

¹ The FY2008 CAFR is to be received and filed by the City Council. The audit opinion was released on March 26, 2009.

included as an appendix in the POS and includes a detailed review of the Capital Improvement Program (CIP), operations and maintenance policy, and projected revenues and expenses for fiscal years 2009 through 2013. Malcolm Pirnie principal conclusions on the Wastewater Department are as follows:

- MWWD is organized in a manner which provides satisfactory and reliable wastewater management services that meet public needs and satisfy current Federal, State, and Regional, and County regulations;
- The CIP is reasonable to address near and long-term capacity objectives of the System, effecting necessary rehabilitation and replacement work, and general compliance with regulatory standards. Furthermore, the CIP incorporates projects to improve effluent quality from the water reclamation facilities, thus providing for future customer requirements;
- Facilities were generally found to be well-maintained, appropriately staffed and the technology employed by MWWD at its wastewater treatment facilities meets or exceeds that of most other comparable utilities, is appropriate for its application, and results in adequate wastewater treatment;
- The wastewater treatment facilities have adequate capacity to meet customer requirements and anticipated future requirements through the planning period;
- The CIP planning process represents a prudent capital planning process that reflects industry standards, has provisions for planned and unplanned improvements to meet regulations and has line items incorporated into it that will allow MWWD to meet the requirements of the Final Consent Decree related to sanitary sewer overflows, and;
- Projections of revenues and expenses reviewed in comparison, factoring in approved rate increases and historical data, were found to be reasonable to support the System's forecast for debt service coverage, cash reserve targets, and to meet the Additional Bonds Test (ABT).

C. Document Preparation Due Diligence

In accordance with the Disclosure Practices Working Group (DPWG) Controls and Procedures, a Financing Group was convened to assist the Disclosure Counsel in developing the Preliminary Official Statements. The Financing Group consisted of the Disclosure Counsel, City's General Disclosure Counsel, Wastewater Department Staff, Debt Management staff, City Attorney staff, and the Financial Advisor. These departments have provided pertinent information for inclusion in Preliminary Official Statements. Representatives from the underwriting syndicate, senior and co-senior manager firms, and the underwriter's counsel have also taken an active role in the disclosure document development process. The Wastewater Department has been involved in all stages of the disclosure document development process and has reviewed the final forms of each POS to ensure accuracy and completeness of the disclosures pertaining to the Wastewater System.

The DPWG met on March 11, March 12, March 16, March 20, March 24, and March 26, 2009, to review and approve the 2009A and 2009B Preliminary Official Statements. Consistent with the DPWG Controls and Procedures, necessary certifications from various officials involved in the preparation or review of the disclosures including the Mayor, the City Attorney, and the Chief Financial Officer, as well as the DPWG will be distributed to the City Council prior to the Council hearing.

Consistent with the Kroll Report recommendations, the Preliminary Official Statement for 2009A Bonds and 2009B Bonds and related appendices were distributed to the City Council offices two weeks prior to the City Council hearing². As with all the City bond financings, staff will inquire 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.

D. City Council Approval Process

The City Council is requested to authorize the resolution that approves the forms and authorizes the distribution of the Preliminary Official Statements for the 2009A and 2009B Bonds. 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. The 2009B Bonds will also be issued in a public offering and the financing is expected to be executed in late May (2-3 weeks after the 2009A Bonds).

As described in the financing plan presented to City Council on March 9, 2009, subsequent to the 2009B Bonds, additional refunding of Outstanding Senior Bonds could occur in multiple tranches through June 30, 2010. The Preliminary Official Statements for subsequent issuances beyond the 2009A and 2009B 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.

E. Financing Schedule and Key Milestones

Week of April 13, 2009	Credit ratings anticipated Request approval of the resolution authorizing the Series 2009A and 2009B Preliminary Official Statements
April 23, 2009	End of 30-day referendum period on Ordinance No. O-19841
Week of April 27, 2009	Distribute final changes to the Preliminary Official Statements to the City Council after DPWG review Print and distribute 2009A Bonds POS
Week of May 4, 2009	Pricing -2009A Bonds Distribute the 2009A Official Statement to the City Council after DPWG review

² Report of the Audit Committee of the City of San Diego, August 8, 2006.

Week of May 11, 2009

Print and distribute Series 2009A Bonds Official Statement
Sewer Bonds closing and receipt of proceeds

May 15, 2009

Subordinated Sewer Revenue Notes, Series 2007 principal due

The same process will be applied for the 2009B Bonds 2 to 3 weeks following the 2009A Bonds.

F. Financing Team

The City's Financing Team for the 2009B 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. This financing team is identical to that of the 2009A Bonds, which was presented to City Council on March 9, 2009, since work on the 2009B Bonds was conducted on a parallel track.

New agreements were necessary for the 2009B Bonds only for the Bond and Disclosure Counsel services. The City Attorney's Office has identified Nixon Peabody, LLC to serve as bond counsel for the 2009B Bonds. Nixon Peabody, LLC has proposed to provide such service for Series 2009B Bonds for a fee in an amount not to exceed \$50,000. Out of pocket expenses are not to exceed \$5,000. The bond counsel fee is contingent upon the successful closing of the Series 2009B 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 \$65,000 for the Series 2009B Bonds. Out of pocket expenses are not to exceed \$5,000. The disclosure counsel fee is contingent upon the successful closing of the Series 2009B Bonds.

