THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	December 20, 2013	REPORT NO: 14-01
ATTENTION:	Council President and City Council	
SUBJECT:	2014 Capital Improvement Program Lease Revenue Bonds	
REFERENCE:	2014 Capital Improvement Program Bond Authorization, Infrastructure Committee (Report No. 13-087) October 21, 2013	

REQUESTED ACTIONS:

1. Authorize the issuance of the Public Facilities Financing Authority of the City of San Diego (the "Authority") Lease Revenue Bonds ("Phase 3 CIP Bonds") in a principal amount not to exceed $130 million to provide for $120 million in multiple series for various General Fund Capital Improvements;

2. Authorize the execution of related financing documents including the form of Second Amendment to the Site Lease, the form of Second Amendment to the Facilities Lease, the form of Second Supplemental Indenture with Wells Fargo Bank, National Association as the Indenture Trustee, the form of the Notice Inviting Bids, the form of the Bond Purchase Agreement, and the Continuing Disclosure Certificate;

3. Authorize the City Attorney to appoint Stradling Yocca Carlson & Rauth as Bond and Disclosure Counsel for the Phase 3 CIP Bonds and pay an amount not to exceed $65,000, for the first series and an amount not to exceed $60,000 for the second series, plus reasonable out of pocket expenses not to exceed $1,500 per issuance. The fees payable to Bond and Disclosure Counsel shall be contingent upon the closing of the bonds; and,

4. Authorize the Chief Financial Officer to establish one or more special interest-bearing account(s) for the bond proceeds of the $120 million Lease Revenue Bonds.

STAFF RECOMMENDATION:
Approve the requested actions.

SUMMARY:

I. Background

Since March 2009, the City has issued three series of Capital Improvement Projects ("CIP") General Fund-backed lease revenue bonds – 2009A Bonds, 2012A Bonds, and 2013A Bonds. The proceeds totaling approximately $213 million have provided funding for various capital needs. As of November 2013, Public Works has utilized (spent or encumbered) approximately 50% of the proceeds of the 2012A Bonds. In order to continue funding the General Fund infrastructure needs through the lease revenue bond program, the Phase 3 CIP Bonds are expected to be issued concurrent with approximately 80% utilization of the 2012A Bonds.

On October 28, 2013, the Infrastructure Committee unanimously approved the Phase 3 CIP Bonds Authorization. A summary of projects and amounts totaling $120 million can be found in Attachment 1. $48.6 million is allocated to Facilities, $44.1 million to Streets, $1.0 million to Sidewalks, $4.3 million to ADA improvements, and $22.0 million to Storm Drains.

II. Discussion

A. Summary of Phase 3 CIP Bonds

- ***Issuer****:* Public Facilities Financing Authority of the City of San Diego.

- ***Not to Exceed Amount***: $130 million, with flexibility to sell bonds in one or more series.

  Based on the review of the projected encumbrance trends, the Phase 3 CIP Bonds will be issued in two series. As discussed above, Series 1, 2014A Bonds, is estimated to be issued in April 2014, and will generate $66.4 million in net proceeds meeting the projected encumbrance needs for approximately 12 months, from May 2014 through April 2015. Series 2 will be programmed to be issued based on the spend-down of the bonds proceeds from Series 1 2014A Bonds. Based on current draw-down projections, Series 2 will be issued in April 2015 generating the remaining amount, approximating $53.6 million in construction proceeds. A final determination on size of each series will be made closer to the issuance of the bonds.

- ***Method of Sale:*** Public Offering, Competitive Sale.

  The Series 1 2014A Bond offering is expected to be conducted as a competitive sale, whereby the bonds will be advertised for sale and any interested investment bank may bid on the bonds at the designated date and time. The bidder offering the lowest interest cost will be awarded the bonds. Due to the City's name recognition in the markets, the well established master lease structure and overall favorable market conditions for large credits, it would be more straight forward and advantageous for the Series 1 2014A Bonds to be sold on a competitive basis. Based on market conditions and the advice of the Financial Advisor ("FA"), if it is determined that a competitive sale is no longer favorable, the City and FA will identify an Underwriting Syndicate and the bond offering will be conducted as a negotiated sale.

- ***Tax Status:*** The Phase 3 CIP Bonds will be issued as tax-exempt issuances. The financed projects under each of the categories are capital in nature, have long useful life, and uses are limited to governmental purpose. Consistent with the IRS regulations for tax-exempt bonds, the weighted average life of the bonds will not exceed 120% of the weighted average remaining aggregate useful life of all the projects funded by the bonds.

