



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: May 19, 2015 REPORT NO: 15-059

ATTENTION: Council President and City Council

SUBJECT: Public Facilities Financing Authority of City of San Diego Senior Sewer Revenue Refunding Bonds

REFERENCE: Budget and Government Efficiency Committee Report No. 15-006, titled Economic Bond Refunding Opportunities – General Fund, Sewer Utility Fund, and Community Facilities District Credits, dated January 16, 2015

REQUESTED ACTIONS:

1. Authorize the issuance of the Public Facilities Financing Authority of the City of San Diego (the “Authority”) Senior Sewer Revenue Refunding Bonds in one or more series in a principal amount not to exceed \$848.1 million and the execution of related financing documents to refund a portion of the Authority’s outstanding Senior Sewer Revenue Bonds, Series 2009A and Senior Sewer Revenue Refunding Bonds, Series 2009B (the “Series 2009A&B Bonds”), and Senior Sewer Revenue Refunding Bonds, Series 2010A (the “Series 2010A Bonds”) and refund State Revolving Fund (“SRF”) Loans. The related financing documents include the forms of the Supplement of the Master Installment Purchase Agreement, the Supplemental Bond Indenture with U.S. Bank, the Bond Purchase Agreement with Bank of America Merrill Lynch, Academy Securities, Fidelity Capital Markets, Jefferies, and Morgan Stanley, the Escrow Agreement with U.S. Bank, and the Continuing Disclosure Certificate;
2. Authorize the City Attorney to retain and enter into an agreement with Bond and Disclosure Counsel, Kutak Rock LLP for the Senior Sewer Revenue Refunding Bonds, Series 2015 (the “2015 Bonds”);
3. Authorize the Chief Financial Officer to establish one or more special interest bearing account(s) for the proceeds of the 2015 Bonds.

STAFF RECOMMENDATION:

Approve the requested actions.

SUMMARY:

I. Background

In May and June 2009, the Authority's Senior Sewer Revenue Bonds, Series 2009A and Senior Sewer Revenue Refunding Bonds, Series 2009B (the "Series 2009A&B Bonds") were issued in the amount of \$453.8 million and \$634.9 million, respectively. Subsequently, in April 2010, the Senior Sewer Revenue Refunding Bonds, Series 2010A (the "Series 2010A Bonds"), were issued in the amount of \$161.9 million. There is currently \$813.6 million in outstanding principal in the Series 2009A&B Bonds, of which \$585.8 million can be called (i.e., paid down) starting May 15, 2019 and \$161.9 million in outstanding principal in the Series 2010A Bonds, all of which can be called starting May 15, 2020. The Wastewater System also has \$133.8 million in State Revolving Fund Loans ("SRF Loans"), which include 9 Senior Loans and 11 Subordinate Loans.

Given the current low interest rate environment coupled with the potential for interest 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 a partial refunding of the outstanding Series 2009A&B and Series 2010A Bonds, which are eligible to be refunded on an "advance refunding" basis, and repayment of the Subordinate SRF loans using refunding bond proceeds (current refunding of SRF loans) if economic to lower annual debt service compared to existing debt service.

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 in an amount sufficient, along with interest earnings, to pay scheduled debt service payments on the refunded bonds until the bonds are eligible to be called, and to redeem all remaining bonds on the call date. Pursuant to the City's Debt Policy, the City will consider conducting an advance refunding if net present value (NPV) savings of at least 4% can be achieved. As discussed under Fiscal Considerations below, the proposed refunding is expected to exceed this threshold. In addition, consistent with a refunding evaluation threshold commonly used by the market, NPV savings is expected to be greater than the amount of negative arbitrage (Negative arbitrage arises in today's market because the interest rate earned in the refunding escrow fund is lower than the interest rate on the refunding bonds). Annual debt service savings produced by the refunding would benefit the Wastewater System.

A current refunding would be utilized to refinance outstanding SRF Loans. Proceeds from the refunding bonds are used to immediately repay a portion of the SRF Loans. Pursuant to the City's Debt Policy, the City will consider conducting a current refunding if net present value (NPV) savings of at least 3% can be achieved. Annual debt service savings produced by the refunding would benefit the Wastewater System. Based on interest rates as of May 2015, none of the outstanding SRF Loans are economic to refund however, the Council authorization allows for current refunding of eligible loans if the market improves in the future.

The Series 2009 A&B Bonds, the Series 2010 A Bonds, and the SRF Loans are defined as the "Sewer Refunding Bonds".

