THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED:	September 18, 2012	REPORT NO: 12-114
ATTENTION:	Council President and City Council Docket of October 1, 2012	
SUBJECT:	San Diego Convention Center Phase III Expansion Plan of Finance and Related Actions	
REFERENCE:	Formation of a Convention Center Facilities District to Provide Funding for the San Diego Convention Center Phase III Expansion Project (Report No. 12-02), dated January 10, 2012; Formation of a Convention Center Facilities District to Provide Funding for the San Diego Convention Center Phase III Expansion Project (Report No. 11-155), dated November 21, 2011; and Amending the San Diego Municipal Code to Provide for Formation of a Convention Center Facilities District to Provide Funding for the San Diego Convention Center, Phase III Expansion Project (Report No. 11-119), dated September 13, 2011	

REQUESTED ACTIONS:

Adopt a Resolution approving a Plan of Finance to fund the San Diego Convention Center Phase III Expansion (the "Convention Center Expansion") and related actions. The related actions include the authorization to reimburse eligible costs incurred prior to the issuance of bonds with bond proceeds, the authorization to execute a Support Agreement between the San Diego Unified Port District (the "Port District") and the City, and the approval of a Joint Community Facilities Agreement between the City and the Port District.

Authorize the City Attorney to enter into an agreement with Nixon Peabody LLP to provide bond and disclosure counsel services for the Convention Center Expansion in an aggregate amount not to exceed $165,000, including 1) fees not to exceed $75,000 in connection with a short term note offering; 2) fees not to exceed $85,000 in connection with long term bonds; and 3) combined out of pocket expenses not to exceed $5,000, with such fees and expenses paid from, and contingent upon the closing of, the respective issuance.

STAFF RECOMMENDATION:
Approve the requested actions.

SUMMARY:

I. Background

Beginning in October 2011, the City Council has taken a number of actions concerning the formation of Convention Center Facilities District No. 2012-1 (the "CCFD") and the related election process to provide a primary funding mechanism for the Convention Center Expansion. Over this time-frame, City Council has also been updated on the general approach being developed for the overall funding of the project. Most recently, Attachment 1 to City Council Report No. 12-02, dated January 10, 2012, concerning "Formation of a Convention Center Facilities District to Provide Funding for the San Diego Convention Center Phase III Expansion Project," provided an update on the revenue sources and conceptual approach to the funding plan (the "January 2012 Update"). The update was also presented at the January 24, 2012 City Council Meeting and it was discussed that the Mayor would present a comprehensive Plan of Finance for City Council approval at a later date that would include the financing structure that would produce the most cost effective bond issue framework. This proposed Plan of Finance is outlined in detail below.

II. Discussion

A. Funding Sources

The funding sources for the Convention Center Expansion consist of (1) special tax revenues generated from the CCFD; (2) support payments from the Port District; and (3) City General Fund fixed annual payments. Each of the funding sources is described in detail below.

Convention Center Facilities District Special Tax Revenues

On January 24, 2012, the City Council adopted a resolution forming CCFD No. 2012-1 and called for a special mailed ballot election of affected hotel property owners regarding the levy of a special tax and issuance of debt to provide the primary funding mechanism for the Convention Center Expansion. The ballot measure was subsequently approved by 92.03% of the votes cast and the City Council declared the election results through a resolution adopted on May 7, 2012. On May 7, 2012, the City Council also adopted a resolution directing the City Clerk to file a Notice of Special Tax Lien with the San Diego County Recorder and authorized the City Attorney to initiate a validation action concerning the CCFD formation resolutions, election procedures, authorization to levy the special tax and issue bonds, and related matters. The City filed the validation action in May 2012 and is awaiting the court's ruling on the matter.

To levy the special tax, the City Council must also approve an ordinance authorizing the levy of the special tax. The introduction of the ordinance has been docketed concurrent with this item, and provides that the special taxes will only be collected after an affirmative validation judgment and California Coastal Commission approval of the Port Master Plan Amendment to incorporate the Convention Center Expansion. If the ordinance is approved, collection of special taxes will be programmed to commence soon after receipt of the validation judgment and Port Master Plan Amendment approval, concurrent with the completion of the operational modifications that will be required to be made to the City's TOT collection system by the City Treasurer's Office to initiate the special tax levy.

Should the conditions precedent described above occur, it is estimated that the CCFD could generate special tax revenues of approximately $37.0 million annually (projected for Fiscal Year 2017, applying City TOT growth rate assumptions for Fiscal Years 2013-2017 and assuming 0% thereafter) to pay debt service on bonds issued to finance the expansion and associated CCFD costs. This estimated special tax revenue is based on the Taxable Property Zone classifications contained in the Final Rate and Method of Apportionment of Special Tax ("Final RMA") for the CCFD and is higher than the previous estimate referenced in the January 2012 Update solely due to higher than projected gross TOT receipts in Fiscal Year 2012 and an increased projection of TOT in Fiscal Year 2013 – from 4.5% to 5.5% – based on the Fiscal Year 2013 adopted budget assumptions for TOT. As described under Plan of Finance below, if there is growth in the special tax revenue in excess of the amount needed to pay debt service on the bonds and associated CCFD costs, the revenue collected could be used to pay off bonds prior to the stated maturity.

