OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Lease Revenue Refunding Bonds, Series 2010A (Master Refunding)

OVERVIEW

The proposed Master Refunding contemplates refinancing the following City General Fund – backed bond issuances (together, the Original Bonds):

- Deferred Capital Improvement Lease Revenue Bonds, Series 2009A (2009A Bonds)
- Taxable Lease Revenue Bonds Series 1996A (1996A Stadium Bonds)
- Refunding Certificates of Participation, Series 1996B (1996 COPs)

The proposed refinancing of the Original Bonds achieves two objectives: 1) fulfills a covenant the City made to Bank of America to refund the 2009A Bonds by June 1, 2010 and 2) takes advantage of lower interest rates to reduce the annual interest expense on the 1996A Stadium Bonds and 1996 COPs, without extending existing maturity dates. In order to realize these objectives, City Council is being asked to approve an ordinance and a resolution authorizing the issuance of not more than $185 million of Lease Revenue Refunding Bonds, Series 2010A (2010A Refunding Bonds), hiring Bond and Disclosure Counsel, and approving the form and content of necessary bond documents.

This report provides an overview of the proposed Master Refunding, discusses certain attributes associated with the 2010A Refunding Bonds, and reviews the actions before the City Council and those remaining before bonds can be issued.

FISCAL/POLICY DISCUSSION

Overview of the Proposed Master Refunding

The refunding proposal calls for the City to use its joint powers authority, the Public Facilities Financing Authority of the City of San Diego (Authority), to be the issuer of the 2010A Refunding Bonds. As noted in the staff report, the Authority was established in 1991 between the City and the City's Redevelopment Agency. The Authority is needed to facilitate the issuance of these lease revenue bonds. Lease revenue bonds are commonly used in California because the debt instrument is structured as a lease and not classified as debt for purposes of debt limit or voter approval.

In simple terms, the 2010A Refunding Bonds involve creating a lease between the City and the Authority. The City is proposing to lease the seven General Fund properties and facilities listed on page 5 of the staff report to the Authority for a nominal rent of $1. The Authority subsequently leases back those same facilities to the City, at a rate sufficient to cover the debt service on the 2010A Refunding Bonds. The lease back to the City is considered a contingent obligation because it is subject to abatement if the City does not have beneficial use of the subject properties for any reason. As stated in the staff report "The City is required to budget and make lease payments from any general funds legally available to it, but the requirement to make lease payments is not one for which the City is obligated to levy or pledge any form of taxation."

The 2010A Refunding Bonds are proposed for an amount not to exceed $185 million including costs of issuance of approximately $1.9 million as detailed in Attachment 1 of the staff report. Each of the Original Bonds will be entirely refinanced. The Original bonds will be retired and replaced with the Master Refunding. Given the City's inability to issue long-term debt in the public capital markets in 2008, the 2009A bonds were considered to be an interim means of financing deferred capital improvements that would ultimately be replaced with publicly issued long-term debt. In keeping with that plan, the term of the 2009A bonds will be extended from 10 to 30 years (through 2040) thereby better matching the useful life of the assets being financed. With respect to the 1996A Stadium Bonds and 1996 COPs, the Master Refunding will mirror preexisting bond maturities (the term of the debt remains the same).

According to the Mayor's Five-Year Financial Outlook, annual payments on the 2009A Bonds were estimated to increase from $4.9 million to $9.5 million beginning in FY 2011; however, based on the debt service schedule provided by staff, it appears that the portion of the debt service on the 2010A Refunding Bonds attributable to the 2009A Bonds will be approximately $6.2 million in FY 2011 increasing to approximately $8.2 million thereafter. This should have a positive impact on the General Fund, and/or the Capital Outlay Fund where the principal portion of debt service is anticipated to be budgeted.

Based on market conditions as of February 19, 2010, staff estimates the True Interest Cost for the 2010A Refunding Bonds to be approximately 5.72%. If this estimate holds until the anticipated bond sale in May 2010, the City's debt service (lease) payments for the 1996A Stadium Bonds and 1996 COPs would be reduced by approximately $950,000 annually through FY 2027 (detail in Attachment 3 of the staff report). These annual savings will accrue to the City's General Fund.

