



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL AND
CITY OF SAN JOSE
FINANCING AUTHORITY BOARD

FROM: Julia H. Cooper
Kerrie Romanow

SUBJECT: SEE BELOW

DATE: March 14, 2022

Approved

Date

3/17/2022

SUBJECT: ACTIONS AMENDING CERTAIN AGREEMENTS RELATED TO THE INTERIM FINANCING PROGRAM TO FINANCE CAPITAL IMPROVEMENTS AT THE SAN JOSE-SANTA CLARA REGIONAL WASTEWATER FACILITY

RECOMMENDATION

- a. City Council adopt a resolution approving and authorizing the execution and delivery of a Third Amendment to the Credit Agreement and a Third Amended and Restated Fee Letter Agreement with Wells Fargo Bank, National Association, related to the issuance by the City of San José Financing Authority of its Subordinate Wastewater Revenue Notes in an aggregate principal amount not to exceed \$300,000,000 outstanding at any one time for the purpose of financing or refinancing Wastewater System and Treatment Plant Projects to revise the calculation of interest and fees for the Notes along with other related changes and authorizing other related actions in connection therewith.
- b. City of San José Financing Authority Board adopt a resolution approving and authorizing the execution and delivery of a Third Amendment to the Credit Agreement and a Third Amended and Restated Fee Letter Agreement with Wells Fargo Bank, National Association related to the issuance by the City of San José Financing Authority of its Subordinate Wastewater Revenue Notes in an aggregate principal amount not to exceed \$300,000,000 outstanding at any one time for the purpose of financing or refinancing Wastewater System and Treatment Plant Projects to revise the calculation of interest and fees for the Notes along with other related changes and authorizing other related actions in connection therewith.

OUTCOME

Approval of these recommendations provide savings to the San José-Santa Clara Regional Wastewater Facility (RWF) project by amending the Credit Agreement (Credit Agreement) and Fee Letter Agreement by and among the City of San José (City), City of San José Financing Authority (Authority), and Wells Fargo Bank, National Association (Bank) to revise the calculation of interest on the notes and the fees payable to the Bank in connection with the notes.

BACKGROUND

The City and the Authority established in October 2017¹ a credit facility to provide interim cash funding for the \$1.4 billion Water Pollution Control Capital Improvement Program (WPC CIP) at the RWF. The \$300 million financing facility bridges the cash flow and financing needs of the City's Environmental Services Department during the WPC CIP's early construction phases prior to issuance of long-term bonds. Such a facility allows the City to borrow funds and pay costs as the funds are needed, thereby minimizing the interest expense compared to a bond issue which requires interest on the full balance to begin accruing upon closing whether the proceeds have been expended or not. Any associated debt service for financing, whether interim or long term, will be paid by installment payments made by the City to the Authority from pledged system revenues received by the City related to the treatment plant and the sewer collection and conveyance system (the Wastewater System, and together with the treatment plant the Wastewater Treatment System) less maintenance and operation costs of the Wastewater Treatment System (Net System Revenues). There is no pledge of funds from the City's General Fund.

In June 2018, the City and Authority approved the First Amendment of the Credit Agreement and Amended the Restated Fee Letter Agreement² to adjust the calculation of interest and fees for tax-exempt notes in order to address increased borrowing cost under the terms of the agreement resulting from tax changes in the Tax Cuts and Jobs Act (Tax Act). The Tax Cuts and Jobs Act, effective on December 22, 2017, changed the federal corporate tax rate from 35% to 21%, had the effect of reducing the value of tax-exempt income to the bank thereby increasing Credit Agreement fees under the terms of the agreement by approximately 22%. City staff negotiated with the Bank to revise the formula in the first amendment to reduce this increase to 14% instead of 22%.

¹ October 3, 2017 joint Council/Authority Meeting:

<https://sanjose.legistar.com/LegislationDetail.aspx?ID=3160813&GUID=4F5AB017-FAEA-40D4-88BD-929872E259CD&Options=&Search=>

² June 26, 2018 joint Council/Authority Meeting:

<https://sanjose.legistar.com/LegislationDetail.aspx?ID=3523897&GUID=34807D4E-EE17-4390-BF06-2421483C15A4&Options=&Search=>

In September 2020, the City and Authority³ approved a Second Amendment to the Credit Agreement to extend the term for an additional three years through October 18, 2023, made changes to pricing that increased the borrowing cost, amended various definitions, and established a LIBOR Floor of 0.50%.

Staff solicited pricing and initiated negotiation of an amendment of the Credit Agreement in 2020 but the market was still adjusting to the impact of the COVID-19 pandemic. City staff in coordination with Public Resource Advisory Group, the City's municipal advisor, have been monitoring the decline of credit pricing with the recovery from the pandemic, and are now able to recommend a third amendment that would lower the interest and fees of the credit facility and cost to the WPC CIP.

ANALYSIS

The proposed amendments to the Credit Agreement would amend various definitions, replacing the benchmark index from LIBOR to the U.S. Secured Overnight Financing Rate. the U.S. Secured Overnight Financing Rate is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. The proposed amendment to the Fee Letter Agreement reduces the fee on the undrawn portion of the \$300 million credit facility (Commitment Fee) from 35 base points (bps) (or 0.35%) per year to 21 bps (or 0.21%). The total interest rate based on the City's credit above the benchmark index (Applicable Spread) on the tax-exempt draws would be reduced from 95 bps (0.95%) to 37 bps (0.37%). On any taxable draws, the Applicable Spread would be reduced from 110 bps (1.10%) to 45 bps (0.45%). All other key terms remain unchanged.