Prior to the issuance of long term bonds supported by the special tax revenue, a third-party study will need to be prepared to analyze the projected special tax revenues. This type of study is expected for public offerings of long term revenue bonds because the revenue stream is new and will represent the primary pledge for repayment of the bonds.

San Diego Unified Port District Support Payments

On November 29, 2011, the Port District's Board of Commissioners approved in principle to contribute funds to the Convention Center Expansion. To this end, a Support Agreement between the Port District and the City has been drafted outlining the specific terms and conditions under which the Port District will make payments to the City for application to the financing of the expansion. The agreement which will be considered by the Port District's Board of Commissioners on September 19, 2012, specifies that the Port District will make fixed annual payments to the City totaling $60 million over a twenty year period commencing upon the completion of construction of the expansion portion of the Convention Center. *The Support Agreement is included in the docket materials and the actions requested of the City Council include authorization of the agreement.*

City General Fund Fixed Annual Payments

As discussed at previous City Council meetings, it is proposed that a General Fund annual payment of not-to-exceed $3.5 million be applied to the debt service of bonds issued for the Convention Center Expansion. The annual payment is proposed to begin upon completion of the expansion and will continue through the life of the bonds. While the annual contribution will be from the City's General Fund, the payments are expected to be directly supported by incremental TOT generated from additional hotel room nights produced as a result of the expanded center.[1]

[1] The Convention Center Expansion is projected to produce approximately $12.7 million in annual incremental TOT revenue according to an AECOM report titled *"Refined Analysis of Additional Business Capture Derived from a Potential Expansion of the San Diego Convention Center"* dated November 15, 2010. This report can be found at: http://www.conventioncenterexpansion.com/Portals/0/Final%20AECOM%20Report%2011-15-2010.pdf

In addition, as described more fully under Plan of Finance, the Final RMA for the CCFD allows for, and the bond documents are expected to contain, sufficient flexibility, to pay off bonds prior to their stated maturity with special tax revenues in excess of debt service. Under these circumstances, the City's payments can also be lowered or terminated concurrent with the early payment of bonds. (Also see Internal Stabilization Fund for Lease Revenue Bonds below.)

B. Plan of Finance

The key elements of the recommended plan of finance are provided below, and include an interim financing on a short term basis to fund pre-construction costs, followed by the simultaneous issuance of multiple series of long term bonds concurrent with the start of the active construction phase of the expansion. Certain features of the bond issuances described below, such as debt service reserve fund levels, timing and number of bond issuances and the optimal number of series of bonds under each issuance, will naturally evolve based on project funding needs, market conditions and revenue trends that exist as the actual financing documents and credit are developed closer to time of bond issuance(s). All of these market sensitive/dependent bond structuring specifics will be described to the City Council in conjunction with the long term bond documents when they are developed and taken forward for City Council review and approval.

Short Term Notes

The current expansion budget remains at $520 million. The project manager estimates that, of this total, approximately $40 million will be required to fund 18 months of design and pre-construction costs. As discussed in the January 2012 Update, it is recommended that a short term financing be issued to fund this portion of the expansion, prior to, and in anticipation of the issuance of long term bonds. Through this approach, only funds sufficient to support initial project work will be financed during the design and pre-construction, reducing the need to issue bonds to meet the entire budget upfront. This also creates the ability to accumulate CCFD special tax revenues to fund reserves and generate equity for the expansion (see discussion below).

It is expected that the structure of the notes will involve the issuance solely by the CCFD of short term revenue anticipation notes ("Notes"), with interest paid from special tax revenues and principal payable from special tax revenues or the proceeds of the long term bonds. The Notes may carry a final maturity of up to two years with the ability to be prepaid. This allows the City certain flexibility to issue the long term bonds only when additional project funds are needed. It is expected that the Notes will be issued as a public offering, but staff will continue to monitor the market to ensure this is the best option for the City. No City General Fund pledge or revenues would be necessary to support the Notes; the City's contribution of its fixed annual payments would be programmed to support the long term lease revenue bond issuance described in further detail below.

It is proposed that the Notes sale be conducted soon after the first levy of the special taxes and in conjunction with the project management team's assessment of the immediate cash flow needs. The start of the special tax levy, as discussed above, will only occur upon receiving an affirmative validation judgment and California Coastal Commission approval of the Port Master

Plan Amendment. Based on the assumption that approximately $41 million of notes could be issued in February 2013 to meet the design and pre-construction needs of the project ($40 million) and provide reimbursement of CCFD formation costs and costs of issuance for the Notes ($1 million), staff expects to docket the note offering documents (the indenture and note purchase agreement) for City Council approval in November 2012.

