THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	October 28, 2011	REPORT NO: 11-143
ATTENTION:	Council President and City Council	
SUBJECT:	Community Facilities District No. 2 (Santaluz) – Improvement Area No. 1 Special Tax Refunding Bonds, Series A of 2011	
REFERENCE:	Bond Refundings Report to Budget & Finance Committee (Report No: 11-334), dated October 12, 2011	

REQUESTED ACTION(S):

Authorize the issuance of the Community Facilities District No. 2 (Santaluz) – Improvement Area No. 1 Special Tax Refunding Bonds, Series A of 2011 ("Refunding Bonds") in a principal amount not to exceed $55.0 million and the execution of related financing documents to refund the Community Facilities District No. 2 (Santaluz) – Improvement Area No. 1 Special Tax Bonds Series A of 2000 and Series A of 2004. The related financing documents include a Second Supplemental Bond Indenture, an Escrow Agreement, a Bond Purchase Agreement, the Preliminary Official Statement, and a Continuing Disclosure Certificate.

STAFF RECOMMENDATION:

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 infrastructure that typically accompanies major development projects. The Mello-Roos Act specifically provides for the establishment of a Community Facilities District ("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. 2 (Santaluz) Improvement Area No. 1 was formed, allows for utilization of CFDs to finance public facilities required in connection with development.[1] 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 ordinances to form the District in March 2000. Subsequently, in October 2000, the District issued CFD No. 2 (Santaluz) Improvement Area No. 1 Special Tax Bonds Series A of 2000 in the amount of $56,020,000 (the "2000 Bonds"), and in February 2004 issued CFD No. 2 (Santaluz) Improvement Area No. 1 Special Tax Bonds Series A of 2004 in the amount of $5,000,000 (the "2004 Bonds"). The bonds were conduit issuances, executed to fund certain public infrastructure facilities within or serving the District. The facilities include portions of Camino Del Sur, Carmel Valley Road, water and sewer facilities, a 25 million gallon reservoir, and a Community Park. The facilities were substantially completed by Fiscal Year 2004, and all facilities have been acquired by the City. The 2000 Bonds and the 2004 Bonds are secured solely by special taxes levied upon approximately 1,000 parcels of property located within the District. The special taxes are levied and collected annually via property tax bills. The proposed Refunding Bonds contemplates the refunding of both the 2000 Bonds and the 2004 Bonds.

II. DISCUSSION

A summary of the key aspects of the financing plan for the Refunding Bonds and structure are provided below. Additional detail is provided following the summary:

- **Method of Sale**: Negotiated Public Offering

- **Issuance Size**: Principal not to exceed $55,000,000

- **Repayment Source**: The Refunding Bonds are payable from Special Taxes levied on taxable property within the District. No funds of the General Fund are pledged to repayment of the Refunding Bonds.

- **Final Maturity**: 19 year term (through September 1, 2030). No extension of the final maturity.

- **Debt Service Reserve Fund:** A cash funded, trustee held Debt Service Reserve Fund ("DSRF") will be maintained and funded with the proceeds of the bonds, sized at approximately Maximum Annual Debt Service.

A. Method of Sale - Negotiated Public Offering

Due to the nature of the security for CFD bonds (i.e., the bonds are secured solely by Special Tax revenues levied on property within the established district) such as the Refunding Bonds, most CFD bond sales in the State of California utilize a negotiated sale method. With a negotiated

[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 ("the Policy"), which is included in the City's Debt Policy. The resolution stated that the new Policy would apply only to CFDs and Assessment Districts formed after the effective date of the resolution. Therefore, in connection with the issuance of the Refunding Bonds, Council Policy 800-03 is still considered operative.

sale, the underwriter is selected early in the financing process. This gives the underwriter adequate time to pre-market the Refunding Bonds to appropriate investors.

B. Issuance Size

Under current market conditions, the proposed Refunding Bonds issuance is anticipated to total approximately $52.9 million to execute a full refunding of the 2000 Bonds and 2004 Bonds. Depending on actual market conditions at the time of pricing the Refunding Bonds, it is possible that only the 2000 Bonds could be economically refunded, in which case the Refunding Bonds par amount would be reduced. Presently, both series are eligible for full refunding, and the not to exceed authorization of $55.0 million will provide sufficient cushion should interest rates rise or market preferences for coupon structures change to facilitate the combined refunding of all of the outstanding 2000 and 2004 Bonds. The Financing Resolution includes the authorization until December 30, 2012 to issue subsequent series of bonds to refund any remaining bonds if the market fluctuates between now and the pricing of the Refunding Bonds.