II. Discussion

A. Plan of Finance

- **Issuer:** Public Facilities Financing Authority of the City of San Diego.
- **Not to Exceed Amount of Ordinance:** \$848.1 million of Senior Sewer Revenue Refunding Bonds with flexibility to sell the Sewer Refunding Bonds in one or more series. The \$848.1 million is based on the callable amount of Series 2009A&B Bonds and Series 2010 A Bonds and the interest due on these bonds through the call dates (approximately \$799.3 million), 11 outstanding Subordinate SRF Loans (approximately \$47.2 million which is expected to be refunded on parity with the outstanding bonds) and related costs of issuance (approximately \$1.6 million).
- **Partial Refunding of Sewer Refunding Bonds:** The current market allows for a partial advance refunding of the Series 2009A&B Bonds and the Series 2010A Bonds to achieve the required net present value (NPV) savings of 4% or more (“2015 Bonds”).
- **Expiration of Ordinance:** The Ordinance authorizes the issuance of refunding bonds in one or more series through June 30, 2017. This gives the City the flexibility to issue additional Sewer Refunding Bonds not refunded with the 2015 Bonds if the bond market moves in the City’s favor.
- **Structure:** Wastewater System supported Sewer Revenue Bonds. Issued under the 2009 Master Indenture and the 1993 Master Installment Purchase Agreement. Sewer System revenue is the repayment pledge with rate covenant protection for bondholders.
- **Debt Service Reserve Fund:** The 2009 A&B and 2010A Bonds have a fully cash funded Debt Service Reserve Fund that currently holds \$76 million.

The market is currently accepting issuance of highly rated revenue bonds, such as the City’s sewer revenue bonds, without debt service reserves. However, since the 2009 Master Indenture controlling 2009 A&B and 2010A bonds requires a fully funded Debt Service Reserve Fund, certain amendments are required to facilitate the ability to issue without a Debt Service Reserve Fund and/or draw down the cash reserves within the common Debt Service Reserve Fund in the future for the benefit of the Wastewater System. Such amendments are proposed to be implemented with the execution of the Supplemental Indenture in conjunction with the 2015 Bonds (see “Financing and Legal Documents” below for discussion).

Upon issuance, the 2015 Bonds will continue to have a fully funded Debt Service Reserve Fund. The reserves associated with the 2015 Bonds can be released at a future date when the amendment as set forth in the Supplemental Indenture become effective. It is anticipated that with the issuance of the 2015 Bonds, the Debt Service Reserve Fund will be slightly reduced due to the reduction of future debt service from the current level of \$76 million (based on current estimates, approximately \$3 million will be released, see

page 8 “Estimated Sources and Uses” for more details). These proceeds released from the Debt Service Reserve Fund may be used to partially fund the escrow to pay the principal and interest on the refunded bonds.

Once the amendments in the Supplemental Indenture take effect, if certain conditions are met, the reserves associated with the 2015 Bonds will be released in the future and can be made available to pay future debt service on the 2015 Bonds and/or pay for the Wastewater System capital improvement projects.

- **Method of Sale:** Public Offering; Negotiated Sale.
- **Tax Status:** The Sewer Refunding Bonds issued as a tax-exempt issuance. Interest on the Sewer Refunding Bonds will not be included in gross income for federal income tax purpose and will be exempt from present State of California personal income taxes.
- **Repayment Source:** Payable from Sewer System Revenues.
- **Final Maturity:** Will match the maturity of the refunded bonds.

B. City Council Authorization

The City Council is requested to (i) authorize the issuance of the Sewer Refunding 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 forms of the Supplemental Indenture, the Supplement of the Master Installment Purchase Agreement, the Escrow Agreement and the Continuing Disclosure Certificate would be approved via ordinance, and Bond Purchase Agreement via resolution.

Staff will be docketing the Preliminary Official Statement (POS) for the 2015 Bonds separately to be authorized via resolution in August 2015, closer to the distribution of the POS to potential investors.

C. Financing & Legal Documents

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

1. Form of the Supplemental Bond Indenture (Indenture) – 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.

As described above under Plan of Finance - Debt Service Reserve Fund, Articles V and VI of the Supplemental Indenture set forth certain amendments to the 2009 Master Indenture, including, among other amendments, providing flexibility in sizing the Debt Service Reserve Fund for future bonds issuances. These amendments allow the reserve requirement to be sized at any level - from Maximum Annual Debt Service to no reserve requirement for all new bonds (the remaining outstanding Series 2009AB and Series 2010A Bonds will continue to have a reserve funded at Maximum Annual Debt Service). In order for these amendments to take effect, there needs to be 51% bondholder consent, which is expected to occur in the future with either new money bond issuances or refunding sewer bond issuances. In addition to the amendments regarding the Debt Service Reserve Fund, Article V includes certain updates to definitions, including certain updates to the section on Permitted Investments.