Long Term Bonds

Concurrent with the project transitioning into the active construction phase, the issuance of long term bonds is expected to occur in the second half of Fiscal Year 2014 to take-out all or a portion of the short term notes and finance the active construction costs (approximately $480 million) required to support the $520 million expansion. Based on preliminary cash flow projections incorporating all available revenue sources discussed above, the long term bonds component is expected to consist of two categories of bond issuances and an equity contribution, described more fully below.

CCFD Revenue Bonds (Primary Bonds)

The Convention Center Expansion will be primarily funded through the special tax revenue generated from the CCFD. As such, the special tax revenue will be used to issue revenue bonds. These would be similar to Community Facilities District bonds and utility revenue bonds in which the bonds are backed by the revenue generated by the district and utility, respectively. The City will be the conduit issuer acting under the authority conferred by the CCFD.

As revenue bonds, the CCFD bonds will need to be structured so that the revenues are sufficient to provide for debt service and necessary coverage levels. The level of coverage (percent of net available revenue above the annual debt service commitment) required is a function of the market, and will be based on an assessment of the credit characteristics of the revenue stream pledged for the repayment of the bonds. In order to receive investment grade ratings and satisfy investor expectations, it is currently anticipated that revenues will need to cover debt service by a range of 120-200%. Stronger revenue coverage levels will produce higher credit ratings and lower interest costs. Conversely, weaker coverage levels will produce lower credit ratings and higher interest costs. The total amount of bond proceeds that can be generated from the primary bonds will be subject to the variables discussed above.

The City has been working with the Financial Advisor (FirstSouthwest) and Senior Manager and Co-Senior Manager underwriters identified for the transaction (Goldman, Sachs and Co. and Citigroup Global Markets Inc., respectively) to determine the optimal structure that would maximize the special tax bonding capacity and generate the most bond proceeds possible through the CCFD bonds (the Port District support payments are expected to be programmed in the CCFD issuances to generate additional proceeds). A benefit of maximizing the amount of CCFD bonds is that these bonds would have no fiscal impact on the General Fund and the bondholders would have no recourse to the City if there is a shortfall in special tax revenues needed to pay debt service.

Based on current market conditions, the plan of finance assumes that two tiers of CCFD bonds will be issued. The first tier ("Tier 1") would be secured only by special tax revenues and, based on current estimates, would require a revenue coverage level of approximately 200%. The second tier ("Tier 2") would be secured by a second lien pledge of special tax revenues and the Port District payments under the Support Payment Agreement, and would be structured considering the flow (timing and amount) of the Port District payments. Based on current estimates, the Tier 2 bonds would have a coverage level of 150%. Taking into account the evolving conditions of the market, the financing team will continue to fine tune the plan of finance by potentially increasing, or reducing, the number of series of bonds offered and/or the coverage levels of each series, in an effort to maximize the amount of bond proceeds from the CCFD bond offerings (and the special tax revenues)

In total, $333.2 million in proceeds ($244.0 million from Tier 1 and $89.2 million from Tier 2) could be generated for the $520 million expansion. By structuring the bonds in two tiers, the overall borrowing costs will decrease because most of the bonds will be Tier 1 Bonds, issued with a higher coverage level and, therefore, securing a lower rate of interest and lower debt service costs.

Lease Revenue Bonds (Gap Bonds)

After using special taxes to maximize the amount of CCFD bonds issued considering necessary coverage levels, and following the allocation of approximately $11.5 million of equity generated from special taxes collected prior to the issuance of the long term bonds (see "Equity Contribution" below), special tax revenue in excess of debt service for both series of CCFD bonds (i.e., the coverage revenue) is proposed to be tapped/leveraged to issue a gap bond issuance which has no coverage requirement, thus efficiently utilizing all special tax revenues. The gap bonds would be issued under a lease revenue bond structure using the Convention Center Expansion Financing Authority (the same joint powers authority that issued the 1998 Convention Center Expansion Lease Revenue Bonds and the 2012 Convention Center Expansion Lease Revenue Refunding Bonds) with a 30 year term. The subject of the lease would be the original Convention Center property. No City assets are being proposed to be leased to support the lease revenue bonds.

Attachment 1 provides a Flow Chart that outlines the expected flow of funds supporting the CCFD bonds and the lease revenue bonds.

