THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	January 9, 2012	REPORT NO. 12-02
ATTENTION:	Council President and City Council	
SUBJECT:	Water System – 2012 Water Revenue Refunding Bonds	
REFERENCES:	Bond Refundings Report to Budget and Finance Committee (Report No: 11-334), dated October 12, 2011	

REQUESTED ACTIONS:

Authorize the issuance of the Subordinated Water Revenue Refunding Bonds ("Refunding Bonds') by the Public Facilities Financing Authority (the "Authority") in a principal amount not to exceed $218.0 million to generate debt service savings on outstanding Subordinate Water Revenue Bonds, Series 2002 ("2002 Bonds") in one or more series by or before June 30, 2013. The related financing documents include - Supplement to the Amended and Restated Master Installment Purchase Agreement, Assignment Agreement, Third Supplemental Indenture, Escrow Agreement, Bond Purchase Agreement, and Continuing Disclosure Certificate.

STAFF RECOMMENDATIONS: Approve the requested actions.

SUMMARY:

I. BACKGROUND

From time to time bonds have been issued to finance portions of the Water Utility's Capital Improvement Program. As of December 31, 2011, the Water Utility has $822,265,000 in outstanding bonds. This includes:

- Water Subordinated Revenue Bonds, Series 2002 - $227.9 million
- Water Revenue Refunding Bonds, Series 2009A - $153.9 million
- Water Revenue Bonds, Series 2009B - $317.4 million
- Water Revenue Refunding Bonds, Series 2010A - $123.1 million

Debt Management staff monitors refunding opportunities as outstanding bonds become callable and the interest rate environment is favorable. Previously, in June 2010, the then outstanding 1998 Certificates of Participation (COPs) were fully refunded. Currently, the outstanding 2002 Bonds are under consideration for a refunding, due to favorable market conditions.

The 2002 Bonds were issued in October 2002 in a par amount of $286.9 million to advance refund a portion of the then outstanding 1998 COPs and to fund new Capital Improvement Projects ("CIP"). Currently, the principal outstanding is $227.9 million, with $211.4 million eligible for refunding[1]. While tax-exempt rates remain at historic lows, the interest rate environment continues to be volatile. However, the Federal Reserve has stated that rates will remain at historic lows until at least mid-year 2013. Staff is monitoring interest rates closely and believes the current market environment allows an optimal opportunity to refund the outstanding 2002 Bonds in order to maximize the cash flow savings for the Water Utility and ratepayers.

II. DISCUSSION

A. Financing Plan and Structure

The proposed financing plan consists of current refunding the outstanding 2002 Bonds in one or more series if the refunding generates at least 3% net present value savings to the Water System. It is currently anticipated that all the 2002 Bonds will be refunded through the issuance of the Subordinated Water Revenue Refunding Bonds, Series 2012A ("2012A Bonds"), which is planned for late March 2012. Key aspects of the financing plan and structure are provided below:

- **Method of Sale**: Public Offering
- **Principal**: Not to Exceed $218,000,000 for one or more series combined
- **Debt Service Reserve Fund (DSRF)**: The DSRF will be funded with transfer from the existing DSRF of the 2002 Bonds. Any excess reserves will be released to the Escrow Fund to refund the 2002 Bonds.
- **Repayment Source**: Under the terms of the financing documents, the Refunding Bonds are limited obligations of the Authority payable solely from the Subordinated Installment Payments made by the Water System. The Installment Payments are secured by and payable solely from the Net System Revenues of the Water System. Net System Revenue is the income derived from the operation of the Water System (primarily water rates and charges) less the maintenance and operation costs.
- **Final Maturity**: 2032; this will match the final maturity of the existing 2002 Bonds proposed to be refunded.
- **Lien Status**: Subordinated Bonds, which is the same as the 2002 Bonds.
- **Use of Procceds of the 2012A Bonds:** Refund the 2002 Bonds if economic and fund costs of issuance for the 2012A Bonds. Bond proceeds will be deposited into a Escrow account in early May, 2012 until the 2002 Bonds can be called on August 1, 2012 (Current Refunding – Escrow 90 days or less).

B. Legal Structure

As with the Water System outstanding revenue bond issuances, 2012A Bonds and any future Refunding Bonds would be issued relying on the legal framework established in 1998 in issuing the first series of Water System bonds. The following two entities are utilized for the issuance of the proposed 2012A Bonds:

[1] The August 1, 2012, maturity in an amount of approximately $16.5 million is not callable, and is not eligible to be refunded; this maturity will be paid off on August 1, 2012.