Certain Attributes of the 2010A Refunding Bonds

As discussed above, the City has identified seven properties to lease to and from the Authority. Three of the properties were the subject of lease agreements for the 2009A bonds. In selecting the new mix of assets, Debt Management and Real Estate Asset Department staff generally looked at the following factors: properties not subject to another lease, fair annual rental value of the property, essentiality of the property/facility, and if the property was a General Fund asset. By choosing the seven identified properties/facilities, two assets previously pledged for the Original Bonds (the Qualcomm Stadium structure, site & certain surrounding property and the Balboa Park Golf Course) would be released from financing encumbrances if the 2010A Refunding Bonds are issued. It should be noted that Section 3.06 of the Master Lease Agreement enables the City to substitute leased assets in the future if desired.

Establishing a Debt Service Reserve Fund (DSRF) equal to maximum annual debt service for bonds is a normal practice. A DSRF provides comfort to bondholders in the event an issuer, for any reason, cannot make their annual debt service payment. For the first time, staff is proposing to evaluate reducing the DSRF to half of the maximum annual debt service. Staff has indicated that they would only do so if 1) there is no increased borrowing cost to the City and 2) no adverse rating agency impact. Given these objectives, the IBA supports this action as it would reduce the amount of bonds to be issued and further lower the City's borrowing costs. The IBA recommends that staff apprise the City Council of developments in this regard when they return to the City Council for additional actions.

Actions before the City Council and Remaining Actions

Even though a bond sale is not anticipated until mid-May, the City Council is being asked to approve an authorizing ordinance and an accompanying resolution in support of the 2010A Refunding Bonds. Specifically, the Ordinance will authorize the following:

- Authority to issue not more than $185 million of 2010A Refunding Bonds
- Form and content of the Master Site Lease
- Form and content of the Master Lease Agreement
- Form and content of the Master Indenture
- Form and content of the Continuing Disclosure Agreement

These documents and authorizations are described in the staff report. The accompanying resolution approves the Bond Purchase Agreement and the hiring of Squire Sanders and Dempsey LLC as Bond Counsel and Disclosure Counsel for an amount not to exceed $357,000 including expenses. At the City Council staff briefing, Debt Management staff was asked 1) why the City Council is being asked to provide these approvals so far in advance of the anticipated bond sale and 2) if additional City Council action was necessary before the 2010A Refunding Bonds could be sold.

The answer relates to timing and the current readiness of certain bond documents for approval. The authorizing ordinance requires introduction and subsequent approval by the City Council two weeks later before the required 30-day referendum period. Allowing for lead docketing time, this process takes approximately two months. As bond documents to be approved by ordinance are currently in substantially final form, City Council approval is sought at this time to set the stage for a subsequent and necessary City Council action. The City Council must approve the bond offering document (Preliminary Official Statement - POS) before the 2010A Refunding Bonds can be issued. Staff plans to seek City Council approval of the POS late April.

In order to satisfy the covenant the City made to Bank of America to refund the 2009A Bonds by June 1, 2010, it is necessary for City Council introduction of the ordinance at this time. Approving the POS at a later date enables the City's offering document to incorporate the latest City information for potential bond buyers in the public markets to consider. The IBA understands that requesting City Council approval for the same financing seven weeks apart may require the Council to review or re-review a complicated transaction twice. As there appear to be trade-offs, the IBA will research best practices in this regard and report back to the City Council when approval is sought for the POS in late April.

CONCLUSION

The proposed Master Refunding involves issuing 2010A Refunding Bonds to refinance the Original Bonds. Refinancing the Original Bonds will enable the City to achieve two important objectives: 1) fulfill a covenant the City made to Bank of America to refund the 2009A Bonds by June 1, 2010 and 2) take advantage of lower interest rates to reduce the annual interest expense on the 1996A Stadium Bonds and 1996 COPs, without extending existing maturity dates.

If recent interest rate estimates hold until the proposed bond sale date in mid-May, the City's debt service (lease) payments for the 1996A Stadium Bonds and 1996 COPs would be reduced by approximately $950,000 annually through FY 2027. Additionally, based on our review, it appears that refinancing the 2009A Bonds will reduce the debt service projected in Mayor's Five-Year Financial Outlook by $3.3 million in FY 2011. If so, these annual savings will accrue to the City's General Fund and/or the Capital Outlay Fund.

Given the General Fund savings opportunity and the ability to satisfy our covenant with Bank of America, the IBA recommends that the City Council approve the requested ordinance and resolution in support of the proposed Master Refunding. Before the 2010A Refunding Bonds can be issued, the City Council will be asked to approve the POS in late April before the planned bond sale in mid-May 2010.

The IBA has been informed that representatives of the financing team will be present for the City Council meeting on March 9, 2010. The IBA encourages the City Council to ask any questions they might have directly to members of the City's financing team including the City's financial advisor, bond counsel and underwriter.

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