



# Memorandum

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

**FROM:** Julia H. Cooper  
Kim Walesh  
Margaret McCahan

**SUBJECT:** SEE BELOW

**DATE:** August 3, 2018

Approved

Date

8/3/18

**SUBJECT: APPROVAL OF THE CITY'S PURCHASE OF THE SAN JOSE CONVENTION CENTER SOUTH HALL PROPERTY AND ACTIONS RELATED TO THE CITY OF SAN JOSE FINANCING AUTHORITY'S COMMERCIAL PAPER PROGRAM IN ORDER TO FINANCE THE PURCHASE THROUGH THE ISSUANCE OF COMMERCIAL PAPER NOTES**

## RECOMMENDATION

(a) It is recommended that City Council take the following actions:

- (1) Conduct a public hearing for the approval of the issuance by the City of San José Financing Authority of commercial paper notes in order to finance the purchase of the San José Convention Center South Hall property ("South Hall");
- (2) Adopt a resolution to approve the issuance of commercial paper notes pursuant to the previously established commercial paper program designated as "City of San Jose Financing Authority Lease Revenue Commercial Paper Notes" to provide financing for the purchase of the South Hall in an amount not to exceed \$47 million and to state the City Council's determination that there will be significant public benefits accruing from such financing; authorize the negotiation, execution, and delivery of amendments to two Letter of Credit and Reimbursement Agreements and authorizing other related actions in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Notes in order to increase the not-to-exceed aggregate principal amount thereof from \$85 million to \$125 million and to extend the stated expiration dates and commitments available under such Letter of Credit and Reimbursement Agreements;

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- (3) Approval of a Purchase and Sale Agreement and Escrow Instructions between the Successor Agency to the Redevelopment Agency of the City of San Jose, as seller and the City of San Jose as buyer to allow the purchase of South Hall for a price of \$47,000,000, plus closing costs; and
  - (4) Adopt the following 2018-2019 Funding Sources Resolution and Appropriation Ordinance Amendments in the Convention and Cultural Affairs Capital Fund (560):
    - i. Establish a revenue estimate for Financing Proceeds in the Amount of \$42,400,000;
    - ii. Increase the Convention Center Expansion appropriation to the Office of Economic Development in the amount of \$40,100,000;
    - iii. Establish the South Hall Site Acquisition Debt Service appropriation to the Finance Department in the amount of \$1,750,000; and
    - iv. Increase the Unrestricted Ending Fund Balance in the amount of \$550,000.
- (b) It is recommended that the City of San José Financing Authority Board take the following actions:
- (1) Adopt a resolution to approve the issuance of commercial paper notes pursuant to the previously established commercial paper program designated as "City of San Jose Financing Authority Lease Revenue Commercial Paper Notes" to provide financing for the purchase of the South Hall in an amount not to exceed \$47 million and to state Authority Board's determination that there will be significant public benefits accruing from such financing; authorize the negotiation, execution, and delivery of amendments to two Letter of Credit and Reimbursement Agreements and authorizing other related actions in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Notes in order to increase the not-to-exceed aggregate principal amount thereof from \$85 million to \$125 million and to extend the stated expiration dates and commitments available under such Letter of Credit and Reimbursement Agreements.

## **OUTCOME**

Approval of these recommendations, will result in the execution and delivery of amendments to two Letter of Credit and Reimbursement Agreements, and amendments to related financing documents, which will extend the letters of credit supporting the City of San José Financing Authority Lease Revenue Commercial Paper Notes Program for 3.5 years from the anticipated effective date of August 28, 2018 and allow for the increase of the aggregate principal size of the Commercial Paper ("CP") program from \$85 million to \$125 million. Approval of these recommendations, both by the City of San José Financing Authority Board and by two-thirds majority approval by the City Council, will allow the issuance CP Notes to fund the purchase of real property, the San Jose Convention Center South Hall property ("South Hall").

