



*City of Arts & Innovation*

# City Council Memorandum

**TO: HONORABLE MAYOR AND CITY COUNCIL**      **DATE: OCTOBER 23, 2018**

**FROM: FINANCE DEPARTMENT**      **WARDS: ALL**

**SUBJECT: ISSUANCE OF REFUNDING SEWER REVENUE BONDS OF THE CITY IN AN AGGREGATE PRINCIPAL AMOUNT NOT TO EXCEED \$200,000,000 AND PROVIDING THE TERMS AND CONDITIONS OF SUCH BONDS (FIFTH SUPPLEMENTAL RESOLUTION) - RESOLUTION**

## **ISSUE:**

Conduct a Public Hearing and adopt a resolution authorizing the issuance of up to \$200 million in sewer revenue refunding bonds (the "2018 Refunding Bonds") to refinance the City's 2009B Bonds and providing the terms and conditions of such bonds (Fifth Supplemental Resolution).

## **RECOMMENDATIONS:**

That the City:

1. Conduct a Public Hearing relative to the refunding of the City's 2009B Sewer Revenue Bonds;
2. Adopt a Resolution authorizing the issuance of the 2018 Refunding Bonds to refinance the City's 2009B Bonds and providing the terms and conditions of such bonds (Fifth Supplemental Resolution);
3. Authorize the City Manager, or his designee, to execute all documents necessary to close the bond refinancing and make certain non-substantive changes to the final documents necessary to complete the transaction;
4. Approve the financing team inclusive of Jones Hall as Disclosure Counsel, Stradling Yocca Carlson & Rauth as Bond Counsel, NHA Advisors as Municipal Advisor and Bank of America Merrill Lynch ("BoFAML") and Citigroup Global Markets ("Citigroup") as Underwriters.

## **BACKGROUND:**

The City currently has two outstanding bond issues, totaling \$396 million in outstanding par, secured by net revenues of the City's Sewer Enterprise: The 2009B Sewer Revenue Bonds and the 2015 Sewer Revenue Bonds. The 2009B Bonds, currently outstanding in the amount of \$196 million, were issued as taxable Build America Bonds, whereby the City receives a credit (historically between 32% and 35% of total interest due) from the Federal Government. The current interest rate being paid on the 2009B Bonds is 7.16%, and 4.81% after including the estimated subsidy from the Federal Government. The 2009B Bonds are callable (can be "prepaid") on 8/1/2019.

The City's sewer system is currently rated "A+" by Standard and Poor's and "A1" by Moody's. While the City has historically met its minimum debt service coverage requirements, the aggregate annual debt service (2009B and 2015 Bonds combined) has increased from about \$17 million to about \$30 million in FY 2018/19 due to the expiration of the capitalized interest period (no payments required) on the 2015

Bonds. The large increase in debt service has strained the Sewer Enterprises ability to achieve desired debt service coverage metrics as well as the ability to fund critical capital projects for the sewer system.

## **DISCUSSION:**

Finance Department staff, in conjunction with various financial partners, continually monitor the debt portfolio of the City and its related entities looking for opportunities to reduce the related cost of repaying its various obligations. As those opportunities arise, staff will assemble a financing team to structure a refunding transaction to take advantage of the financial market opportunity.

The 2018 Refunding Bonds will be structured as tax-exempt bonds and will be amortized to the same maturity of the 2009B Bonds being refunded (August 1, 2039). The financing team recommended for this transaction consists of Jones Hall as Disclosure Counsel, Stradling Yocca Carlson & Rauth as Bond Counsel, NHA Advisors as Municipal Advisor, and BofAML and Citigroup as Underwriters. Both Bond Counsel and Disclosure Counsel firms have extensive experience working with the City on other transactions, and NHA Advisors was hired by the City as part of the Municipal Advisor RFQ process earlier this year. BofAML and Citigroup were chosen to serve as underwriters through a competitive RFQ process managed by City staff and NHA Advisors in August 2018.

The City seeks to achieve multiple objectives with the 2018 Refunding Bonds, including:

- **Present Value (PV) Savings:** Current estimated PV savings are \$14 million, or 7.6% of the refunded par amount.
- **Near-Term Cash Flow Savings:** The City expects to generate over \$19 million in gross cash flow savings from FY 2019 through FY 2023. This amount will be critical to funding CIP requirements over the next five years.
- **Cumulative Cash Flow Savings:** After FY 2023, annual gross savings is estimated at \$1.4 million per year. In total, there will be an estimated \$44 million of cumulative savings through the life of the bonds.
- **Improved Debt Service Coverage:** By lowering debt service, debt service coverage (assumes no transfer from rate stabilization fund) over the next few years should increase from 0.95% (assumes no refunding) to over 1.10% (after refunding).