Based on current estimates, it is expected that $175.3 million could be generated from the gap issuance for the project with an annual debt service ranging between $9-13 million over the life of the bonds. (The debt service is estimated to increase after the capitalized interest period from $10.4 million in Fiscal Year 2018 to $13.1 million in Fiscal Year 2022, reducing to approximately $12.1 in Fiscal Years 2023-2037, and dropping to $9.1 million in Fiscal Years 2038-2045. Fluctuation in debt service is a function of the availability of the amount of excess special taxes/coverage revenue from the CCFD bonds to fund the gap issuance. During the 20 year period that the Port District Support Payments are available to the CCFD, there will be more coverage revenue to support the gap issuance and vice versa). Excess special tax revenues above the debt service requirement for the CCFD bonds, combined with the City's fixed annual payments of $3.5 million annually, would support this gap bond issuance. Based on this debt service estimate, the special tax revenues derived from the coverage revenue of the CCFD bonds are estimated to cover approximately $5.5 million to 9.5 million of annual debt service for the lease revenue bonds, with the City's annual General Fund payments of $3.5 million providing the remaining amount. While the City's portion of the debt service would be limited to $3.5 million annually, distinct from the CCFD bonds, which are not a debt obligation of the City, this gap bond issuance would be structured as City General Fund backed lease revenue bonds and would be an obligation of the City's General Fund.

Internal Stabilization Fund for the Lease Revenue Bond Issuance – Protection for the City General Fund

A standalone Stabilization Fund is proposed to be established internally by the City solely for the General Fund backed lease revenue bonds in order to cushion against any downturn in the special tax revenues that will flow to support the gap issuance. As an internal fund of the City, it would not be covenanted under bond legal documents. If there is a decrease in special tax revenues to a point in which the amount available, combined with the City's maximum payment of $3.5 million annually, is insufficient to cover debt service, the difference would be withdrawn from the Stabilization Fund. The plan currently assumes that the fund would be established with special tax revenues that accrue prior to the issuance of the long term bonds. For example, if the initial levy could occur in February 2013 and if the long term bonds are issued in July 2014, the initial funding level of the Stabilization Fund could be sized up to an amount equal to one year of debt service on the lease revenue bonds, currently estimated to be $13.2 million. Over the life of the lease revenue bonds, should a draw on the Stabilization Fund be required for the City to meet debt service in a given year, thereby reducing the funding level below the initially established amount described above, excess special tax revenues in subsequent year(s) would be utilized by the City to replenish the Stabilization Fund to the original level.

Equity Contribution

In addition to the funding of the Stabilization Fund for the General Fund backed lease revenue bonds, it is projected that $11.5 million of additional special tax revenues could accrue prior to the issuance of the long term bonds. These additional revenues will be applied as a cash contribution to the expansion or to pay down a portion of the Notes, which offsets the long term bond offering amount(s). The exact application of the revenues among the Stabilization Fund, the Notes pay-down, and equity for the expansion will be established after commencement of the special tax levy, based on a cost benefit analysis and consideration of the timing of the issuance of both the Notes and long term bonds.

Potential Early Redemption of Bonds

Each series of long term bonds, all issued concurrently, is expected to have a term of 30 years. However, it is expected that a portion of the long term bond financings will be structured to allow the CCFD and the City to retire bonds early in a pro rata fashion (unless rating agencies require different criteria for early redemption) to the extent there are revenues in excess of debt service and administrative costs of the CCFD each year. Under these circumstances, the City's contribution can also be terminated concurrent with the early retirement of the lease revenue bonds. For illustrative purposes, if special taxes grow at an annual rate of 2%[2] (0% is currently assumed after Fiscal Year 2017), preliminary projections indicate that the final maturity for the bonds could be accelerated by approximately eight years on the back end (Fiscal Year 2036 vs. Fiscal Year 2044). Similarly, if special taxes grow at an annual rate of 3%[2], preliminary projections indicate that the final maturity for the bonds could be accelerated by approximately ten years on the back end (Fiscal Year 2034 vs. Fiscal Year 2044). The structuring of the early redemption provision and an estimate of the scope of bonds that may be redeemed early will be impacted by rating agency ratings criteria, interest rates and financing conditions at the time of the sale of the long term bonds, and projected versus actual growth in special taxes over time.

Reimbursement Resolution

The City must adopt a reimburement resolution in accordance with section 1.150-2 of Treasury Regulations ("Regulations") in order to be reimbursed for any hard construction costs it may advance to the expansion prior to the issuance of bonds. By adopting a reimbursement resolution, the City will satisfy the Official Intent Requirement under the Regulations and be able to reimburse project related expenses using bond proceeds. Adoption of the reimbursement resolution will not obligate the City to expend or advance any funds for the expansion; it merely enables the City to get reimbursed for all qualified project related expenses that the City advances to the project. Staff recommends approval of the resolution so that the flexibility to reimburse from bond proceeds is established.