The financial and legal services presented above are specific to the 2009A and 2009B 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

As presented to the City Council at the March 9, 2009 meeting, the following are the underwriter syndicates for the 2009A and 2009B Bonds:

- (i) Underwriter syndicate selected for the 2009A 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 2009B Bonds (Refunding)
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

G. Credit Ratings

The City met with the three rating agencies during the week of March 23, 2009 to request credit ratings for the Sewer Bonds and the Sewer Refunding Bonds. The DPWG reviewed the ratings materials prepared by staff with review from the financial advisor, underwriters, and the disclosure counsel. Ratings on the 2009A & 2009B Bonds will be available prior to the release of the POS, which is currently anticipated in late April 2009.

H. Reimbursement Resolution

In the event that the City needs to front the project related expenses, the City must adopt a reimbursement resolution in accordance with section 1.150-2 of Treasury Regulations ("Regulations"). By adopting a reimbursement resolution the City will satisfy the Official Intent Requirement under the Regulations and be able to reimburse project related expenses using funds available from the proceeds of the 2009A Bonds. Adoption of the reimbursement resolution will not obligate the City to expend any funds; it merely enables the City to get reimbursed for all qualified project related expenses that the City may have fronted to meet on-going CIP needs.

III. FISCAL CONSIDERATIONS

Interest Rate and Projected Debt Service

In accordance with the Council approved Debt Policy, the 2009A and 2009B 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. The 2009B Bonds and other future refunding tranches will only be issued if the net present value savings is at least 3% of the refunded bonds.

2009A Bonds

Based on interest rates as of the week of March 23, 2009, the par issue size of the 2009A Bonds, including refunding of approximately \$51 million of the Series 1997A & B Outstanding Senior Bonds, is an estimated \$458 million. The estimated average annual debt service is \$30.4 million with an estimated total debt service of \$913.0 million over a 30 year term.

2009B Bonds

As of the week of March 23, 2009, approximately \$454 million of the Outstanding Senior Bonds generate an estimated 3.0% in net present value savings, of which \$403 million is expected to be refunded by the 2009B Bonds. Based on this, \$424.2 million in 2009B Bonds are expected to be issued resulting in an average annual debt service savings of \$1.5 million. 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.

See Attachment 1 for the Estimated Costs of Issuance related to the 2009A and 2009B Bonds.

IV. ALTERNATIVES

Do not approve the requested actions necessary to continue with the issuance of the Sewer Bonds and Sewer Refunding Bonds as public offerings to repay the 2007 Notes, make available additional funds to upgrade and expand the Wastewater System and take advantage of refunding opportunities. 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. By not taking advantage of refunding opportunities, the City will pay a higher interest costs on outstanding debt. It is recommended that the requested actions be approved to continue with the implementation of the cost effective financing plan to address the repayment obligations and meet the ongoing new capital funding needs of the Wastewater System.

V. PREVIOUS COUNCIL and/or COMMITTEE ACTION:

Ordinance No. O-19841 adopted by City Council on March 23, 2009 authorized the issuance of the Sewer Revenue Bonds and Sewer Revenue Refunding Bonds, and the related legal documents. These documents included the financing ordinance, the Supplement to the Master Installment Purchase Agreement, the Indenture, the Supplemental Indenture, the Bond Purchase Agreements, the Continuing Disclosure Certificate and the Escrow Agreement.

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:

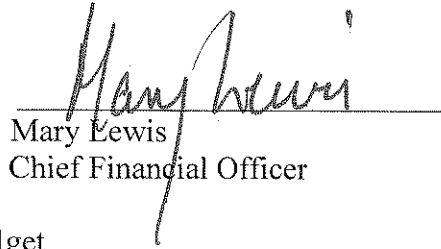
Business entities involved in the 2009A Bonds are Banc of America Securities, LLC (Book-running Senior Manager); Citigroup Global Markets, Inc. and Siebert Brandford Shank & Co., LLC (Co-senior managers); Fidelity Capital Market Services and Wedbush Morgan Securities (Co-managers); Hawkins Delafield & Wood LLP (disclosure counsel); Nixon Peabody L.L.P. (bond counsel); Stradling, Yocca, Carlson & Rauth L.L.P (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 2009B 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

Attachment

1. Estimated Costs of Issuance Budget

Attachment 1

Estimated Costs of Issuance
2009A & 2009B Bonds

Role	Firm	2009A Bonds	2009B Bonds
Financial Advisor	Montague DeRose and Associates, LLC	\$92,500	-- ¹
Bond Counsel	Nixon Peabody LLC	\$236,000	\$55,000
Disclosure Counsel	Hawkins Delafield & Wood LLP	\$255,000	\$70,000
External Auditor - FY 08	Macias Gini & O'Connell LLP	\$20,000	\$20,000
Credit Rating Fees	S & P, Moody's & Fitch	\$150,000	\$75,000
Trustee	Bank of New York Mellon	\$3,775	\$3,775
Printing Costs	TBD	\$10,000	\$10,000
Electronic Posting of OS	TBD	\$3,000	\$3,000
Feasibility Engineer ²	Malcolm Pirnie, Inc.	\$247,229	\$5,000 ⁴
Underwriter Discount ³	Syndicate	\$2,061,675	\$1,908,900
Contingency (3%)		\$23,108	\$7,253
Total Estimated Costs of Issuance (rounded)		\$3,102,287⁵	\$2,157,928

¹ Amount reflects costs associated with both the 2009A and 2009B issuances

² Feasibility Engineer expenses are cash funded; will not be paid from bond proceeds

³ Approximate amounts based on market conditions. Includes takedown, underwriter's counsel fees and out-of-pocket expenses

⁴ Estimate

⁵ Amount differs from the Report to City Council – 09-016 due to estimated issue size change to \$458.2 million and estimated increase in underwriters' discount based on current market conditions