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## **BACKGROUND**

### **Commercial Paper Program**

The Commercial Paper Program ("CP Program") utilizes a lease revenue financing structure. Under this program, the City of San José Financing Authority (the "Authority") issues commercial paper notes ("CP Notes") at prevailing interest rates for periods of maturity not to exceed 270 days. Although the maturity of a CP Note may not exceed 270 days, the Authority may issue additional CP Notes to pay off the maturing notes instead of repaying the principal and interest owed on the maturing CP Notes.

The CP Notes are secured by separate direct-pay letters of credit ("LOCs") provided by State Street Bank and Trust Company and U.S. Bank (together, the "Banks") and are additionally secured by a pledge of lease revenues from various City assets. With the approval of these recommendations and the adoption of the related resolutions, the expiration dates of both LOCs will be extended for 3.5 years from the anticipated effective date of August 28, 2018. Each LOC currently is issued in the principal amount of \$42,500,000 (half the program size of \$85 million) plus interest calculated at the rate of 10% for a period of 270 days. The request to increase the issuance amount would increase the principal amount of each LOC to \$62,500,000 (half the requested program size of \$125 million) plus interest of 10% for a period of 270 days.

See Attachment A for a description of the mechanics of the Authority's CP Program along with a summary of the program amendments since inception in 2004. See Attachment B for the technical aspects of the mechanics of commercial paper.

### **South Hall**

The former Redevelopment Agency of the City of San José (the "Redevelopment Agency") acquired twenty parcels of land between 1999 and 2001 located in an area bounded by South Market Street on the east; Balbach Street on the south, Viola Avenue on the north and South Almaden Road on the west for the future expansion of the San Jose Convention Center. The land was purchased for approximately \$14.6 million. Around the same time period, the Redevelopment Agency commissioned LMN Architects and Price Waterhouse to prepare an expansion study for the site. The Redevelopment Agency developed the land into a parking lot and constructed a semi-permanent tent structure for conventions and other event use - known as South Hall. The Successor Agency to the Redevelopment Agency currently receives revenue from the parking lot located on the west side of South Hall. Team San Jose, as the operator/manager of the City's convention and cultural facilities, programs and maintains the South Hall.

Historically the South Hall site was contemplated for future expansion of the San Jose Convention Center, additional parking and possibly a third adjacent hotel. In 1985, the General Plan designation was changed by the Planning Commission and City Council from Medium

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Density Residential and Core Area Commercial with Residential Support for the Core Area Overlay to Public/Quasi-Public.

Pursuant to the Successor Agency's approved Long Range Property Management Plan (LRPMP), the Convention Center South Hall qualified to be transferred to the City pursuant to a Compensation Agreement among the taxing entities and the City. The required timeframe for the transfer to happen was 18 months from the execution of the LRPMD. No agreement was reached within 18 months after approval of the LRPMP (March 8, 2016) thereby requiring the property to be sold through the solicitation process.

South Hall is approximately 191,668 square feet, Zoned - Public/Quasi Public, with a General Plan designation - Public/Quasi Public and is currently used as convention center space with a semi-permanent tent structure located on the site along with a public parking lot. The sale transaction is required to be approved by the Successor Agency Board and the Countywide Oversight Board.

#### **Debt Management Policy and Municipal Code Requirements Related to Lease Financings**

The proposal to issue these Commercial Paper Notes is subject to the City's Debt Management Policy, City Council Policy 1-15 and San José Municipal Code Chapter 4.34 related to lease financings. Under Section III (D) of the Debt Management Policy, the Finance Department is required to conduct its due diligence for the proposed lease financing and identify a source of repayment. As discussed below, the source of repayment for the CP Notes will be part of a permanent funding plan to be developed which could be a combination of various source of funds including Convention Center Facilities District revenues, bonding or other available funds. In the interim, interest payments on the CP Notes outstanding will be budgeted and paid from the Convention and Cultural Affairs Capital Fund (Fund 560) that is primarily funded by transfers of revenues generated within the Transient Occupancy Tax (TOT) Fund. The Debt Management Policy's provision that requires a feasibility study be performed prior to the issuance of a lease financing are not applicable to the issuance of these notes as a feasibility study is required only when the revenues of the project being financed are the source of repayment. In this case, project revenues are not the source of repayment of the CP Notes and there are several identified funding sources.