C. Timeline

Upon City Council approval of the plan of finance, staff will begin preparing the various legal documents associated with issuance of the Notes. Under the following schedule, the Notes could be issued in February 2013 *if the validation action and Coastal Commission milestones are met in January*, with the long term bonds issued the second half of Fiscal Year 2014.

November 2012	• Approval of issuance of Notes and related financing documents (via Resolution)
February 2013	• Begin Collection of Special Tax • Approval of Preliminary Official Statement for Notes • Notes sale and execution of Note Purchase Agreement • Notes closing and deposit of proceeds with trustee (all subject to validation and Coastal Commission approval of Port Master Plan Amendment)
2014	• Long-term bonds issued to take out Notes and fund remaining construction costs

[2] The historical TOT growth rate over the 10 year period between Fiscal Years 2001 and 2010 averaged 3% annually. CCFD special tax projection assumes 0% growth after Fiscal Year 2017.

E. Joint Community Facilities Agreement

The requested actions include City Council's approval of a Joint Community Facilities Agreement ("JCFA") between the City and the Port District. Under the portion of the Mello-Roos Community Facilities Act that is incorporated into the City Municipal Code provision governing the CCFD, a district may be formed and bonds authorized to finance facilities owned or operated by a public entity other than the agency that created the district, only if a JCFA or a joint exercise of powers agreement is adopted. The JCFA is required to contain a description of the facilities and services to be provided or constructed and the distribution of special tax proceeds. The legislative body of each entity must also adopt a resolution declaring that the JCFA would be beneficial to that entity.

Due to the fact that the City formed the CCFD to fund facilities that will be owned by the Port District, a JCFA has been prepared. The JCFA specifies that the facility to be financed is the Convention Center Expansion, and affirms that the City is solely responsible for administering the CCFD, including levying, collecting, and enforcing the special tax, administering and providing for payment of any bonds authorized by the CCFD, and managing construction of the expansion. The Port District acknowledges that it is the lead agency under the California Environmental Quality Act for the expansion project and the associated Environmental Impact Report (EIR).

F. Bond and Disclosure Counsel Services

The City Attorney's Office has identified Nixon Peabody LLP to serve as Bond and Disclosure Counsel for the issuance of both the short term note offering and the permanent bonds with total fees not to exceed $165,000. For services rendered in connection with the short term note offering, fees are not to exceed $75,000. For services rendered in connection with the permanent bonds, fees are not to exceed $85,000. Reasonable out of pocket expenses combined for both components are not to exceed $5,000. The fees payable to Bond and Disclosure Counsel for each component shall be contingent upon the closing of the corresponding issuance, and paid out of the proceeds of such issuance.

G. Financing Team

In order to prepare this comprehensive plan of finance, the following financing team members were identified through various competitive selection processes: FirstSouthwest (Financial Advisor); Nixon Peabody LLP (bond and disclosure counsel); Goldman, Sachs and Co. (Underwriter – Senior Manager); Citigroup Global Markets Inc. (Underwriter - Co-Senior Manager); and Orrick, Herrington & Sutcliffe LLP (CCFD Formation and Validation Counsel). Agreements for each have been approved by City Council or Mayoral action (as required) with the exception of bond and disclosure counsel (City Council authorization requested with this action) and bond underwriters (City Council authorization to be requested in conjunction with Note and Bond Purchase Agreements and the financing resolution and ordinance, respectively).

FISCAL CONSIDERATIONS:

Based on current market conditions, the **preliminary illustrative** bond sizing projections for the delivery of $520 million to fund the expansion are as follows:

($ millions)	CCFD No.2012-1 Bonds		Gap Bonds	Project Equity	Total
	Tier 1	Tier 2			
Bond Proceeds (30 year bonds)	$261.4	$95.8	$192.2	---	$549.5
Annual Debt Service	$15.5	Ranges $5.2-5.9	Ranges (1) $9.3-13.2	---	Ranges (2) $30.0-34.6
Total Gross Debt Service	$464.6	$171.0	$337.4	---	$973.1(3)
Expansion Proceeds	**$244.0**	**$89.2**	**$175.3**	**$11.5**	**$520.0**

(1) Reflects debt service beginning in Fiscal Year 2018, after a capitalized interest period of approximately 2 ½ years.
(2) There is a range due primarily to the amount and timing of the Port District Support Payments.
(3) Does not add due to rounding.

Interest Costs and Ratings Levels

Under current market conditions, it is estimated that the all-in true interest cost of the CCFD Tier 1 Bonds and Tier 2 Bonds would be 4.27% and 4.42%, respectively. This is based in large part on the assumed revenue coverage for each. Since the CCFD bonds will be supported by pledged revenues (i.e., no General Fund backstop), the bond market and credit rating agencies will expect revenues to exceed (or cover) debt service by a certain percentage. The stronger coverage levels of the Tier 1 Bonds (200% currently estimated) compared to the Tier 2 Bonds (150% currently estimated) should result in a higher credit rating and lower interest cost for the Tier 1 Bonds compared to the Tier 2 Bonds. Based on current market conditions it is estimated that the rating on the Tier 1 Bonds could be in the AA-/A+ category range, while the Tier 2 Bonds could be in the A/A- category range. This estimation is based principally on the credit characteristics of the special tax revenue and the structure of the CCFD bonds, as evaluated by current ratings criteria/methodologies published by the rating agencies.

