THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	January 16, 2015	REPORT NO: 15-006
ATTENTION:	Budget and Government Efficiency Committee	
SUBJECT:	Economic Bond Refunding Opportunities – General Fund, Sewer Utility Fund, and Community Facilities District Credits	
REFERENCE:		

REQUESTED ACTIONS:

Forward the following economic refunding proposals to City Council for consideration and approval in accordance with the respective timelines established for the bond refundings: 1) Ballpark 2007A Lease Revenue Refunding Bonds; 2) partial refunding of 2009A, 2009B, and 2010A Sewer Revenue Bonds; 3) Community Facilities District No. 2 (Santaluz) Improvement Area No. 3 Special Tax Bonds Series B of 2000; and 4) Community Facilities District No. 2 (Santaluz) Improvement Area No. 4 Special Tax Bonds Series A of 2004. The City Council will be requested to authorize the issuance of the refunding bonds for the respective transactions, and approve the related financing and disclosure documents.

STAFF RECOMMENDATION:

Forward the requested actions for City Council's consideration and approval.

EXECUTIVE SUMMARY:

This Report presents the description of four economic refundings that are proposed over the next seven months. Staff are presenting this combined Report to the Committee since the current market environment and interest rates creating refunding opportunities for outstanding debt are similar, and a combined discussion and approval will allow for a more efficient docketing of these refundings at City Council. The goals of each refunding are the same: to reduce the debt service on several series of bonds that meet the thresholds outlined in the City's Debt Policy. The bonds that are proposed for refunding – the Ballpark 2007A Lease Revenue Bonds (Petco Park), various Sewer Revenue Bonds, and Community Facilities District Special Tax Bonds – will be executed to reduce the cost of outstanding debt service while conforming to the City's Debt Policy. This Report discusses the favorable market environment for issuing municipal debt, and describes each refunding, the associated debt service savings under current market conditions, and the timelines.

It is expected that the legal and financing documents for each transaction would be presented to City Council in accordance with the respective time-lines provided below. The disclosure documents for each financing will be reviewed by the Disclosure Practices Working Group before they are docketed. The pricing and closing of each series of economic refunding bonds would be subject to market conditions and the fulfillment of the City's net present value savings thresholds for economic refundings. Under current market conditions, the proposed economic refundings would produce annual debt service savings to the General Fund, Sewer Utility Fund and special taxpayers within CFD No. 2 IA 3 & 4.

I. Background

The tax-exempt market remains attractive for municipal issuers. Since July 2013, when the City priced its last economic refunding (City/MTDB Old Town Light Rail Transit Extension Refunding and the Balboa Park/Mission Bay Park Refunding), interest rates have continued to trend lower. To illustrate the recent interest rate trend, the 30-year Municipal Market Data AAA Index (the "MMD Index," which is a standard index of AAA rated municipal bonds) was 2.67% in early 2015, which represents a decline of 116 basis points (approximately 1.16%) from 3.83% on July 1, 2013. This performance has been driven by Federal Reserve rate guidance throughout the year combined with strong technical factors in the municipal market including strong investor demand, low issuance volume, and light inventories in the secondary trading market.

Looking ahead, there are a number of factors that could put pressure on the municipal market in the coming 12 months, including investor reaction to the end of the Federal Reserve's long-running bond purchase program (also referred to as quantitative easing), the anticipation of greater municipal bond supply, and the potential slow down of investment dollars into bond mutual funds. These are offset by certain factors that are helping keep interest rates in check, including continued international geo-political turmoil and economic growth concerns. In light of these factors, most experts are forecasting that interest rates will gradually increase over calendar year 2015 with a market consensus projection expecting the benchmark 10-year U.S. Treasury to increase 1.00% by the end of 2015.

Given the current attractiveness of the municipal market coupled with the potential for rate increases later in 2015 and beyond, the City will be best positioned to attain economic savings by locking in current favorable rates to mitigate future interest rate risk and moving forward with the refunding of several series of bonds currently outstanding and eligible to be refunded on either a "current refunding" or an "advance refunding" basis.

An advance refunding, which may only be conducted once for each bond issue under IRS guidelines, is utilized when refunding bonds are issued more than 90 days prior to the date the bonds can be called. In this case, proceeds from the refunding bonds are placed in an escrow fund to pay scheduled debt service payments on the refunded bonds until the bonds are eligible to be called. Per the City's Debt Policy, the City will consider conducting an advance refunding if net present value savings of at least 4% can be achieved. The following refundings meet this threshold and will be conducted as advance refundings: the Series **2007A Ballpark Lease Revenue Bonds**, and select bonds from the **Series 2009A, Series 2009B, and likely the Series 2010A Sewer Revenue Bonds** depending on market conditions (partial refunding).