**UNDER BOTH THE DEBT MANAGEMENT POLICY AND SAN JOSE MUNICIPAL CODE SECTION 4.34.200, APPROVAL OF THE ISSUANCE OF THESE NOTES REQUIRES A TWO-THIRDS VOTE BY THE CITY COUNCIL (8 VOTES).**

## ANALYSIS

The sale process of South Hall site requires a non-refundable deposit of ten percent (10%) of the purchase price, or \$4.7 million. The deposit is due within 5 business days after the approval by the Countywide Oversight Board which is expected to be August 20. As a separate action on the August 14 agenda, the Successor Agency has submitted to the SARA Board approval of the sale of the site to the City. The City Council approved the appropriation of the funds for the deposit on June 19, 2018. The balance of the purchase price and closing costs, \$42.4 million, will be paid with proceeds of CP Notes. The close of escrow will be 30 days after the Oversight Board approval, which is expected on or around September 19, 2018. It is important to note that the City of San José will receive approximately \$4.3 million dollars once the proceeds of the sale of the South Hall site are distributed to the eligible taxing agencies, reducing the amount paid for the property to \$42.7 million. Additional information regarding the amount to be received by the City and debt service payment funding sources can be found in the Cost Summary/Implications section of this memorandum.

Purchase of the South Hall site by the City is vital to both the current operations of the Convention Center and to the future expansion of the Convention Center. The South Hall tent structure affords approximately 80,000 square feet of space and is used by conventions and events. The South Hall site also provides additional parking, generating approximately \$138,000 in net annual revenue that formerly went to SARA, but will now be received in the City's General Purpose Parking Fund. Though the Convention Center was successfully expanded in 2013, Team San Jose reports that many events cannot take place at the San Jose McEnery Convention Center because the facility is not large enough. A study commissioned by the City and conducted by CSL confirmed that expansion of the Convention Center in the future will be necessary to retain competitiveness. The South Hall site is the only immediately adjacent property on which the Convention Center can expand. City staff will work with Team San Jose to determine planning process and time frames to proceed with a Convention Center expansion project, including exploring the potential to accommodate a hotel or any additional uses adjacent to or above a future Convention Center expansion.

Pursuant to the existing Letter of Credit and Reimbursement Agreements (together, and as heretofore amended, the "Reimbursement Agreements"), the LOCs issued by the Banks are in an aggregate principal amount of \$85.0 million plus an interest component. Accordingly, the maximum principal amount of CP Notes cannot exceed \$85.0 million plus the interest component. Due to the current amount of CP Notes issued and already committed, there is insufficient capacity to issue CP Notes for the purchase of South Hall.

The Finance Department engaged in discussions with the Banks to request an increase to the commercial paper maximum amount from \$85 million to \$125 million and extend the LOCs' current expiration date on November 30, 2018. The Banks provided a proposal for a 3.5-year term and a 4.5-year term. The Finance Department selected the 3.5-year term, which if approved and assuming an effective date of August 28, 2018 would expire on February 28, 2022.

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The 3.5-year option has an annual commitment fee of 0.42% paid quarterly in arrears. The current commitment fee is 0.52% with an expiration date of the LOCs on November 30, 2018.

### **Source of Repayment**

The recommended budget actions included in this memorandum allow for the payment of interest and associated expenses for the CP Notes using hotel-related taxes – a strategy staff recommends over the short term. Within the next three to five years, a longer term financing strategy that includes the repayment of principal will be developed for City Council review and approval that considers both the expansion of the Convention Center and future development of the property.

### **Authorization to Issue Commercial Paper Notes**

It is necessary that Council conduct a public hearing, as required by State law, to authorize the issuance of CP Notes for financing the purchase of South Hall. No later than 5 days before the public hearing to be held by the City Council on August 14, 2018, a notice advertising the hearing will be published in the *San Jose Post-Record*.