The estimated true interest cost on the lease revenue bonds, based on current market conditions, is 4.28%. The lease revenue bonds would be expected to have a credit rating in the A category, based on the City's current General Fund Lease Revenue Bond credit ratings.

The ratings and credit review process will occur closer to the date of the public offering at which time a more precise estimate of the ratings and interest rate levels for the bonds will be known.

Impact to City Debt Ratios

In accordance with the City's Debt Policy, Section 4.2, an analysis of the impact of the additional General Fund backed bond obligation (i.e., the lease revenue bonds) was conducted. Section 4.2 of the Debt Policy recommends that debt service as a percentage of General Fund revenues be below 10%. Under the current lease revenue bond levels, the debt service as a percentage of General Fund revenues is at 4.24% for Fiscal Year 2013, and is projected to steadily decline to 3.34% by Fiscal Year 2018. Accounting for the City's $3.5 million project payment towards the issuance of the lease revenue bonds, the ratio of debt service as a percentage of General Fund revenues would increase by 0.25% beginning in Fiscal Year 2017. For illustration purposes, all else being equal, the debt service as a percentage of General Fund revenues ratio would increase to 3.59% in Fiscal Year 2018 compared to 3.34% before the issuance of the lease revenue bonds, as noted above.

Since the CCFD bonds are not secured by the City's General Fund, there will be no impact to the City's debt burden from the issuance of the CCFD bonds, which constitutes the bulk of the debt (approximately 65%).

<u>Additional Considerations/Risks</u>

A discussion of potential risks to meeting the budget for the Expansion Project and posssible mitigation measures is provided below. The City's finacing team and project management will coordinate closely during the project and financing implentations to address issues as they arise so that the project can be completed with the funding identified and according to schedule.

Impact from Increase in Interest Rates

A rise in interest rates could impact the City's ability to fully fund the $520 million project budget using the revenues identified for the project. Assuming the revenue levels and long term financing structure described above, if interest rates rise by approximately 160 basis points the ability to generate $520 million for the Convention Center Expansion would be impacted. If this occurs, staff will explore structuring variations with the Financial Advisor and Underwriters to determine if additional proceeds can be generated.

Impact from Increase in Construction Costs

The project manager has identified and outlined the following factors as among those that could cause the City to experience increases in the estimated cost of construction.

1. *Conceptual Validation.* The Expansion design team completed only the conceptual validation stage of the design process. Recognizing that the detailed design process for the project has not yet begun, preliminary project descriptive material was prepared about the various building spaces, materials, and systems. Independent professional estimators, experienced in estimating convention centers at this early stage in the process, were engaged to define the anticipated costs.
2. *Structural Design.* The design of the structure as a whole is not yet settled nor is the interaction with, and code interpretations from, the respective code officials as is typical of this early stage of design.
3. *Recovery of Housing Market.* When the housing market does recover, it could lead to significant upward cost pressure on concrete, steel, drywall, etc.
4. *Labor/Sub-Contractor Shortages.* The recession has significantly impacted the size of the construction labor pool and, as the recovery continues, it is possible that there will be

a shortage of labor should a number of large projects happen currently. Additionally, there may be bonding capacity issue for some trades.

5. *Ongoing Pressure on Copper and Oil.* Both will continue to come under pressure as the US recovery gains pace.

Several methods of reducing these Construction Cost Risks, as identified by the project manager, include:

1. *Selection of Construction Team.* The City has proceeded with the process of selecting a Construction Manager at Risk ("CMAR") to work with the design team as it develops the design. This early involvement has several benefits assigning the contractor to:
   - Be charged with developing a schedule and sequence for the project construction;
   - Assist in determining the best, most cost-effective means of constructing;
   - Provide input from the many construction trades about material and component availability;
   - Provide estimating updates throughout the design process and suggest alternatives if needed to keep the project on budget;
   - Evaluating options and guide the team towards solutions that provide the best value.
2. *Guaranteed Maximum Price.* At a milestone in the design process, the CMAR will be charged with providing the Guaranteed Maximum Price (GMP). At this point a major portion of the cost risk will be shifted from the City to the CMAR.
3. *Contingencies.* The current cost estimate and all additional cost estimates to come contain an appropriate amount of design and construction contingencies to reduce the risk of exceeding the budget. As the design develops and the risks associated with design, material costs, and the other risks mentioned above will be reduced allowing for the reduction in contingencies currently applied.
4. *Program Reduction.* Although not the preferred method of mitigating the risk of construction cost increases, the program for the proposed Expansion could be reduced to keep project within budget.