The table below specifies the estimated sources and uses of proceeds of the Refunding Bonds:

Sources and Uses of Refunding Bond Proceeds*

Estimated Sources		
Par Amount of the Refunding Bonds	$	52,875,000
Net Original Issue Discount (OID) [1]		(383,783)
Release of Debt Service Reserve Funds		4,963,399
Prepayment Funds [2]		85,000
Total Proceeds	**$**	**57,539,616**
Estimated Uses		
Deposit to Defease 2000 Bonds [3]	$	48,674,124
Deposit to Defease 2004 Bonds [4]		4,193,006
Refunding Bonds Debt Service Reserve Fund		4,149,364
Costs of Issuance [5]		519,316
Rounding		3,806
Total Uses of Funds	**$**	**57,539,616**

* Preliminary; subject to change. Based on interest rates as of October 18, 2011.

[1] OID is the amount by which the price paid for the bonds is discounted from the par value of the bonds, and generally results in a lower bond coupon rate. OID is driven by market preferences, and is often attractive to CFD bond investors due to the mandatory call of bonds if a District property owner prepays the lien of special taxes.

[2] Amount deposited by a District property owner to prepay the property owner's lien of special taxes.

[3] Reflects outstanding principal to be defeased ($47,180,000), and accrued interest to the defeasance date of March 1, 2012 ($1,494,124).

[4] Reflects outstanding principal to be defeased ($3,970,000), accrued interest to the defeasance date of March 1, 2012 ($103,906), and $119,100 of call premium.

[5] Costs of Issuance include legal fees, special tax consultant fees, financial advisor fees, verification agent fees, underwriter's discount, City staff costs, and other expenses related to the issuance of the bonds.

C. Repayment Source – Special Taxes

Debt service on the Refunding Bonds would be payable from Special Taxes levied on taxable property within the District over the term of the Refunding Bonds, in accordance with the Rate and Method of Apportionment of Special Taxes approved by the City Council and through a landowner election process. The Refunding Bonds are not general or special obligations of the City. The Refunding 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 approximately equivalent to the maximum annual debt service on the Refunding Bonds. In addition, the District has provided a covenant in the Indenture wherein it will diligently pursue foreclosure on property delinquent in the payment of Special Taxes if certain delinquency thresholds as required under the bond indenture are reached. This covenant exists for the outstanding bonds, and is generally expected by the market for these types of land secured transactions.

D. Interest Rate and Projected Debt Service

Under market conditions as of October 18, 2011, the estimated True Interest Cost ("TIC") for the Refunding Bonds is approximately 4.78%. The estimated annual debt service payments due on the Refunding Bonds would be $4.2 million over a 19 year period, compared to $4.7 million for the existing bonds being refunded. The difference in the average annual debt service for the outstanding bonds compared to the Refunding Bonds is approximately $524,000. The estimated net annual savings to the District as a result of the refunding, and after accounting for interest earnings on the DSRF for the existing bonds, is approximately $220,000 annually through 2030 starting with tax year 2012-2013. The net present value ("NPV") savings level for the combined refunding as a percentage of the bonds refunded is 5.4%.

As set forth in the Financing Resolution, refunding bonds would only be issued if a NPV savings level of at least 3.00% is achieved for the combined refunding of the two outstanding series. This is recommended due to the small amount of principal outstanding ($4.0 million, or 7.8% of the principal being refunded) for the 2004 Bonds, and the fact that rates would need to decrease considerably for an economic stand-alone refunding of the 2004 Bonds due to the impact of fixed costs of issuance that would be incurred for a stand-alone refunding (i.e., regardless of the size of the refunding), which is practicably unlikely. In addition, if the two outstanding series of bonds can be refunded into one series, as contemplated, post-issuance administration costs of the District would decrease, through the efficiencies gained from administering one series.

E. Rating

The estimated refunding numbers are based on current market conditions for a BBB+ rated land secured transaction. Land based securities, such as the Refunding Bonds, are usually below investment grade and are not rated. However, recently, some land secured transactions have received investment grade ratings in the BBB+ and A rating categories. These transactions, particularly those in the high BBB and A category, have generally had certain characteristics that make them a stronger credit than other land secured transactions. These characteristics include diversity of ownership, a built out district, and low delinquency rates. Based on the recommendations of the underwriter and the City's financial advisor for the transaction, City staff will seek a rating on the Refunding Bonds. The underwriter and City's financial advisor observe the largely built out district, high diversity of ownership (no individual property is responsible for more than approximately 2.7% of the Fiscal Year 2012 special tax levy), and low delinquency rate for the District (1.6% for Fiscal Year 2011) should result in an investment grade rating for the transaction. The savings estimates discussed on page 4 assume a BBB+ rating on the transaction. To the extent the Refunding Bonds are rated higher, the savings will further improve.