The public hearing will allow the City Council and Authority Board to hear and consider information concerning the approval of the financing by the Authority and the City for the issuance of CP Notes, related to the purchase of South Hall, and the significant public benefit of such financing with the Authority as issuer. Under State law "significant public benefit" includes lower costs of financing. Establishing the financing with the Authority as the issuer, rather than the City as the issuer, makes the financing less complicated and, because the Authority can issue CP Notes whereas the City would have to issue Certificates of Participation, which would involve creating a new financing program.

The table below summarizes the amounts of CP Notes currently outstanding and CP Notes authorized, but not yet issued. The unutilized CP issuance amount is approximately \$21.8 million, prior to the expansion of the CP Program.

**Commercial Paper Notes Outstanding**  
*(as of July 1, 2018)*

<u>Project</u>	<u>Amount</u> <u>(in millions)</u>
<b><u>CP Notes Already Issued</u></b>	
Energy Conservation Equipment	\$ 7.6
Central Service Yard Phase II	4.5
Convention Center Expansion/Renovation	2.7
Convention Center Exhibit Hall	12.9
Flood Improvements	2.0
San Jose Clean Energy Project	<u>10.0</u>
Total Current CP Projects	<b>\$ 39.7</b>
<b><u>CP Notes Authorized but Not Issued</u></b>	
ESCO	2.2
Water Meters	2.3
Flood Improvements	<u>19.0</u>
Total CP Authorized, Not Issued	<b>\$ 23.5</b>
<b>Total Outstanding and Committed</b>	<b>\$ 63.2</b>
<i>CP Program Issuance Capacity – Current</i>	<i>\$ 85.0</i>
<b>Unutilized Issuance Capacity</b>	<b><u>\$ 21.8</u></b>

**Document Approvals Related to CP Program Expansion and Extension**

There are a number of agreements and financing documents that require amendment and need to be approved by either the Authority, the City Council or both, in order to expand the CP Program and to extend the current expiration date of the Letters of Credit. The principal documents are described below.

- Amendment to Sublease. As noted above and in Attachment A, the repayment of the CP Notes is secured by a pledge of lease revenues from various City assets. While the City is requesting an increase to the maximum amount available under the CP Program, the Banks are not requiring additional facilities be pledged under the Site Lease or Sublease. The facilities currently subject to the Site Lease and Sublease are the Tech Museum, the Animal Care Center, Fire Station No. 1, Fire Station No. 3, Communication Center, and the South San Jose Police Substation. These properties have a combined insured replacement value of approximately \$180.3 million on the City's schedule of insured properties. If any of the underlying leased assets above are no longer available for the City's continued use and occupancy, replacement assets would need to be identified or the CP Program capacity may be adversely impacted. Replacement assets require approval by the Banks.

However, the Sublease does require amendment in order to increase the maximum base rental in connection with the increase in the maximum principal of CP Notes that may be outstanding from \$85 million to \$125 million.

- Trust Agreement. The Amended and Restated Trust Agreement, as supplemented, requires an additional supplement, the Sixth Supplement, in order to increase the maximum aggregate principal amount of CP Notes that may be outstanding from \$85 million to \$125 million.
- Letter of Credit and Reimbursement Agreements. The Letter of Credit and Reimbursement Agreements as previously amended, one each with State Street and U.S. Bank, each authorize the issuance of an irrevocable direct pay letter of credit backing 50% of the outstanding principal and interest of the CP Notes. The Third Amendment to each of these agreements will increase the total commitment of each bank from the current commitment of approximately \$45.6 million to approximately \$67.1 million. This commitment includes the maximum combined principal amount of \$125 million and interest calculated at the rate of 10% for 270 days. The Third Amendment also extends the current expiration date of each Letter of Credit for 3.5 years from the anticipated effective date of August 28, 2018 to February 28, 2022. Significant terms of this agreement that will not be amended by the Third Amendment are described in Attachment C.
- New Fee Letters. Each bank requires the City and the Authority to execute a fee letter specifying the commitment and other fees charged by each bank for the issuance of its letter of credit ("LOC"). The annual rate payable for each LOC will be decreased from 0.52% to 0.42% (Level I in the chart below) for both the utilized and unutilized portions of the commitment. Even with the commitment fee rate decreasing, the annual fee payable for the LOCs will increase by approximately \$89,140 due to the addition in the size of the commitment. The total combined annual fee for the LOCs is estimated at \$567,461. The annual fee amounts are allocated to each debt service appropriation in accordance with their proportionate share of CP capacity.