Project Delays

The project manager has also identified the potential impact of a project delay as follows:

The budgeting process for the Expansion used a 4% escalation factor in determining construction cost growth. In other words, costs were calculated in current dollars and then escalated at 4% *per annum* to the estimated mid-point of construction. Accordingly, for each month of unanticipated delay the project experiences (beyond an active construction commencement date of January 1, 2014), construction costs will increase by approximately $1.5 million for the same program.

Market Condition Impacts

It is important to understand that the financing plan developed is based on current market conditions as of September 10, 2012. It cannot be known today what market conditions will be at the time the long term bonds are issued, currently expected to occur in the second half of

Fiscal Year 2014. As such, the structure of the long term bonds could be different, depending on market preferences. For example, it is possible that the number of series of bonds issued or the coverage levels required for the CCFD No. 2012-1 bonds could change. Interest rate levels will also fluctuate over time and will have an impact on the long term bonds. In addition, the ratings criteria of the credit rating agencies can change over time affecting the level of ratings and interest rates. Staff will continue to monitor market conditions with the City's financing team and make adjustments to specific features of the financing structure, while maintaining the objective of implementing a cost effective and financially sound bond program. As staff returns to City Council for the long term bond authorizations, City Council will be informed of shifting market conditions and the impact to the financing structure.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

May 17, 2011: the City Council was presented with an informational report concerning the proposed Convention Center Phase III Expansion Project.

August 2, 2011: the City Council adopted a Resolution authorizing the Assignment and Authorization Agreement related to the Proposed Convention Center Phase III Expansion, and adopted a Resolution authorizing the Law Firm of Orrick Herrington & Sutcliffe to Provide Formation Counsel Services regarding the Formation of a Convention Center Financing District.

September 21, 2011: the Budget and Finance Committee forwarded an action to the City Council to amend the San Diego Municipal Code to provide for the formation of a Convention Center Facilities District to provide funding for the Project.

October 25, 2011: the City Council approved an ordinance amending the Municipal Code to facilitate formation of a Convention Center Facilities District.

December 6, 2011: the City Council adopted a Resolution of Intention to form CCFD No. 2012-1 and a Resolution Declaring the Need to Incur Bonded Indebtedness to provide funding for a contiguous expansion of the San Diego Convention Center.

January 24, 2012: in conjunction with a noticed Public Hearing, the City Council adopted a Resolution Forming CCFD No. 2012-1 and Providing for the Levy of a Special Tax, a Resolution Deeming it Necessary to Incur Bonded Indebtedness, and a Resolution Calling a Special Mailed-Ballot Election.

May 7, 2012: the City Council adopted a Resolution Declaring the Results of a Special Mailed-Ballot Election within CCFD No. 2012-1 and a Resolution Authorizing and Directing the City Clerk to File a Notice of Special Tax Lien and Authorizing the Filing of a Judicial Validation Action in Relation to the Formation of CCFD No. 2012-1 and Related Matters.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

Outreach to hotel owners/operators has been ongoing. Significant community outreach occurred through a series of meetings conducted with hotel property owners and operators over the past year. For the January 24, 2012 Public Hearing, Notices of Public Hearing were mailed to each hotel property owner that would be subject to the special tax, and the Notice was published in the San Diego Daily Transcript prior to the Public Hearing. The notice provided a link to the City Clerk web-page for easier access to the documents associated with the Public Hearing. The ballot materials mailed in connection with the special mailed ballot election contained an impartial analysis of the measure prepared by the City Attorney's office and a link to additional reference materials on the City Clerk's website. The City has also established a web-link (www.sandiego.gov/ccfd) containing a repository of documents concerning CCFD No. 2012-1, including a Fact Sheet for Hotel Property Owners.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Landowners who own property upon which hotels are located within the City that will be subject to the special tax. Business entities involved in the financing of the project include Nixon Peabody LLP (bond and disclosure counsel services); FirstSouthwest (Financial Advisor); Goldman, Sachs and Co. (Underwriter – Senior Manager); Citigroup Global Markets Inc. (Underwriter - Co-Senior Manager); and Orrick, Herrington & Sutcliffe LLP (CCFD Formation and Validation Counsel).