In addition, the **CFD No. 2 IA 3 Special Tax Bonds Series B of 2000** and **CFD No. 2 IA 4 Special Tax Bonds Series A of 2004** are candidates to be refunded on a "current refunding" basis. Per the City's Debt Policy, the City will consider conducting a current refunding if net present value savings of at least 3% can be achieved; these series meet this threshold.

II. Series 2007A Ballpark Lease Revenue Refunding Bonds

The original Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds, Series 2002 (Ballpark Project) (the "Original Ballpark Bonds") were issued in the amount of $169.7 million in February 2002 under a General Fund backed lease revenue bond structure to finance a portion of the construction of the Ballpark (also referred to as Petco Park) and adjacent Public Park, and certain related infrastructure.

In March 2007, the City refunded the Original Ballpark Bonds through the issuance of the Series 2007A Bonds, which were privately placed in a principal amount of $156.6 million. Currently there is $129.8 million in outstanding principal in the Series 2007A Bonds, and the bonds can be called starting February 15, 2017.

Based on current rates, the entire Series 2007A bonds could be advance refunded generating cumulative cash flow savings to the General Fund of approximately $20 million over the remaining 17 year term of the bond issue, an average annual cash flow savings of approximately $1.4 million in Fiscal Years 2016 – 2032. The net present value savings would be 12.5%. No material change to the repayment term will be made; the final maturity of the refunding bonds will occur in the same Fiscal Year as the Series 2007A Bonds (FY2032).

The refunding bonds will use a lease revenue bond structure involving leasing agreements, similar to the Series 2007A Bonds, between the City and the Public Facilities Financing Authority (PFFA). The leased property for the Series 2007A Bonds is currently the Ballpark and adjacent park (also known as the Park-at-the Park). For the refunding, the financing team is exploring the ability to lease only the Ballpark and release the adjacent park from the lease.

The Series 2007A Bonds currently carry a debt service reserve fund including $3.8 million in cash and a $7.5 million Ambac surety policy. The underwriters for the transaction and the City's financial advisor for the bond issue have advised the City that under current market conditions, it is viable to market the bonds without a debt service reserve fund, consistent with the City practice for its recent General Fund lease revenue bond issuances. The $3.8 million released from the Series 2007A Bonds debt service reserve fund will be transferred to be used as a source of funds for the refunding thus reducing the issuance size of the refunding bonds, which results in lower annual debt service on the bonds after the refunding is complete.

Refunding Timeline

Debt Management anticipates taking the legal documents and financing ordinance to City Council for review and approval in late-February/early March 2015, and the Preliminary Official Statement (POS) for approval via resolution in early-May 2015. The proposed refunding bonds are anticipated to be priced in late-May, with bond closing planned approximately 45 to 60 days thereafter. The refunding proceeds will be placed in an escrow fund until February 15, 2017, when the outstanding bonds will be redeemed.

III. Sewer Revenue Refunding Bonds

In May and June 2009, the Public Facilities Financing Authority Sewer Revenue Bonds, Series 2009A and Sewer Revenue Refunding Bonds, Series 2009B (the "2009A&B Bonds") were issued in the amount of $453.8 million and $634.9 million, respectively. Subsequently, in April 2010, the PFFA Sewer Revenue Refunding Bonds, Series 2010A (the "Series 2010A Bonds"), were issued in the amount of $161.9 million. There is currently $864.1 million in outstanding principal in the 2009A&B Bonds, which can be called starting May 15, 2019 and $161.9 million in outstanding principal in the 2010A Bonds, which can be called starting May 15, 2020.

At current interest rates, a partial refunding of the outstanding sewer bonds is expected. The maturities selected for the advance refunding from each of the outstanding series will depend on the interest rates at the time of pricing.

Based on current rates, maturities between Fiscal Years 2020 and 2027 of the outstanding bonds (Series 2009A&B Bonds) totaling an estimated $354 million can be advance refunded. The projected annual cash flow savings from the refunding for the Wastewater system are $1.0 million in Fiscal Years 2016-2019 and $2.6 million in Fiscal Years 2020-2027, totaling cumulative gross savings of approximately $25 million. The net present value savings would be approximately 6.0%. Debt Management is also evaluating if certain maturities of the 2010A bonds can be included in the refunding, which could generate additional annual cash flow savings.