Pursuant to the terms of the Fee Letters, the annual commitment fee increases if the long-term underlying lease revenue debt rating of the Authority is downgraded by any of the three major rating agencies. The current ratings of the Authority's long-term underlying lease revenue bonds are Aa3<sup>1</sup>/AA/AA by Moody's, Standard & Poor's, and Fitch.

The applicable commitment fee rate is determined by the rating level that includes the lowest rating for any long-term lease revenue debt as outlined in the table below.

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<sup>1</sup> Moody's determines its lease revenue bond ratings in part based on "essentiality" of leased asset; bonds tied to an essential asset, facilities like City Hall carry a higher rating (Aa2) than bonds tied to a less essential asset such as Recreational Facilities (Aa3). In the case of a split rating from a rating agency, the Fee letter requires the Level to be based on the lowest rating.



However, if the ratings assigned by the rating agencies are all at different levels, the middle of the three levels is used to determine the fee rate.

<b>Level</b>	<b>City Lease Revenue Debt Rating (Moody's/S&amp;P/Fitch)</b>	<b>Commitment Fee Rate</b>
I	Aa2/AA/AA or above	0.42%
II	Aa3/AA-/AA-	0.52%
III	A1/A+/A+	0.67%
IV	A2/A/A	0.87%
V	A3/A-/A-	1.12%
VI	Baa1/BBB+/BBB+	1.37%
VII	Below Baa1/ BBB+ or Rating Suspension, Withdrawal, or Cancellation	2.37%

The Fee Letters also include the following terms:

Amendment/Transfer Fee     \$5,000 plus fees of counsel to the Banks

Early Termination Fee        Equal to the Commitment Fee accrued from the date of  
 termination through the end of the Termination Fee Period  
 (waived on March 1, 2020)

**Authorization to Execute Documents**

The forms of the amendments to the Letter of Credit and Reimbursement Agreements with State Street and U.S. Bank, the Trust Agreement, the Sublease, other financing documents, and the authorizing resolutions of the City Council and the Authority will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about August 3, 2018. Staff recommends that the Executive Director or Treasurer of the Authority or their designees (the "Authority Designated Officers") be authorized to execute these amendments as posted, on behalf of the Authority and that the City Manager or the Director of Finance or their designees (the "City Designated Officers") be authorized to execute this agreement, as posted, on behalf of the City, as applicable, with such modifications as the Authority Designated Officers or the City

Designated Officer determines to be desirable or appropriate, upon consultation with the City Attorney.

Staff also recommends that the Designated Officers each be authorized to enter into one or more future extensions of the Letter of Credit and Reimbursement Agreements provided that the annual fees for each extension do not exceed 1.0% of the commitment.

### **Risks associated with the CP Program**

The CP Program is subject to the following risks:

- LOC Renewal Risk - Should the Banks decide not to renew the LOCs upon expiration in February 2022 and no replacement banks are identified, the CP Notes outstanding will need to be repaid in full. The General Fund is ultimately responsible for the repayment of outstanding notes. LOC fees are subject to change at future renewal dates based on market conditions.
- Interest Rate Risk - The interest rate for CP Notes may increase significantly depending on the overall financial market conditions.
- Downgrade Risk - The Banks' credit ratings may be downgraded in the future due to changes in the market's perception of the financial health of the Banks. To the extent a downgrade occurs, the CP Notes may become unmarketable. Additionally, if the City is downgraded by any of the credit rating agencies, the annual fees for the LOCs backing the CP Notes may be increased based on the schedule agreed to by the Banks, the Authority, and the City (see table above on increased fees).
- Marketability Risk - If there is a lack of market demand for CP Notes, the notes may be tendered back to the Authority and the Authority may not be able to find buyers for these notes.