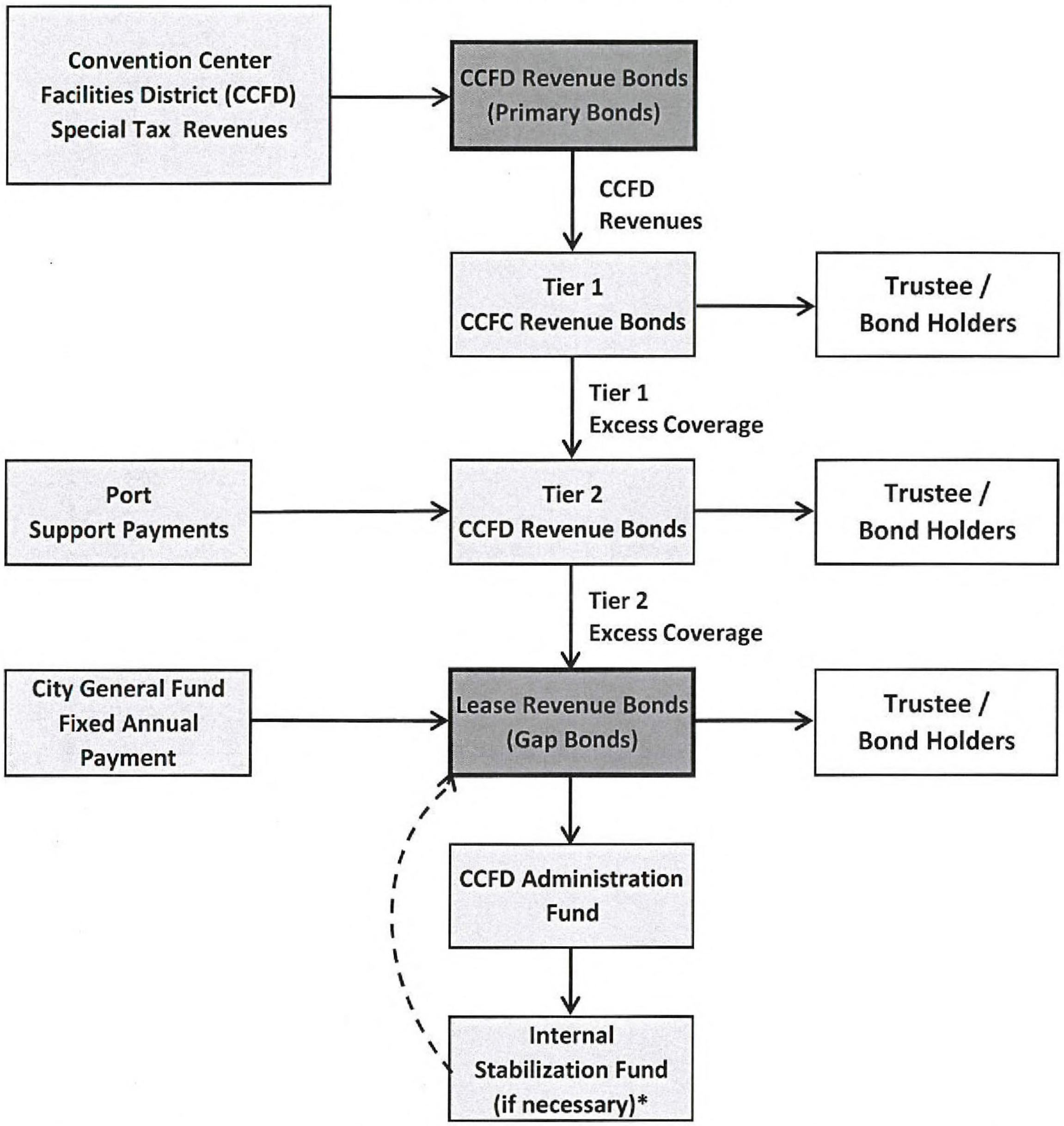
Lakshmi Kommi
Debt Management Director

Jay M. Goldstone
Chief Operating Officer

Attachment 1: Flow of Funds Summary

San Diego Convention Center Phase III Expansion Plan of Finance

Flow of Funds Summary



* The Stabilization Fund will be held by the City and applied to the Lease Revenue Bonds only if special taxes are insufficient to cover all but the City's $3.5 million portion of the debt service. Should a draw on the Stabilization Fund be required for the City to meet debt service in a given year, thereby reducing the funding level below the initially established amount described above, excess special tax revenues in subsequent year(s) would be utilized by the City to replenish the Stabilization Fund to the original level.

Notes: (1) This Flow of Funds summary is intended for illustrative purposes and should be reviewed in conjunction with the full Report to City Council for additional detail regarding the information presented above. It should also be noted that certain elements of the financing structure, such as the number of bond series, will naturally evolve based on market conditions and revenue trends that exist as the actual financing documents and credit are developed closer to the time of issuance.

(2) CCFD Special Tax Revenues, once collected by the City Treasurer, will be remitted to the bond trustee. The bond trustee will then apply the appropriate priority of such revenues for payment of debt service, pursuant to the Bond Indentures for the CCFD Revenue Bonds and Lease Revenue Bonds.