The San Diego Facilities and Equipment Leasing Corporation (the "Corporation"), established on February 3, 1986 to acquire and lease to the City real and personal property to be used in the municipal operations of the City. The City is the sole member of the Corporation.

The Public Facilities Financing Authority of the City of San Diego (the "Authority"), was established in May 1991, pursuant to a Joint Exercise of Powers Agreement, between the City and the Redevelopment Agency of the City. The Authority serves as the issuing authority for City's bond issuances, including the 2002 Water Revenue Bonds that are being proposed to be refunded. In December 2011, the California Supreme Court issued a ruling upholding the dissolution of Redevelopment Agencies throughout the State as of February 1, 2012. Subsequent to this ruling, the transaction Bond Counsel has confirmed that the Authority as the issuing entity remains intact even if the Redevelopment Agency of the City dissolves, and City would be able to utilize the Authority as the financing vehicle for the issuance of the Refunding Bonds.

Under the terms of the Amended and Restated Master Installment Purchase Agreement (MIPA), the Corporation assists the City in funding the CIP of the Water System. These components are referred to as the Project and are listed in the Supplement to the MIPA. The City acts as an agent of the Corporation to construct, acquire, and install the Project. The City purchases components of the Project from the Corporation with installment payments from the net system revenues of the Water 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.

The Authority and Corporation will each approve via resolution the Assignment Agreement (described herein Section II.D), assigning to the Authority the Corporation's right to receive installment payments made by the City, allowing the Authority to serve as the enabling entity to issue the 2012A Bonds.

C. City Council Approval Process

The Financing Ordinance authorizes the issuance of the Refunding Bonds in an amount not to exceed $218 million to be issued in one or more economic refundings by or before June 30, 2013. The exact amount of the 2002 Bonds refunded through the 2012A Bonds depends on the market conditions at the time of the sale of the bonds which is planned for late March 2012 (see below). It is the financing team's expectation that all the outstanding 2002 Bonds would be refunded in March 2012. To the extent market conditions deteriorate providing for only a partial refunding opportunity, the Financing Ordinance provides for flexibility to conduct a partial refunding in March 2012, to be followed by another series by or before June 30, 2013. Consistent with the City's Debt Policy, the City will only refund portions of the 2002 Bonds that generate at least 3% NPV Savings.

It is recommended that the City Council approve all financing documents included with this item for successful pricing and closing of the proposed offering. Certain of the documents as listed below including the Assignment Agreement, Bond Purchase Agreement, Continuing Disclosure Agreement, Escrow Agreement, Supplement to the Amended and Restated MIPA, and Third Supplemental Indenture, for the Refunding Bonds would be approved via ordinance, and would go into effect in 30 days after the approval of the ordinance.

Staff will be docketing the Preliminary Official Statement (POS) for the 2012A Refunding Bonds separately to be authorized via resolution in mid-March 2012, closer to the distribution of the POS to bond investors.

D. Financing & Legal Documents

The **Financing Ordinance** authorizes the issuance of the Refunding Bonds, which includes 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 2012A Bonds and subsequent Refunding Bonds by or before June 30, 2013. The operative legal documents for the 2012A Bonds include:

- The **Assignment Agreement** between the Authority and the Corporation assigns to the Authority the Corporation's right to receive installment payments made by the City for the 2012A Bonds. The Assignment Agreement will be entered into between the Authority and the Corporation to allow for the Authority to make debt service payments on behalf of the City on the proposed 2012A Bonds. The 2012A Assignment Agreement will be approved via resolutions of the Authority and Corporation. The City Council will acknowledge via the financing Ordinance the City's obligation under the Assignment Agreement to send the Installment Payments to the Trustee, on behalf of the Corporation.

- The **Bond Purchase Agreement** between the City, Authority, and underwriters' representative defines the terms and conditions of the 2012A Bonds once they have been priced. The Bond Purchase Agreement will also be approved via resolution of the Authority.

- The **Continuing Disclosure Certificate** details the City's ongoing obligation to file annual reports and material event notices with the Municipal Securities Rulemaking Board for the benefit of the bondholders.

- The **Escrow Agreement** by and between the Authority and Wells Fargo Bank National Association (the "Escrow Agent") would create an Escrow Agreement to refund certain 2002 Subordinated Revenue Bonds which could be current refunded and the bond funds shall be placed in an escrow for the purpose of providing funds necessary to refund and redeem the Refunded Bonds on August 1, 2012 (Bond Call Date).