### **EVALUATION AND FOLLOW-UP**

This memorandum presents the set of recommendations related to the City Council and the Authority Board's approval of various actions related to expanding the City of San José Financing Authority Lease Revenue CP Program for the purposed of acquiring the South Hall site.

### **PUBLIC OUTREACH**

The City Council will hold a public hearing on August 14, 2018, as required by Section 6586.5 of the Government Code of the State of California, to consider information concerning the approval of issuance of the CP Notes. The Notice of Public Hearing to be held in conjunction

with the approval of the issuance of the CP Notes will be published in the *San Jose Post-Record* no later than five days before the August 14, 2018 hearing announcing the time and location of the public hearing.

The proposed resolutions of the City Council and the Financing Authority Board and various financing documents will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about August 3, 2018.

### **COORDINATION**

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

### **COMMISSION RECOMMENDATION/INPUT**

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

### **FISCAL/POLICY ALIGNMENT**

As discussed above issuance and repayment of the CP Notes is consistent with the City's Debt Management Policy. The proposed financing plan is also consistent with the City's Debt Management Policy which establishes objectives in order to obtain cost-effective access to the capital markets, which includes minimizing debt service and issuance costs; maintaining access to cost-effective borrowing; and ensuring compliance with applicable State and Federal laws.

### **COST SUMMARY/IMPLICATIONS**

The CP Notes issued for the identified purposes, including all associated fees and interest, will be repaid in part by various City funds. To the extent that those funds do not cover all the project, interest, and financing costs, it is anticipated that the CP Notes will be repaid from any available sources.

The Convention Center Expansion project currently budgeted in the Convention and Cultural Affairs Capital Fund has an existing allocation of \$7.0 million. The actions included in this memorandum increase this amount by \$40.1 million for a new total of \$47.1 million, which is the full purchase price plus a conservative estimate of closing costs as of the writing of this memorandum (actual closing costs will likely be much lower). While staff is seeking authorization to issue CP Notes for the full purchase price of South Hall at \$47 million, only \$42.4 million is anticipated to be issued at this time. The cushion of \$4.6 million allows for any adjustments that may be necessary prior to the official close of Fiscal Year 2017-2018. As

discussed below, any adjustments would be brought forward as part of the 2017-2018 Annual Report.

Annual interest payments and CP expenses on an issuance of \$42.4 million is estimated to be \$1.75 million per year based on current interest rates; an interest rate increase of 150 basis points would be approximately \$2.3 million per year. Even with varying levels of interest rates, staff modeling indicates that resources from the Convention Center Facilities District Revenue Fund and the Convention and Cultural Affairs Fund provide sufficient debt service coverage over a five-year period. As discussed earlier in the report, repayment of the principal amount of CP Notes issued to acquire the site will be developed as part of a financing plan for the expansion of the Convention Center, anticipated for City Council review and approval within the next three to five years.

Over the medium term the Administration will employ several strategies to both minimize risk should interest rates rise and provide some flexibility for continued capital investment at Convention Center facilities:

***1) Allocate South Hall Sale proceeds to the Convention Center and Cultural Affairs Fund***

The proceeds from the sale will be redistributed to the taxing entities, including the City. The South Hall site is currently collateral for two outstanding HUD Loans and sales proceeds must be used to repay these outstanding loans. The balance outstanding as of August 2, 2018 is \$16.31 million. The table below summarizes the current HUD collateral. Upon payment of the outstanding balance the HUD liens will be released on the remaining three properties.