The refunding bonds will be issued under the same legal construct of the current outstanding bonds, as supplements to the 1993 Master Installment Purchase Agreement and 2009 Master Indenture. The term of the refunding bonds will match the term of the selected maturities of the Series 2009A&B Bonds and the Series 2010A Bonds, if refunded.

<u>Refunding Timeline</u>

Debt Management anticipates taking the legal documents and Financing Ordinance to City Council for review and approval by March 2015 and the POS for approval via resolution in June 2015. The proposed Sewer Revenue Refunding Bonds, Series 2015 are expected to be priced by June, with bond closing planned for late June 2015. The refunding proceeds will be placed in an escrow fund until May 15, 2019, when selected maturities of outstanding 2009A&B Bonds will be redeemed, and until May 15, 2020, when selected maturities of the outstanding 2010A Bonds will be redeemed.

IV. Conduit Financings – CFD No. 2 IA 3 & 4 Special Tax Bonds Refundings

In March of 2000 and February of 2004, the City Council adopted the necessary resolutions and ordinances to form the Community Facilities District No. 2 (Santaluz) ("CFD No. 2" or "District") and establish Improvement Areas No. 3 and No. 4 therein ("CFD No. 2 IA 3 & 4"). Subsequently, the District issued CFD No. 2 (Santaluz) Improvement Area No. 3 Special Tax Bonds Series B of 2000 ("2000 Special Tax Bonds") in the amount of $4.35 million in October of

2000 and CFD No. 2 (Santaluz) Improvement Area No. 4 Special Tax Bonds Series A of 2004 ("2004 Special Tax Bonds") in the amount of $9.97 million in February of 2004. The bonds were conduit issuances, executed to fund certain public infrastructure facilities within or serving the District. The facilities include street improvements, water and sewer facilities, and regional park improvements. The 2000 Special Tax Bonds and 2004 Special Tax Bonds are secured solely by special taxes levied upon 317 parcels of primarily residential property located within Improvement Areas 3 and 4. There is currently $3.35 million of 2000 Special Tax Bonds outstanding and $6.6 million of 2004 Special Tax Bonds outstanding; both are eligible to be called on September 1, 2015.

Based on current rates, all of the 2000 Special Tax Bonds and 2004 Special Tax Bonds could be current refunded generating cumulative cash flow savings over the remaining term of the bonds (through 2030 and 2033, respectively) of approximately $977,000 for the 2000 Special Tax Bonds and $1.7 million for the 2004 Special Tax Bonds. The average annual cash flow savings to the improvement areas and the special taxpayers would be approximately $65,000 for the 2000 Special Tax Bonds and $97,000 for the 2004 Special Tax Bonds between Fiscal Years 2016 and 2033. The net present value savings would be approximately 16.1% for the 2000 Special Tax Bonds and approximately 13.7% for the 2004 Special Tax Bonds. No change to the repayment terms will be made; the terms of the refunding bonds will match the terms of the 2000 Special Tax Bonds and the 2004 Special Tax Bonds and the final payment dates will remain September 1, 2030 and 2033, respectively.

Refunding Timeline

Debt Management anticipates taking the legal documents, POS's, and Financing Resolutions to City Council for review and approval in April 2015. The proposed CFD No. 2 IA 3&4 Special Tax Refunding Bonds are expected to be priced by the end of May, with bond closing planned for early June 2015. The refunding proceeds will be placed in an escrow fund until September 1, 2015, when the outstanding bonds will be redeemed.

CITY COUNCIL AUTHORIZATION

At this time, it is expected that the legal and financing documents for the three transactions would be presented to City Council in accordance with the respective time-lines provided above. The disclosure documents for each financing will be reviewed by the Disclosure Practices Working Group before they are docketed.

FISCAL CONSIDERATIONS:

The pricing and closing of each series of economic refunding bonds would be subject to market conditions and the fulfillment of the City's net present value savings thresholds for economic refundings. As described above, under current market conditions, the proposed economic refundings would produce annual debt service savings to the General Fund, Sewer Utility Fund and special taxpayers within CFD No. 2 IA 3 & 4.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

Not applicable.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Business entities involved in the proposed financings include investment banks, financial advisors, bond and disclosure counsels and trustees. The selected firms will be identified in the Reports to City Council that are issued when the financing and legal documents are docketed for City Council action. Key stakeholders also include the special tax payers in CFD No. 2 IA 3 & 4 who would benefit from the special tax refundings due to lower debt service on the refunding bonds.

Respectfully submitted,

Lakshmi Kommi
Debt Management Director

Mary Lewis
Chief Financial Officer