- The **Supplement to the Amended and Restated MIPA** between the City of San Diego and the San Diego Facilities and Equipment Leasing Corporation documents the sale of certain components of the City's Water System and provides for installment payments by the City to pay the debt service on the 2012A Bonds.

- The **Third Supplemental Indenture** between the Authority and the Trustee provides for the issuance of the Series 2012A Bonds under the terms of the 2009 Indenture and the 2012A Bond Purchase Agreement.

E. Financing Team

The City's Financing Team for the 2012A Bonds consists of the Chief Financial Officer, Debt Management, Public Utilities Department, the Comptroller's Office, the City Attorney's Office, and outside consultants, including Montague DeRose and Associates LLC as independent Financial Advisor, Orrick, Herrington & Sutcliffe LLP as Bond and Disclosure Counsel, PFM Asset Management LLC as Verification Agent and Wells Fargo Bank National Association as Bond Trustee.

The City Attorney's Office has identified through a request for proposals ("RFP") process Orrick, Herrington & Sutcliffe LLP to serve as bond and disclosure counsel for the 2012A Bonds. Orrick, Herrington & Sutcliffe LLP has proposed to provide such service for the 2012A Bonds for a fee in an amount not to exceed $120,000, inclusive of out-of-pocket expenses. Montague DeRose and Associates LLC was selected to serve as the financial advisor through the as-needed financial advisory list of Debt Management created through a request for proposal process in an amount not to exceed $45,000 which includes reasonable out-of-pocket expenses not to exceed $5,000. The Bond and Disclosure Counsel fees and the Financial Advisor fees are contingent upon the successful closing of the Series 2012A Bonds. PFM Asset Management LLC will provide one-time verification services, in an amount not to exceed $2,800, as to sufficient monies deposited with the Trustee for the refunding of the 2002 bonds. Wells Fargo Bank, N.A. is the bond trustee for the Water System's debt obligations, and will receive $3,800 at bond closing, with recurring annual fees estimated at $1,800.

Based on a request for proposals process conducted for underwriter services, syndicate members were identified based on the following selection criteria: investment banking experience and the banking team's qualifications as presented in the proposals and verified through reference checks, knowledge of the City's Water System, firm's financial capacity to underwrite, the strength of the institutional and retail distribution networks, marketing outreach capabilities, and local and regional community outreach efforts. Morgan Stanley & Co. Inc. serves as the Senior Book-Running Manager, De La Rosa as the Co-Senior Manager and RBC Capital Markets and Stone and Youngberg LLC as the Co-Managers for the proposed 2012A Bonds.

F. Financing Schedule - 2012A Bonds

Jan 23/24, 2012	Introduction of Financing Ordinance and approval of Financing Documents
February 6/7, 2012	Approval of Financing Ordinance and Financing Documents
March 12/13, 2012	Request approval of the resolution authorizing the Preliminary Official Statement
Week of March 19, 2012	Release Preliminary Official Statement to Investors
Week of March 26, 2012	Pricing – 2012A Bonds
Week of May 1, 2012	2012A Bond closing and deposit proceeds into the Escrow Fund to refund the 2002 Bonds
August 1, 2012	Refund 2002 Bonds

III. FISCAL CONSIDERATIONS

Estimated Sources and Uses of Bond Proceeds (preliminary and subject to change)

Based on market rates as of December 27, 2011, assuming all bonds are refunded, the par amount of the 2012A issue is estimated at $191,195,000. The par amount of the 2012A Bonds, the transfer of the debt service reserve fund (DSRF) from the 2002 Bonds, and the Original Issue Premium of the 2012A Bonds, will serve as the sources to refund the 2002 Bonds, fund the DSRF, and costs of issuance associated with the 2012A Bonds (see "Estimated Sources and Uses" table below).

The following estimate assumes all of the 2002 Bonds are economic to refund. Based on the current rates, the estimated All-in True Interest Cost is 3.49% for the refunding bonds issued with the final maturity of August 1, 2032.