- ***Structure**:* One or more series to be issued under supplements to the Master Indenture and Master Site and Facilities Lease established with the 2012 Deferred Capital Improvement Bonds (see Legal Structure).

- ***Repayment Source***: Payable from General Fund.

- ***Final Maturity:*** 30-year term per Series.

B. Legal Structure

The Public Facilities Financing Authority of the City of San Diego (the "Authority") is the issuer of the Phase 3 CIP Bonds. In 2012, the City issued 2012A&B Bonds under a Master Site Lease and a Master Facilities Lease (together the "Master Lease"), and a Master Indenture. Under this structure, the documents allow for future bonds to be issued through supplements to each of the documents. The 2013 Bonds issued in July 2013 were under supplements to the Master Indenture and the Master Lease. The proposed Phase 3 CIP Bonds, Series 1 and Series 2 will also be issued under supplements to the Master Indenture and the Master Lease.

<u>Leased Properties</u>

The Lease involves lease agreements between the City and the Authority of existing City-owned General Fund properties (the "Leased Properties"). The Phase 3 CIP Bonds are structured as an asset transfer bond offering which is a lease transaction where the financed assets are substituted with other essential assets of the City. Additional assets commensurate with the Phase 3 CIP Bonds will be added to the existing pool of assets pledged for the 2012 and 2013 Bonds. Pooling assets in a common Lease helps strengthen the Indenture and adds diversity and value to bond holders. Essential properties such as libraries, police stations and fire stations, necessary for core operations of the City or revenue generating ground leases, are generally considered as strong assets by the rating agencies and investors in a lease revenue bond offering.

As with prior lease revenue bond issuances, Debt Management staff worked closely with the Real Estate Assets Department ("READ") to identify additional unencumbered assets to be included in the Leased Properties for the proposed Phase 3 CIP Bonds with the capacity to generate $120 million in total proceeds. Below is a preliminary list of the proposed properties identified:

- Central Police Vehicle Maintenance Facility
- Fire Station 16 (Mt. Soledad)
- City Operations Building & Parkade
- Carmel Valley Community Park Town Recreation Center

- Fire Station 24 (Carmel Valley)
- Scripps Ranch Library
- North University Community Library & Recreation Center

To establish the annual fair rental value, a legal requirement to issuing lease revenue bonds, the properties are currently being appraised by the independent appraisal companies retained by READ. As required under the lease financing structure, the maximum annual debt service payable by the City on the lease revenue bonds will not be in excess of the combined annual fair rental value of the Leased Properties. The City properties are leased until the final maturity of the Phase 3 CIP Bonds, unless modified under conditions set forth in the legal documents. The combined preliminary value of the City owned properties is estimated $122 million. Given that the Phase 3 CIP Bonds are being issued in two series, only assets required for Series 1 2014A Bonds will be pledged initially, followed by the pledge of additional assets when the Series 2 bonds are issued.

A final list, with any additions to or removals from proposed properties will be determined and reported based on the final appraisals and estimated annual debt service concurrent with the request for approval of the Preliminary Official Statement. Further, if final appraised value of assets pledged is in excess of what is required for the annual debt service, soon after the bonds are priced, properties will be dropped from the initial pledge. Title reports are being obtained for all the properties in order to establish that the assets are not already encumbered and are free and clear of liens.

<u>Are there sufficient suitable properties for future Lease Revenue Bond issuances?</u>

Also see Attachment 2 (Lease Revenue Bonds – Pledge of Properties).

The IBA Report, 13-54, dated December 6, 2013, described several key limitations with the sole reliance on the lease revenue bond model for addressing the large infrastructure needs over the long term. Availability of leasable properties was listed as one of the considerations and recommended that Debt Management and READ review properties that may be suitable for future lease revenue bonds.

Based on the detailed review of the General Fund properties recorded in the Comptroller's system and applying prevailing credit standards for the sale of lease revenue bonds, it is safe to conclude there are needed suitable properties (similar to those used in the previous deferred capital bond series) to accomplish the remaining bond issues during Fiscal Years 2015-2017 at a combined total of approximately $260 million. Please see Attachment 2 for additional detail on the evolving trends for pledge of properties within the Lease Revenue Bond credit space. Attachment 2 also provides historical use of properties and relevant metrics on additional suitable properties for future uses.