F. Value to Lien Ratio

Currently, the aggregate estimated value to lien ratio for the District is 15.6 to 1. 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. 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 an individual lot or lots is less than 3 to 1, credit enhancements must be provided to the satisfaction of the City. There were seven parcels upon which special taxes were levied in tax year 2011-12 for which the value to lien ratio was less than 3 to 1. The provision in the Council Policy with respect to credit enhancement was generally intended to require a master developer in a conduit special district new money issuance to step forward to provide additional credit enhancement in any cases where the property value was insufficient, in order to increase the security for the bonds. In this case, the property in the District has already been developed and sold to end users (e.g., residential homeowners), and there is no master developer to step forward to provide the enhancement. Given that the overall value to lien ratio for the District is 15.6 to 1 and there are approximately 1,000 parcels subject to the special tax, it is believed that the low value to lien ratio for seven of the 1,000 parcels should not be material to the credit for the transaction. As such, the Financing Resolution provides for a waiver of the applicable section of Council Policy No. 800-03, requiring additional credit enhancements.

G. The Financing Team

The Financing Team for the Refunding Bonds includes staff of the Department of Finance, including Debt Management and the City Comptroller's Office, the City Attorney's Office, and outside consultants, including the financial advisor (Fieldman, Rolapp & Associates), a special tax consultant (David Taussig & Associates), bond and disclosure counsel (Stradling, Yocca, Carlson, & Rauth), the Book Running Senior Manager (Piper Jaffray & Co.), the Co Manager (Southwest Securities, Inc.), and the underwriter's counsel (Nossaman, Guthner, Knox & Elliot LLP), BondResource Partners, LP as Verification Agent, and Union Bank, N.A. as trustee.

Fieldman Rolapp & Associates was selected to provide financial advisory services for this transaction from the City's As-needed Financial Advisors List based on the firm's experience in land secured financings and the fee estimate. The fee to Fieldman Rolapp & Associates for this issuance is for an amount not to exceed $28,000, plus out of pocket expenses not to exceed $1,500.

David Taussig & Associates was selected to provide special tax consulting services for this transaction as additional services pursuant to an existing agreement for annual special tax administration services related to the District, and based on the firm's experience in land secured financings and the fee estimate. The fee to David Taussig & Associates for this issuance is for an amount not to exceed $30,000, plus out of pocket expenses not to exceed $500.

Piper Jaffray & Co. was identified as the Book Running Senior Manager for the Refunding Bonds through a competitive process. A Request for Proposals for the Refunding Bonds was issued in September 2011. In total, eight underwriting proposals were received of which five firms proposed to serve as a Senior Manager and three firms proposed solely as a Co-Manager. Southwest Securities, Inc. was selected to serve as Co Manager. The syndicate members were identified based on the investment banking and underwriting experience of the firms on similar transactions, financial capacity to underwrite the bonds, and marketing outreach capabilities.

The City Attorney's Office has identified Stradling, Yocca, Carlson, & Rauth to serve as bond and disclosure counsel for the transaction. Stradling, Yocca, Carlson, & Rauth has proposed to provide such services for a fee in an amount not to exceed $68,250. Expenses are not to exceed $2,000.

Union Bank, N.A. is the existing trustee for the 2000 Bonds and the 2004 Bonds, and will serve as the trustee for the Refunding Bonds. Compensation for the trustee includes $2,300 for the transaction and ongoing annual fees of $1,800 plus certain transactional expenses.

The verification agent for the transaction, BondResource Partners, LP, was selected from the City's As-needed Financial Advisors List. Compensation for the verification agent is not to exceed $2,800.

Payment of fees for the above referenced outside consultants are contingent on the successful closing of the Refunding Bonds, and will be paid from bond proceeds.