2. Form of the Supplement of the Master Installment Purchase Agreement (MIPA) – The MIPA is an agreement between the City and the Public Facilities Financing Authority of the City of San Diego, pursuant to which the Authority has agreed to provide the Project to the City and the City has agreed from time to time to purchase Components of the Project through Installment Payments.
3. Form of the Continuing Disclosure Certificate (CDC) – The CDC details the City’s ongoing obligation to file annual reports and notices of certain enumerated events with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access system for the benefit of the bondholders.
4. Form of the Escrow Agreement – The Escrow Agreement among, the City, the Authority and the Trustee provides for the deposit of moneys in the escrow account to refund part of the outstanding principal of the Series 2009A&B Bonds and Series 2010A Bonds since the Sewer Refunding Bonds will be issued prior to the first eligible redemption date of the Series 2009A&B Bonds, and Series 2010A Bonds. The agreement sets forth the manner in which funds are to be invested pending their expenditure and a schedule of debt service payments to be made with respect to the bonds being refunded.

The execution of the following financing document is authorized by the Resolution:

5. Form of the Bond Purchase Agreement (BPA) – 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 Schedule and Key Milestones

Following are the critical milestones related to the execution of the 2015 Bonds, including the authorization of the financing ordinance and the POS.

June 2015	Introduction & approval (two readings) of the financing ordinance authorizing the issuance of the Series 2015 Bonds, and the financing documents. Authority approval of the Series 2015 Bonds.
August 2015	City Council approval of the disclosure document (POS) for 2015 Bonds. Print and distribute the POS.
Week of August 31, 2015	Bond Sale.
4-6 weeks after pricing	Bond Closing, Escrow Fund established & Refunded portions of the 2009A, 2009B, and 2010A Bonds are legally defeased.
May 15, 2019	The refunded portion of the 2009A and 2009B Bonds are called by the Escrow Agent using proceeds from the Escrow Fund.
May 15, 2020	The refunded portion of the 2010A Bonds are called by the Escrow Agent using proceeds from the Escrow Fund.

E. Financing Team

The City's Financing Team for the 2015 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, and the Financial Management Department. The Financing Team also includes staff of the City Attorney's Office and Public Utilities Department. External members include: Montague DeRose & Associates (Montague) as the Municipal Advisor; Kutak Rock LLP, as Bond and Disclosure Counsel; and US Bank, National Association as Trustee and Escrow Agent.

Municipal Advisor: Montague DeRose & Associates (Montague) was selected to provide municipal advisory services for this transaction through a competitive process utilizing the City's As-Needed Financial Advisors Pool based on the firm's experience in sewer revenue bond financings, and the fee proposal. The fee to Montague for this issuance is contingent upon the successful closing of the 2015 Sewer Refunding Bonds for an amount not to exceed \$50,000 plus out of pocket expenses not to exceed \$10,000 and is to be paid out of bond proceeds.

Bond and Disclosure Counsel: The City Attorney's Office has identified, via a RFP process, Kutak Rock LLP to serve as Bond and Disclosure Counsel for the 2015 Sewer Refunding Bonds for an amount not to exceed \$83,000 inclusive of reasonable out of pocket expenses. The fees payable to Bond and Disclosure Counsel shall be contingent upon the closing of the bonds and paid out of bond proceeds.

Trustee/Escrow Agent: US Bank will serve as the Trustee and Escrow Agent for the 2015 Bonds (and will also serve as the Trustee for the existing 2009A&B and 2010A bonds). Compensation for the Trustee and its counsel is \$4,750 for the 2015 Bond transaction, with an estimated ongoing annual fee of \$1,000. Compensation for the Escrow Agent is \$500 (a one-time fee).

Underwriting Syndicate: Bank of America Merrill Lynch was selected to serve as Senior Manager for the 2015 Bonds. In addition, the underwriting syndicate include four Co-Managers: Academy Securities, Fidelity Capital Markets, Jefferies, and Morgan Stanley. They were selected through a competitive process utilizing the City's established pool of Underwriters. The solicitation specific to the 2015 Bonds was issued on March 3, 2015. In total, 24 underwriting proposals were received of which 11 firms proposed to serve as a Senior Manager or Co-Manager and 13 firms proposed solely as a Co-Manager.