The City and its financing team has been diligently working on the various legal documents, preliminary official statement and rating credit presentation. The City expects to obtain credit ratings from S&P and Moody's by October 22<sup>nd</sup>, price (set interest rates) on the 2018 Refunding Bonds during the week of October 29 or November 5, and the close of the transaction in late November 2018.

### **Good Faith Estimates:**

The good faith estimates discussed below with respect to the 2018 Refunding Bonds are provided in accordance with California Government Code Section 5852.1. Such good faith estimates have been provided by NHA Advisors, the City's Municipal Advisor, in consultation with BofAML, as Senior Managing Underwriter of the 2018 Refunding Bonds. They are based on assumptions of the Estimated Principal Amount of the 2018 Refunding Bonds and on market interest rates prevailing at the time such estimate is prepared.

**Principal Amount:** The Municipal Advisor has informed the City that, based on the City's financing plan and current market conditions, its good faith estimate of the aggregate principal amount of the 2018 Refunding Bonds to be sold (the Estimated Principal Amount) is \$156 million. This amount excludes approximately \$19.4 million of net premium estimated to be generated from current market pricing. Net premium is generated when, on a net aggregate basis for a single issuance, the prices paid for the bonds are higher than the face values of such bonds. A bond trades at a premium when it offers a coupon rate higher than the prevailing market interest rates.

**True Interest Cost of the Bonds:** The Municipal Advisor has informed the City that its good faith estimate of the true interest cost of the Bonds (rate necessary to discount amounts payable on

respective principal and interest payment to purchase price received for Bonds) is 3.74%.

Finance Charge of the Bonds: The Municipal Advisor has informed the City that its good faith estimate of the finance charge for the 2018 Refunding Bonds (sum of all fees and charges paid to third parties, or costs associated with 2018 Refunding Bonds) is \$750,000. Such fees and charges include fees for bond and disclosure counsel, municipal advisor, trustee, city attorney, printing and underwriting. These fees are all paid for with bond proceeds. Bond Insurance is not currently assumed to be cost effective. If the actual cost of bond insurance is determined to be lower than the additional savings (from lower interest rates) it generates, a bond insurance policy could potentially be purchased closer to the time of pricing. The estimated savings from refunding takes into account all of these costs.

Amount of Proceeds to be Received: The Municipal Advisor has informed the City that its good faith estimate of the amount of proceeds expected to be received by the City for sale of the 2018 Refunding Bonds (less the finance charge of the Bonds, as estimated above, and any reserves funded with proceeds of the 2018 Bonds) is \$174.7 million.

Total Payment Amount: The Municipal Advisor has informed the City that its good faith estimate of the total payment amount of all payments the City will make to pay debt service on the 2018 Refunding Bonds calculated to the final maturity of the 2018 Bonds is \$256 million.

The foregoing estimates constitute good faith estimates only. The actual principal amount of the 2018 Refunding Bonds issued and sold, the true interest costs, the finance charges, the amount of proceeds received, and the total payment amount may differ from such good faith estimates due to:

1. The actual date of the sale of the 2018 Refunding Bonds being different than the date assumed for purposes of such estimates;
2. The actual principal amount of the 2018 Refunding Bonds sold being different from the Estimated Principal Amount;
3. The actual amortization of the 2018 Refunding Bonds being different than the amortization assumed for purposes of such estimates;
4. The actual market interest rates at the time of sale of the 2018 Refunding Bonds being different than those estimated for purposes of such estimates;
5. Other market conditions; or
6. Alterations in the City's financing plan, delays in the financing, additional legal work (including federal tax law due diligence), or a combination of such factors.

The actual date of sale of the 2018 Refunding Bonds and the actual principal amount of 2018 Refunding Bonds sold will be determined by the City based on the timing of the need for proceeds of the 2018 Refunding Bonds and other factors. The actual interest rates and amortization of the 2018 Refunding Bonds will depend on market interest rates at the time of sale. Market interest rates are affected by economic and other factors beyond the control of the City. If market rates change so that the transaction is no longer financially beneficial, the City can terminate the transaction at any time before the refunding bonds are issued.

### **FISCAL IMPACT:**

Based on current interest rates ( $\approx 3.74\%$ ), PV savings is estimated at \$14 million, or 7.6% of refunded par. Overall, there is an estimated \$44 million of gross cash flow savings expected through FY 2040. From FY 2019 through FY 2023, annual savings is estimated to range between \$3.0 million and \$5.7 million, totaling \$19.9 over the next five years. After that, annual gross cash flow savings is estimated at \$1.4 million per year.

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Approved as to form: Gary G. Geuss, City Attorney

**ATTACHMENTS:**

1. Notice of Public Hearing
2. 5<sup>th</sup> Supplemental Resolution
3. Preliminary Official Statement
4. Bond Purchase Agreement
5. 2009B Escrow Agreement
6. Presentation