**HUD Loan Balances**  
*As of August 2, 2018*

<b>HUD Collateral</b>	<b>Projects Financed</b>	
	<b>CIM/88 Tower</b>	<b>Story-King Intersection</b>
South Hall Site	\$6,905,000	\$1,352,745
Jose Theater		1,326,552
Lot 5A		3,092,471
Fairmont Garage <sup>1</sup>		3,633,232
<b>Total</b>	<b>\$6,905,000</b>	<b>\$9,405,000</b>

<sup>1</sup> Fairmont Garage was transferred to the City from the former Redevelopment Agency prior to dissolution.

The estimated net sales proceeds after the repayment of the HUD loans is \$30.69 million. These proceeds will be wired directly to the County Auditor-Controller for subsequent distribution by the Auditor-Controller among the Taxing Entities pursuant to Health and Safety Code Section 34188. The City's share is approximately 14% or \$4.3 million.

Once the final amount has been received, staff anticipates bringing forward budget actions to receive this funding into the Convention and Cultural Affairs Fund to either pay down additional CP principal or provide a source of reserve funding should hotel taxes decline.

**2) *Reallocate resources within the Convention Center Facilities District (CCFD) Revenue Fund to provide additional capacity for debt service payments***

The CCFD Fund was established to finance the most recent expansion of the Convention Center and is funded on a 4% room rate tax on hotels within the District. Given the strength of the local hotel market, these revenues now also fund debt service payments related to the use of CP for other Convention Center capital projects, including kitchen and HVAC work, and Exhibit Hall Lighting and Ceiling Upgrades. After the fiscal year close, staff may recommend the accelerated repayment of some of this outstanding CP debt and reallocate the South Hall debt service to this fund as part of the 2017-2018 Annual Report.

**3) *Evaluate near-term Convention Center and cultural facilities capital needs and final revenues and expenditures from Fiscal Year 2017-2018***

While the primary goal of staff will be to minimize risk, some amount of resources should remain available to capital investment at the Convention Center and other cultural facilities, including interim improvements to the South Hall tent site. Though the tent is a semi-permanent structure, it is currently integral to Convention Center operations and may require some rehabilitation over the short term to ensure its continued functional use. Additionally, 2017-2018 hotel-related revenues are on pace to meet or exceed budget expectations and Team San Jose performance is expected to result in a lower operations subsidy, which would provide additional savings to the Convention and Cultural Affairs Fund. Should these trends continue through fiscal close, staff will evaluate the need to allocate a portion of the additional funding for continued capital improvement along with the accelerated pay down of outstanding CP debt.

**BUDGET REFERENCE**

The table below identifies the appropriation adjustments to correspond with the recommended actions.

Fund #	Appn #	Appn. Name	Total Appn.	Rec. Budget Action	2018-2019 Proposed Capital Budget*	Last Budget Action (Date, Ord. No.)
560	R190	Financing Proceeds	\$0	\$42,400,000	N/A	N/A
560	408W	Convention Center Expansion	\$7,000,000	\$40,100,000	N/A	6/19/2018, Ord. No. 30124
560	NEW	South Hall Site Acquisition Debt Service	\$0	\$1,750,000	N/A	N/A
560	8999	Unrestricted Ending Fund Balance	\$0	\$550,000	N/A	N/A

\* The 2018-2019 Proposed Capital Budget was adopted by the City Council on June 19, 2018.

**CEQA**

CEQA – PP18-073, CEQA Guidelines 15312, Surplus Government Property Sales.

/s/  
 JULIA H. COOPER  
 Director of Finance  
 Treasurer, City of San Jose Financing Authority

/s/  
 KIM WALES  
 Deputy City Manager  
 Economic Development Director

/s/  
 MARGARET McCAHAN  
 Budget Director

I hereby certify that there will available for appropriation in the Convention and Cultural Affairs Capital Fund in Fiscal Year 2018-2019, moneys in excess of those heretofore appropriated therefrom, said excess being at least \$42,400,000.

/s/  
 MARGARET McCAHAN  
 Budget Director

For questions, please contact Lisa C. Taitano, Assistant Director of Finance, at (408) 535-7041.