To the extent there are additional proposals beyond the funding envisioned under the Enhanced Option B infrastructure plan for the lease revenue bonds using current General Fund revenue for repayment, as needed, specific properties will be identified and applied to the future financing plans. And/or, depending on the nature of the infrastructure improvements and flexibility, alternate financing plans for the bonds utilizing capitalized interest feature can be applied which does not require pledge of existing properties.

C. City Council Authorization

The City Council is requested to (i) authorize the issuance of the Phase 3 CIP Bonds, in one or more series; (ii) approve the financing legal documents; (iii) authorize the City Attorney to appoint the Bond and Disclosure Counsel; and (iv) authorize the Chief Financial Officer to establish one or more Special Interest-bearing accounts for the bond proceeds contingent upon approval of the bond documents and contingent upon the issuance of the bonds. Certain of the financing legal documents, including the leases, the second supplemental indenture, and a continuing disclosure certificate must be approved via ordinance, and are subject to a 30 day referendum period. Staff will be docketing the Preliminary Official Statement (POS) for the 2014A Bonds (Series 1) separately to be authorized via resolution in March 2014, closer to the distribution of the POS to potential investors.

<u>Financing & Legal Documents</u>

The financing Ordinance approves and authorizes the execution of the one of more of the following financing documents:

1. <u>Form of the Second Amendment to Master Site Lease (Site Lease)</u> – The Site Lease is the agreement between the City and the Authority under which the City leases the City owned Leased Properties to the Authority.

2. <u>Form of the Second Amendment to Master Facilities Lease (Facilities Lease)</u> – The Facilities Lease is the agreement between the City and the Authority under which the City leases the Leased Properties back from the Authority. The lease payments made by the City are equal to the principal and interest payments on the bonds issued by the Authority. The Facilities Lease contains certain covenants of the City, including that it will take the necessary action to include all lease payments due under the lease in the City's operating budget each year.

3. <u>Form of the Second Supplemental Master Indenture (Indenture)</u> – The Indenture is an agreement between the Authority and the Trustee for the bonds. The Indenture provides for the issuance of the bonds, and includes information regarding the amount of the bonds, the maturities and interest rates on the bonds, the use of bond proceeds, and the nature of the security for the bonds (i.e., that the bonds are limited obligations of the Authority payable from lease payments. The Indenture also sets forth terms, including the specific rights, responsibilities, and obligations of each party with respect to the issuance of the bonds. Under the Indenture, the Authority assigns its rights to receive lease payments under the Facilities Lease to the Trustee to make debt service payments to bondholders.

4. <u>Form of the Continuing Disclosure Certificate</u> – The Continuing Disclosure Certificate ("CDC") details the City's ongoing obligation to file annual reports and material events with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access system for the benefit of the bondholders.

5. Form of the Notice Inviting Bids – As stated earlier, the financing plan currently envisions that the 2014A Bonds (Series 1) will be sold on a competitive basis. In a competitive sale, the Notice Inviting bids is a notice published for the investment community describing the bonds, the sale date and bidding instructions. The bids are accepted until a specified date and time when the winning bidder is selected.

6. Form of the Bond Purchase Agreement – Staff is also seeking authorization of the form of the Bond Purchase Agreement ("BPA"), in the event that the Phase 3 CIP Bonds, Series 1 or Series 2, were to be sold on a negotiated basis. The BPA is an agreement among the City, the Authority, and the Underwriters for the transaction pursuant to which the Authority agrees to sell, and the Underwriters agree to buy the bonds. It specifies the purchase price of the 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 Authority 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. Financing Time Line

Following are the critical milestones related to the execution of the Phase 3 CIP Bonds, including the authorization of the financing ordinance for Phase 3 CIP Bonds and the disclosure document for the 2014A Bonds (Series 1). The exact timing of the sale of Series 2 will be determined based on the actual project draw down trends of the 2014A Bonds (Series 1) and the projected draw down needs of the Series 2 funds. The Preliminary Official Statement for Series 2 will be brought forward for City Council approval when the Series 2 Bonds are to be sold.