Estimated Sources and Uses of Funds

Estimated Sources	
Par Amount of 2012A Bonds	$191,195,000
Original Issue Premium	21,916,360
Debt Service Reserve Fund + Accrued Interest	22,464,957
Total Proceeds	**$235,576,317**
Estimated Uses	
Refunding Escrow Deposits	$216,665,097
Debt Service Reserve Fund	17,759,683
Costs of Issuance[1]	1,147,090
Additional Proceeds (rounding)	4,447
Total Uses of Funds	**$235,576,317**

[1]Costs of Issuance include underwriter's discount, bond and disclosure counsel fees, financial advisory fees, rating agency fees, Preliminary Official Statement and Official Statement electronic printing/posting costs, CDIAC and other related fees. See Attachment 1 for details.

Refunding Results

The refunded bonds on a Subordinate Lien structure would generate an estimated 11.53% in net present value savings of refunded par inclusive of the costs of issuance incurred. The cumulative nominal savings are projected at approximately $32.3 million, with average annual cash flow savings, net of costs of issuance expenses, of approximately $1.5 million for Fiscal Years 2013 - 2033 resulting in improved net system revenues and corresponding rate coverage levels. Staff will provide updated estimates to the City Council at the time of the Council hearing.

Interest Rate and Projected Debt Service. In accordance with the City's Debt Policy, the 2012A Bonds will be priced on a fixed rate basis with the interest rate fixed at the time of the pricing the bonds. The original final maturity of August 1, 2032, will remain unchanged. The debt service payments will be paid semi-annually.

IV. ALTERNATIVES

Do not approve the proposed action necessary to issue the 2012A Bonds to take advantage of refunding opportunities. The Water System will continue paying current debt service on the outstanding 2002 Bonds, compared to lower debt service attainable if market conditions enable the City to move forward with the refunding thus generating savings over the life of the outstanding bonds. It is recommended that the request be approved to continue with the implementation of the refunding proposal to cover the Water System's repayment obligations.

V. PREVIOUS COUNCIL and/or COMMITTEE ACTION:

On October 19, 2011, an update on various economic bond refunding opportunities for the Water Utility and Special Districts were presented to the Budget and Finance Committee. The Committee took action unanimously approving to submit the refunding proposal for the bond refundings to the City Council.

VI. COMMUNITY PARTICIPATION AND OUTREACH EFFORTS:

Pursuant to Proposition 218, the City provided property owners 45 days advance notice of the City Council's formal consideration of rate increases necessary to support the CIP and corresponding bond issuance projections from FY 2008 to FY 2011. Notices were mailed to property owners of record and City of San Diego water bill customers, advising them that the City Council would hold hearings to consider adoption of the water rate increases for Fiscal Years 2008 through 2011. The hearings were held as scheduled and the rate increases were subsequently approved by the City Council. On December 19, 2011, the Public Utilities Refunding Plan was presented to the Independent Rates Oversight Committee (IROC) as an informational item.

VII. KEY STAKEHOLDERS & PROJECTED IMPACTS:

Business entities involved in the 2012A Bonds are Morgan Stanley Inc. (Book-Running Senior Manager); De La Rosa (Co-Senior Manager); RBC Capital Markets, Stone & Youngberg LLC (Co-Managers); Orrick, Herrington & Sutcliffe LLP (Bond and Disclosure Counsel); Nixon Peabody LLP (Underwriter's Counsel); Wells Fargo Bank N.A. (Trustee); Montague DeRose and Associates LLC (Financial Advisor) and PFM Asset Management LLC (Verification Agent).

Respectfully submitted,

Lakshmi Kommi
Debt Management Director

Mary Lewis
Chief Financial Officer

Attachments:
1. Estimated Costs of Issuance Budget

Attachment 1

Estimated Costs of Issuance Budget

2012A Bonds

Role	Firm	2012A Bonds
Financial Advisor	Montague DeRose & Associates LLC[1]	$45,000
Bond & Disclosure Counsel	Orrick, Herrington & Sutcliffe LLP[1]	$120,000
Credit Rating Fees	Moody's & Fitch	$155,000
City's General Disclosure Counsel	Hawkins, Delafield & Wood LLP	$12,500
Bond Trustee	Wells Fargo Bank	$3,800
Printing Costs & Electronic Posting of OS	Elabra, Inc.	$1,000
Verification Agent	Public Financial Management	$2,800
Underwriter Discount, Expenses [2]	Syndicate	$786,835
Contingency		$20,155
Total Costs of Issuance		$1,147,090

[1] Amount is not to exceed and is contingent on successful closing of the bonds.
[2] Approximate amounts based on market conditions. Includes takedown, underwriter's counsel fees and out-of-pocket expenses.