The Commitment Fee and Applicable Spread were based on the credit ratings associated with the San José-Santa Clara Clean Water Financing Authority 2009A Bonds; however, these bonds matured on November 15, 2020 and those ratings have since been withdrawn. In the absence of public ratings from the rating agencies, the documents provide that an alternate pricing methodology based on Debt Service Coverage Ratio (DSCR) would apply. The DSCR is calculated as the ratio of (a) the amount of Adjusted Net System Revenues in a consecutive 12-month period (*selected by the City, occurring during the 18 months prior to the date of calculation*) to (b) Maximum Debt Service – essentially (a) divided by (b), which places the current fees into the lowest fee rate category based on the City's DSCR. The Commitment Fee and Applicable Spread would increase in the event the DSCR falls below the two times (2.0x) the coverage ratio. The proposed amendment would implement the fees described below:

³ September 29, 2020 joint Council/Authority Meeting:

<https://sanjose.legistar.com/LegislationDetail.aspx?ID=4641751&GUID=A1287E5D-FF9A-49C3-93E8-E1AF35535F7B&Options=ID|Text|&Search=Fee+Letter+Agreement+with+Wells+Fargo>

Subject: Actions Amending Certain Agreements related to the Interim Financing Program to Finance Capital Improvements at the San José-Santa Clara Regional Wastewater Facility

Page 4

<i>Level</i>	<i>Ratings on Long-Term, Unenhanced Wastewater Obligations (Moody's/S&P/Fitch)</i>	<i>Commitment Fee (Undrawn Amount)</i>	<i>Applicable Spread (Drawn Amount) [Taxable / Tax-Exempt]</i>	<i>Debt Service Coverage Ratio (DSCR)</i>
Level 1	Equal to Aa2/AA/AA	0.210%	0.450% <i>I</i> 0.370%	>2.0x
Level 2	Equal to Aa3/AA-/AA-	0.235%	0.525% <i>I</i> 0.445%	1.85x-≤2.0x
Level 3	Equal to A1/A+/A+	0.285%	0.675% <i>I</i> 0.595%	>1.70x-≤1.85x
Level 4	Equal to A2/A/A	0.325%	0.825% <i>I</i> 0.745%	>1.45-≤1.70x
Level 5	Equal to A3/A-/A-	0.375%	0.975% <i>I</i> 0.895%	>1.25-≤1.45x
Level 6	Below A3/A-/A-	1.375%	N/A	≥1.10x-≤1.25x
Level 7			N/A	<1.10x

CONCLUSION

Approval of the recommendations amend the Credit Agreement and Fee Letter Agreement with Wells Fargo Bank, National Association to revise the calculation of interest on the notes and the fees payable to the Bank in connection with the notes.

EVALUATION AND FOLLOW-UP

No additional evaluation or follow-up to the Council or the Authority is anticipated.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the March 29, 2022 Council Meeting, along with all the referenced financing documents.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

There is no commission recommendation or input associated with this action.

COST SUMMARY/IMPLICATIONS

Costs for the proposed amendments to the Credit Agreement, which include the cost for professional services (note counsel, bank counsel, and the City's municipal advisor) is estimated to be approximately \$60,000 and will be paid from the Note Proceeds. The actions recommended as part of this memorandum will result in reductions to the interest and fee cost components applicable to the Notes pursuant to the documents being amended. It is anticipated that the total costs for the various projects under the Program will be less than the amounts budgeted in the 2021-2022 Adopted Capital Budget and 2022-2026 Capital Improvement Program due to reduction of the interest and fee cost components.

When compared to the previous Program, the estimated costs due to the recommendations of this memorandum could offset a portion of the projected rate increases over the new Program's three-year term. However, actual costs will vary depending on the pace of capital project construction and the interest rate and will continue to be closely monitored. The estimated revenues and annual debt service payments related to the Program will be included in the 2022-2023 Proposed Capital Budget and 2023-2027 Proposed Capital Improvement Program. In 2022-2023, a maximum budgeted revenue adjustment of 9%, which includes estimated revenues needed for annual debt service payment, among other projected cost increases, will be recommended for approval as part of the upcoming budget process. Financing costs for both the interim financing program amended by this memorandum and the future amortization of long-term bonds will continue to be included in the calculation of annual rate increases.

The Program, over the longer term, is expected to reduce the City's overall costs of borrowing for the RWF's CIP program. The City pays lower borrowing cost for the Program than if it were to issue long-term 30-year bonds to finance the construction of the CIP projects immediately. The long-term bonds will be issued when the line of credit for the interim financing is fully utilized which is estimated to occur in November 2022.

The Notes issued for the identified purposes are expected to be repaid from the proceeds of long-term financing. Future debt service costs are subject to appropriation by the City Council and will be brought forward for review and approval as part of the annual budget development process.

Subject: Actions Amending Certain Agreements related to the Interim Financing Program to Finance Capital Improvements at the San José-Santa Clara Regional Wastewater Facility

Page 6

BUDGET REFERENCE

The table below identifies the fund and appropriation to pay debt service costs related to the Program.

Fund #	Appn #	Appn. Name	Total Appn.	Last Budget Action (Date, Ord. No.)
512	402C	Debt Service Repayment for Plant Capital Improvement Projects	\$5,422,000	6/22/21, Ord. No. 30621

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment.

/s/
JULIA H. COOPER
Director of Finance

/s/
KERRIE ROMANOW
Director of Environmental Services

For questions, please contact Nikolai J. Sklaroff, Deputy Director of Finance, Debt and Treasury Management Division, at (408) 535-7832.