January 2014	Introduction & approval (2 readings) of the Financing Ordinance authorizing the issuance of the Phase 3 CIP Bonds and approval of the financing documents. 30 Day Referendum Period after the City Council approval of the financing ordinance.
March 2014	City Council approval of the disclosure document (Preliminary Official Statement) for 2014A Bonds (Series 1) Authority approval of the 2014A Bonds (Series 1)
Week of March 24, 2014	Bond Sale (Series 1)
April 2014	Bond Closing and delivery of proceeds for 2014A Bonds (Series 1)

E. Financing Team

The City's Financing Team for the Phase 3 CIP Bonds consists of staff of the Department of Finance, including the Chief Financial Officer and staff of the Debt Management Department, the Comptroller's Office, the Treasurer's Office, the Risk Management Department, and the Financial Management Department. The Financing Team also includes staff of the Real Estate Assets Department, the City Attorney's Office, the Department of Public Works, Engineering & Capital Projects, and the Department of Transportation & Storm Water. External members include: Public Financial Management, Inc. ("PFM") as the financial advisor; Stradling Yocca Carlson & Rauth ("SYCR"), as Bond and Disclosure Counsel; Wells Fargo Bank, National Association as Trustee; Chicago Title Company as title insurance provider; and DF Davis Real Estate, Inc., Hilco Real Estate Appraisal, James Naughton Jr., MAI, and Jean C. Catling Company as appraisers.

Financial Advisor: PFM is selected to provide financial advisory services for this transaction from the City's As-needed Financial Advisors List established through RFP process based on the firm's experience in General Fund lease revenue bond financings, competitive method of sale, and the fee proposal. The fee to PFM for this issuance, which is contingent upon the successful closing of the Phase 3 CIP Bonds, is for an amount not to exceed $80,000 ($50,000 for Series 1 and $30,000 for Series 2), plus out of pocket expenses not to exceed $3,000 for each issuance.

Bond and Disclosure Counsel: The City Attorney's Office has identified via RFP process Stradling Yocca Carlson & Rauth ("SYCR") to serve as Bond and Disclosure Counsel for the Phase 3 CIP Bonds and pay an amount not to exceed $65,000 for Series 1 and $60,000 for Series 2, plus reasonable out of pocket expenses not to exceed $1,500 for each issuance. The fees payable to Bond and Disclosure Counsel shall be contingent upon the closing of the bonds and paid out of bond proceeds.

Trustee: Wells Fargo Bank, the existing trustee for the Master Lease parity obligations, will continue to serve as the Trustee for this new parity issuance. Compensation for the Trustee includes $5,000 for the transaction and ongoing estimated annual fees of $2,000 per series.

FISCAL CONSIDERATIONS:

A. Phase 3 CIP Bond Proceeds, Interest Rate and Projected Debt Service

Based upon current market conditions, the total proceeds from the 2014A Bonds Series 1 is approximately $67 million, providing funding to establish the $66.4 million Construction Fund for CIP expenditures and pay for financing costs of issuance.

<u>2014A Bonds Series 1 Estimated Sources and Uses of Funds</u>

<u>Estimated Sources</u>	
2014A Bonds Series 1	
Total Proceeds	**$ 66,989,000**
<u>Estimated Uses</u>	
2014A Bonds Series 1	
Deposit to Construction Fund	$ 66,400,000
Costs of Issuance and additional proceeds due to rounding [1]	589,000
Total Uses of Funds	**$ 66,989,000**

(1) Costs of Issuance include underwriter's discount, bond and disclosure counsel fees, financial advisory fees, trustee fees, title insurance costs, appraisal fees, auction platform fees, rating agency fees, Preliminary Official Statement and Official Statement electronic printing/posting costs, and City staff costs. Additional proceeds due to rounding are $5,000.

Below is a summary of fiscal impact at current market rates (estimates, subject to change).

- All-in True Interest Cost for the 2014 CIP Bonds (Series 1): 4.66%
- Average annual debt service: $4.2 million (Fiscal Year 2015 - 2044)
- Budgeted in the Citywide Program Expenditures Department

Assuming the same cost of borrowing for Series 2, the average annual debt service is estimated to be $3.3 million, commencing Fiscal Year 2016. Below is the estimated annual debt service for the entire $120 million:

FY 2015:	$4.2 million
FY 2016 – FY 2044:	$7.5 million
FY 2045:	$3.3 million

A drop in effective interest rates in recent months has resulted in a lower TIC of 4.66% (compared to 5.1% in mid-October 2013). The actual cost of borrowing will depend on the market coniditions at the time the bonds are sold.

The maximum effective interest rate established under the Financing Ordinance is 7.00%. Under the current market conditions, it is not expected that the actual pricing for the Series 1 2014A Bonds will result in an effective interest rate of 7.00%; should that occur, the average annual debt service would be approximately $5.4 million.