The syndicate members were identified based on the investment banking experience of the firms on similar transactions, capacity to underwrite the transaction, and bond marketing outreach capabilities.

FISCAL CONSIDERATIONS:

Bond Proceeds, Interest Rate, Projected Debt Service and Savings

Based on current market conditions approximately \$344.7 million in outstanding 2009A, 2009B, and 2010A Bonds are expected to be refunded with the issuance of the 2015 Bonds. The market has seen interest rates move rapidly in the past few months. As of March 2015, interest rates were lower and based on those levels, approximately \$536.9 million in outstanding bonds were eligible for an advance refunding while meeting the Debt Policy threshold of 4% NPV savings.

The Estimated Sources and Uses are based on interest rates as of May 14, 2015. The total proceeds from the 2015 Bonds are expected to be approximately \$403 million which, together with the monies released from the Series 2009A&B and Series 2010A Bonds debt service reserve fund, will be used for the refunding and pay for financing costs of issuance. The estimated \$403 million deposit in the Escrow Fund, along with earnings on the, will be utilized by the Escrow Agent to pay the interest due on the refunded bonds until the call dates, and to call the refunded bonds on the respective call dates.

Estimated Sources and Uses of Funds *

Estimated Sources

2015 Bond Proceeds	\$399,953,197
Release of excess funds from common DSRF ⁽¹⁾	2,958,364
Total Sources of Funds	\$402,911,561

Estimated Uses

Escrow Fund to refund 2009A&B and 2010A Bonds ⁽²⁾	\$402,170,420
Costs of Issuance ⁽³⁾	741,141
Total Uses of Funds	\$402,911,561

* Preliminary; subject to change. Based on interest rates as of May 14, 2015. Assumes an October 1, 2015 delivery date.

(1) DSRF is Debt Service Reserve Funds.

(2) Includes debt service on the refunded portion of the Series 2009A&B and Series 2010A Bonds to their respective call dates (May 15, 2019 and May 15, 2020) and redemption of remaining principal (\$344.7 million) on the call date, net of escrow earnings.

(3) Costs of Issuance includes underwriter's discount, bond and disclosure counsel fees, municipal advisory fees, trustee and escrow fees, verification agent fees, rating agency fees, Preliminary Official Statement and Official Statement electronic printing/posting costs.

This advance refunding scenario provides a cumulative cash flow savings to the Wastewater System of approximately \$27.0 million over the remaining 11 years of the refunding, an average annual cash flow savings of approximately \$1.3 million in Fiscal Years 2016-2020 and approximately \$3.4 million in Fiscal Years 2021-2026. The net present value savings is estimated at 5.9%. With the refunding, the new total debt service of the 2015 Bonds is \$460.9 million compared to \$487.9 million of the refunded bonds.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

On January 28, 2015, Debt Management presented four proposed economic refunding items to the Budget and Government Efficiency Committee, of which one was the 2015 Bonds. The Budget and Government Efficiency Committee forwarded the 2015 Bonds to the City Council for approval.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

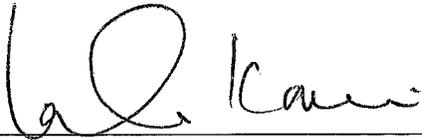
In February 2015, the Sewer Refunding Plan was presented to the Independent Rates Oversight Committee (IROC) as an informational item.

In 2007, the Public Utilities Department conducted a Proposition 218 noticing process as part of the approval for the rate increases necessary to support the CIP and corresponding bond issuance projections for the Wastewater Utility.

The Public Utilities Department regularly conducts community outreach on a project basis.

KEY STAKEHOLDERS:

Business entities included in the financing: Kutak Rock LLP (Bond and Disclosure Counsel); US Bank, National Association (Trustee/Escrow Agent); Montague DeRose & Associates (Municipal Advisor); Bank of America Merrill Lynch, Academy Securities, Fidelity Capital Markets, Jefferies, and Morgan Stanley (Underwriters); Standard & Poor's (Rating Agency); Fitch Ratings (Rating Agency); AVIA Communications (Electronic Printing of POS and OS); Causey Demgen & Moore P.C. (Verification Agent); and Raymond James & Associates, Inc. (Escrow Fund Bidding Agent).



Lakshmi Kommi
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