H. The Financing Documents

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

a. Financing Resolution – The Financing Resolution authorizes the issuance of the Refunding Bonds, establishes the terms of the bonds sale, and provides for the approval of the financing documents.

b. The Second Supplemental Bond Indenture – The Second Supplemental Bond Indenture, along with the Original Indenture, dated October 1, 2000, and the First Supplemental

Bond Indenture, dated February 1, 2004, constitutes the Indenture for the District. The Indenture is an agreement between the District and the Trustee for the District, Union Bank, N.A., which outlines the District's and the Trustee's responsibilities and obligations and the rights of the bondholders with respect to the Refunding Bonds, and pledges Special Taxes levied within the District to repay the Refunding Bonds. The Indenture includes information regarding the amount of the Refunding 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). (If a full refunding of the 2000 Bonds and 2004 Bonds cannot be initially executed due to market conditions at the time of pricing, the supplemental indenture for any subsequent economic refunding of the remaining bonds will be based on the form of the Second Supplemental Bond Indenture.)

c. The Bond Purchase Agreement – The Bond Purchase Agreement ("BPA") is an agreement among the District and the Underwriters for the transaction pursuant to which the District agrees to sell, and the Underwriters agree to buy, the Refunding Bonds. It specifies the purchase price of the Refunding Bonds, and certain terms of the bonds, such as interest rates and maturities. The agreement also specifies documents that the parties must receive prior to bond closing, including the Bond Counsel opinion regarding the validity and tax exempt nature of the bonds as well as certain opinions and certificates of the City Attorney and other City and District officials. Such opinions and certificates would confirm, among other things, that all steps necessary to authorize the execution of the financing documents and the issuance of the bonds have been properly taken.

d. The Escrow Agreement - The Escrow Agreement is an agreement between the District and Union Bank, N.A. It provides for the establishment of an Escrow Fund in which sufficient funds are deposited from the issuance of the Refunding Bonds to pay principal and accrued interest on the 2000 Bonds and 2004 Bonds to the call date of March 1, 2012.

e. 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 Refunding Bonds includes information about the Refunding Bonds, sources of repayment of the Refunding 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 Refunding Bonds.

Appendices to the proposed POS include: A copy of the current Rate and Method of Apportionment (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); and information concerning the Depository Trust Company's book entry only system (Appendix F).

f. The Continuing Disclosure Certificate – The Continuing Disclosure Certificate (the "CDC") is included in the POS, and is a commitment by the District to file certain information related to the Refunding Bonds and the District annually with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access System for the benefit of the bondholders. 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, 2012.

H. Schedule

The Disclosure Practices Working Group reviewed the proposed financing and the POS on October 20, 2011 and October 28, 2011. Should the City Council approve the Financing Resolution and related financing documents for the Refunding Bonds, it is anticipated that the Refunding Bonds would be sold the week of December 5, 2011. The bond closing (receipt of bond proceeds) would occur the week of December 19, 2011.

III. FISCAL CONSIDERATIONS:

As described above, under "Interest Rate and Projected Debt Service" under current market conditions as of October 18, 2011, the estimated True Interest Cost ("TIC") for the Refunding Bonds is approximately 4.78%. It is estimated the issuance of the Refunding Bonds will result in net savings to the District of approximately $220,000 annually through 2030 starting tax year 2012-2013.

IV. 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: The adoption of City Council resolutions on February 8, 2000 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; the March 14, 2000 adoption of City Council resolutions and an ordinance establishing the District, declaring the necessity to issue bonded indebtedness, and authorizing the levy of special taxes, following a noticed public hearing and election; the adoption of an Ordinance on April 10, 2000 levying special taxes within Improvement Area No. 1; the adoption of various resolutions and an ordinance on January 8, 2002, January 28, 2002, and August 5, 2002 to effect change proceedings involving a public hearing and election process relating to the amendment of the list of eligible facilities to be financed by the District and the existing Rate and Method of Apportionment; and the adoption of resolutions on September 12, 2000 and January 26, 2004 to authorize the issuance of the 2000 Bonds and the 2004 Bonds, respectively.

On October 19, 2011, the Debt Management Department presented a report to the Budget and Finance Committee on Fiscal Year 2011 Proposed Bond Refundings and the committee took action to forward the Refunding Bonds transaction to City Council for consideration and approval.

V. COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

On July 25, 2011, the City Council adopted Resolution R-306929, approving the Fiscal Year 2012 Special Tax Levy for Community Facilities District No. 2 (Santaluz).

VI. KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Key stakeholders include the special taxpayers in CFD No. 2 (Santaluz) – Improvement Area No. 1, who would benefit from the refunding due to the lower debt service on the Refunding Bonds. Business entities involved in the transaction are: Piper Jaffray & Co. (Underwriter - Senior Manager); Southwest Securities, Inc. (Underwriter – Co Manager); Nossaman, Guthner, Knox & Elliot LLP (Underwriter's Counsel); Stradling, Yocca, Carlson and Rauth (Bond and Disclosure Counsel); Fieldman, Rolapp & Associates (Financial Advisor); David Taussig & Associates (Special Tax Consultant); Union Bank, N.A. (Trustee); and BondResource Partners, LP as Verification Agent.

Respectfully submitted,

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