In accordance with the City's Debt Policy, Section 4.2, an analysis of the impact of additional General Fund backed bonds was conducted, specifically for the impact of the Phase 3 CIP Bonds (Series 1 and 2). Section 4.2 of the Debt Policy recommends that debt service as a percentage of General Fund revenues be below 10% (this does not take into account other long term fixed obligations such as pension and OPEB costs). Under the current lease revenue bond levels, the debt service as a percentage of General Fund revenues is at 4.46% for Fiscal Year 2014. The Series 1 2014 Bonds debt service commences in Fiscal Year 2015 and would increase the debt service as a percentage of General Fund revenues from 4.40% to 4.72% in Fiscal Year 2015 (no impact in Fiscal Year 2014). Subsequent to the issuance of Series 2 as currently planned, the debt service as a percentage of General Fund revenues would increase from 3.57% to 4.12% in Fiscal Year 2016.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

- Infrastructure Committee Report Number 13-087 – 2014 Capital Improvement Program Bond Authorization (October 28, 2013)
- Infrastructure Committee Report Number 13-088 – Deferred Capital Bond Funded Program Update (October 23, 2013)
- FY 2015-2019 Five Year Financial Outlook (November 14, 2013)

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:
Community outreach and public participation is handled on a project basis through the Department of Public Works. Also see above.

KEY STAKEHOLDERS:
Business entities included in the financing: Stradling Yocca Carlson & Rauth (Bond and Disclosure Counsel); Wells Fargo Bank, National Association (Trustee); Public Financial Management, Inc. (Financial Advisor); Standard & Poor's (Rating Agency); Fitch Ratings (Rating Agency); Chicago Title Company (title insurance); D.F. Davis Real Estate, Inc., Hilco Real Estate Appraisal, James Naughton Jr., MAI and Jean C. Catling Company (appraisals); and the Printer (Electronic Printing of POS and OS).

Lakshmi Kommi
Debt Management Director

Mary Lewis
Mary Lewis
Chief Financial Officer

Attachment:

1. Phase 3 CIP Bonds – Project List
2. Lease Revenue Bonds – Pledge of Properties

Attachment 1

Phase 3 CIP Bonds – Project List

Project #	Project Name/Description	Total DC3 Need
	Total Infrastructure Bond 3	**$120,000,000**
L- 14004	Mission Beach Brdwalk Bulkhead Phased	$600,000
S-12005	Midway Street Bluff Repair	$100,000
AID00005	**Resurfacing of City Streets Annual Allocation**	$43,460,000
	Streets Total	**$44,160,000**
S-00787	Fire Station 22 - Point	$2,600,000
S-00791	South Mission Beach Station	$2,100,000
S-00692	Skyline Library	$2,800,000
S-00792	L.J. Cove Life Guard Station - Construction	$250,000
S-00788	Fire Station #05 (Hillcrest)	$8,200,000
S-00783	Mid-City Fire Station 17	$11,200,000
S-13022	Mission Hills/Hillcrest Branch Library	$4,000,000
S-00802	San Ysidro Library	$3,000,000
S-13005	University Village Tot Lot	$150,000
S-00800	San Carlos Library	$1,000,000
S-14017	FS51 Skyline Hills	$1,000,000
S-14018	Home Avenue Fire Station	$2,000,000
S-11011	Tierrasanta Sports Field Lighting	$400,000
ABT00001	**Facilities Annual Allocation***	$9,880,000
	Facilities TOTAL	**$48,580,000**
AIK00003	**Sidewalks TOTAL**	**$1,000,000**
ABE00001	**ADA Improvements TOTAL**	**$4,300,000**
ACA00001	**Storm Drain Annual Allocation TOTAL**	**$21,960,000**

*** Includes funding for: North Park Recreation Center and Balboa Park Chess Club**

Lease Revenue Bonds – Pledge of Properties

Background

Lease Revenue Bonds ("LRBs") are lease obligations secured by an installment sale or by a lease-back arrangement between the City and the issuing Joint Powers Authority ("JPA"). Under the lease-back arrangement, the City leases certain properties to the JPA for a nominal rent and in turn leases the properties back from the JPA. The City would make rental payments to the JPA annually for leasing the properties; the annual payments made by the City would be equivalent to the annual debt service on the bonds issued by the JPA. The JPA receives the annual rental payments from the City and assigns the payments to the trustee for the transaction to make principal and interest payments to the bondholders. Hence identification of *Leased Properties* is a critical component of each lease revenue bond transaction.

City's existing Lease Revenue Bonds and Leased Properties

Generally, the Lease Revenue Bonds are issued using two options: 1. by pledging upfront the facilities that will be built with the proceeds of the bonds being proposed to be issued; and, 2. by pledging preexisting facilities already owned by the agency for a bond offering that provides funding for a different set of capital improvements. This second option is more commonly known as the asset transfer option. Historically, City has utilized both options.

The second option, asset transfer, offers two primary advantages: First, as with the deferred capital bonds where a significant portion of the proceeds are spent on improving existing streets and storm drains, which are right of ways, i.e., not pledgeable assets, City could rely on a separate pool of assets to encumber instead of pledging the streets or storm drains. Second, if the City were to pledge an existing facility using asset transfer, during the construction period of the capital improvements, City does not have to capitalize interest payments for the bonds during that period. This lowers the bond issue amount and resulting in lower debt service and thus overall lower borrowing costs.

Examples of the first option, where the financed asset was used as leased property include the 1998 LRBs issued to finance the expansion of the Convention Center (refunded in 2012) and the 2002 LRBs issued to finance Petco Park construction (refunded in 2007). These examples are situations where a new project is built and it is possible to use the new project as the asset being used as collateral. However, this requires the issuance of bond proceeds sufficient to capitalize the interest due on the bonds for the construction period, since the City would not have use and occupancy of the leased property until after construction. Upon completion of the asset, it would serve as the leased property. The use of capitalized interest increases both the size of the bonds issued and the repayment over the life of the bonds.

More frequently, the City's LRBs have been structured as an asset transfer bond offerings; this is the second option. These are lease transactions where the leased properties are existing essential assets of the City rather than the assets financed with the proceeds of the bonds. This structure is typically utilized when the assets to be financed with the bond proceeds are not eligible to be used as leased properties. Examples include streets, sidewalks, and storm drains. The City's recent LRBs issued in 2009, 2012, and 2013 to finance capital improvement projects utilized the asset transfer structure.

In 2012, the City established a Master Lease with the issuance of the 2012 LRBs, which allows for future CIP bonds to be issued under the same lease agreement by including additional properties to the existing pool of leased properties. Using a Master Lease structure provides for lower costs, stronger credit, and desired diversity in the Leased Properties. This also allows the City to potentially include some less essential assets in the pool, while still maintaining a strong overall quality of leased properties.

<u>Identification of Leased Properties and evaluation criteria</u>

Evaluation of leased properties for the bond pledge is based on financial, legal, credit and essentiality considerations.

Financial: The leased properties for a LRB transaction would need to have sufficient value, i.e., the total appraised value of the properties would need to be approximately equal to the value of the bonds being issued. More specifically, based on the appraised value of the properties the annual market fair rental value is determined, which should be at least equal to the annual debt service of the bonds.

Legal: The properties selected for a transaction should have no prior liens – should not be pledged for prior bonds or other obligations (unencumbered properties). Also, there should be no restrictions to pledge the property for the life of the bonds (typically 30 years). Some City properties, like pueblo lands, may have certain Charter restrictions that do not allow the city to pledge the property for more than 15 years. Many City properties like museums in Balboa Park, parking garages, or recreation centers may be used and occupied by third parties. Prior to pledging such properties the City would need to ensure it is permissible under existing use or operating agreements with the third parties. Similarly, the City has many long term operating leases with hotels or other operators, where it owns the underlying land. This land could be used as leased property but is subject to review of the operating lease agreements. Finally, the City should expect to have use of the property for the life of the bonds.

Credit: The "quality" of leased property is one of the many factors considered by the investors and the rating agencies in determining whether the lease is an essential lease or not. And, the credit rating of a lease revenue bond takes into account this expectation. Typical remedies in an event of default by the issuer include the Bond Trustee's ability to take possession and re-let the leased properties. Since an issuer is less likely to default on the annual debt service payments when assets pledged are essential to its core operations, such assets are viewed by the market and the rating agencies as stronger security. Assets typically considered essential to the operations of the City, include police and fire facilities, libraries, or city operations and administration buildings. Facilities like stadiums, recreation centers, golf courses, parking garages, are considered less essential. When multiple assets are pledged for a bond issue, diversity within the essential assets is also considered a positive credit factor for rating agencies and mitigates concentration risk for investors. *In recent years, City has successfully argued that revenue generating assets such as the City's long term ground leases hold as much value to the City as the traditional assets essential for core operations. Due to this, City was able to innovatively tap more ground leases with no change to the credit rating and the same level of bond pricing as the traditional essential properties. In addition, for the proposed bond issue, select community recreation centers are added to the preliminary list of properties. Although, these community centers are not traditionally viewed as essential assets for a lease obligation, staff would like to present certain unique credit strengths of these properties including their desirable location, high real estate value, and improvements required for master housing development. Generally, a pledge of non essential properties results in lower credit ratings and higher spreads in interest rates.

Historically, while Lease Revenue Bonds are a highly successful bond category in California and in the nation, the essential purpose of the lease is currently going through an extremely close scrutiny by the investors and the rating agencies. Several major institutional investors are opting not to purchase the bonds due to the risk of non appropriation of debt service by the issuers under financial distress including Chapter 9 bankruptcy filings by San Bernardino, Stockton, and the budgetary decisions made by issuers such as Stockton with respect to lease revenue bond payments.

Property categories that fall within the <u>essential lease properties</u>:

- Police Facilities
- Fire Facilities
- Libraries
- Core Operations facilities
- Long term ground leases *(see above)

The following categories are deemed <u>non essential lease properties</u>:

- Golf Courses
- Parking Garages
- Recreation areas
- Sports Facilities
- Meeting/Convention Facilities
- Open Space
- Property used or rented for non essential/non-core operations

<u>City Property Encumbrances:</u>

Following is the listing of number of General Fund properties pledged for various bond issuances and a listing of suitable property categories that remain unencumbered:

I. <u>Lease Revenue Bonds other than Deferred Capital Bonds</u>

• Ballpark Refunding Bonds	1 (Ballpark) [1]
• Qualcomm Refunding Bonds and Balboa Park Refunding COPs	3
• Fire and Life Safety Refunding Bonds	4
• Convention Center Refunding Bonds [2]	1 (Convention Center)
• MTDB Bonds and Balboa Park COPs [2]	3

1. Excludes portions owned by Padres L.P.
2. Properties pledged for Convention Center Bonds and MTDB Bonds are not owned by the City.

Total No. of Properties: 12 (10 City owned properties)

Source: Debt Management Department.

II. Deferred Capital/CIP Bond Issuances:

• 2009A CIP Bonds ($103 million)	3
• 2012 A CIP Bonds ($75 million)	4
• 2013 A CIP Bonds ($35 million)	2
• ***2014 CIP Bonds ($120 million proposed)***	*7*

Total No. of Properties: 16

Source: Debt Management Department.

Note: Each of the CIP Bond series was part of a larger Lease Revenue Bond issuance and properties pledged were based on the total bond issue size. The number of properties associated with each bond series is an approximation based on the pro-rata share.

III. Unencumbered Properties:

Relying on the essential lease criteria described above, the following categories and approximate number of properties were researched and earmarked as potentially available to pledge for future lease revenue bonding needs subject to appraisal studies to establish market value; title report search to ensure property has clear liens; there are no exclusions, limitations for pledge due to federal/state funding for specific properties; and there are no tideland or pueblo land restrictions. The identified property categories also assume that the facilities are at least in an *average* condition and repair to establish a fair rental value for the property by the appraisers and properties are moderate to large in physical size and/or in original acquisition value.

• Police Facilities	9
• Fire & Lifeguard Facilities	40
• Central Library and Branch Libraries	33
• Core Operations Facilities[1]	6
• Long term ground leases[2]	26

1. City Administration Building and San Diego Community Concourse facilities are not included
2. Reflects long term General Fund leases that collect an annual rent of $100,000 or more

Total No. of Properties: 114

Property Data Source: Office of the City Comptroller and Real Estate Assets Department.

Looking Ahead – Future Infrastructure Needs

The future infrastructure needs identified within the Enhanced Option B funding plan include storm drains, streets and sidewalks, improvements to existing buildings and other facilities, ADA improvements, park and open space improvements, and construction of new facilities (fire stations, libraries, etc.). With the exception of new facilities, where the financed asset itself could be used as leased property, lease revenue bonds for improvements to existing facilities and the other assets types listed above, would require the use of asset transfer structure, and therefore identification of sufficient eligible unencumbered assets.