Attachments

## Attachment A

### Mechanics of City of San José Financing Authority Commercial Paper Program and Summary of Program Amendments since Inception in 2004

The City leases to the City of San José Financing Authority (the "Authority") various City-owned facilities pursuant to a Site Lease (as amended, the "Site Lease"). The Authority subleased these same facilities back to the City pursuant to a Sublease (as amended, the "Sublease") in exchange for the rental payments which support repayment of the CP Notes. The facilities subject to the Site Lease and Sublease are the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communication Center, the South San José Police Substation, and the Tech Museum.

The Authority issues the CP Notes under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to an Amended and Restated Trust Agreement between the Authority and Wells Fargo Bank, National Association (as amended and supplemented, the "Trust Agreement") and a Second Amended and Restated Issuing and Paying Agent Agreement between the Authority and Wells Fargo Bank, National Association. Barclays Capital, Inc. serves as the current dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. As noted above, the CP Notes are backed by a separate LOC issued by each bank, pursuant to a Letter of Credit and Reimbursement Agreement among each bank, the City and the Authority (as amended, the "Letter of Credit Agreements").

Under their respective LOCs, each bank is separately responsible for payments on all draws made on the applicable LOC. Each LOC currently is issued in the principal amount of \$42,500,000 (half the program size of \$85 million) plus interest calculated at the rate of 10% for a period of 270 days. The request to increase the issuance amount would increase the principal amount of each LOC to \$62,500,000 (half the requested program size of \$125 million) plus interest of 10% for a period of 270 days.

The CP Program was initially established in January 2004 and has been amended, expanded and contracted through various City Council and Authority Board actions over time. A summary of these actions is provided in the table below.

<b>Date</b>	<b>City Council/City of San José Financing Authority Board Actions</b>
January 13, 2004	Authorized the issuance of tax-exempt CP Notes in an amount not to exceed \$98 million to finance public improvements of the City including the offsite parking garage for the new City Hall and non-construction costs for technology, furniture, equipment, and relocation services for the new City Hall.
November 9, 2004	Authorized the issuance of tax-exempt CP Notes to provide additional funding for the "Integrated Utility Billing, Customer Service and Performance Management System" (the "CUSP Project").
June 21, 2005	Authorized the issuance of taxable CP Notes, under the same \$98 million not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable CP Notes to pay for expenses otherwise authorized under the CP Program, but ineligible to be paid from tax-exempt CP proceeds.
November 15, 2005	Authorized expanding the capacity of the CP Program from \$98 million to \$116 million and authorizing the issuance of CP Notes to pay a portion of the costs of the Phase II improvements at the City's Central Service Yard and a portion of the demolition and clean-up costs at the City's Main Service Yard.

Date	City Council/City of San José Financing Authority Board Actions (cont.)
May 22, 2007	Authorized the issuance of CP Notes in an amount not to exceed \$8.25 million to pay for capital improvements at the City's HP Pavilion.
October 21, 2008	Authorized the issuance of CP Notes to refund bonds and other obligations of the City or the Authority pursuant to Government Code Sections 53570 et seq and 53580 et seq.
December 8, 2009	Authorized staff to amend and renew the Letter of Credit and Reimbursement Agreement supporting the CP Notes in order to extend the term to January 27, 2013.
April 20, 2010	Authorized the issuance of CP Notes to fund a loan to the low and moderate income housing fund and to fund short-term cash flow needs of the City.
March 15, 2011	Authorized the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, and other related actions pertaining to the Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease.
June 19, 2012	Authorized the issuance of CP Notes in an amount not to exceed \$10.0 million to provide funding for additional projects for the Convention Center Expansion and Renovation Project.
December 4, 2012	Authorized staff to amend and restate the Letter of Credit and Reimbursement Agreement supporting the CP Notes in order to extend the term to March 15, 2013.
February 12, 2013	Authorized staff to negotiate two new Letter of Credit and Reimbursement Agreements supporting the CP Notes; and authorized the execution and delivery of a Fourth Amendment to the Site Lease, a Fourth Amendment to the Sublease, and other related actions pertaining to the Authority's Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease. The facilities currently subject to the Site Lease and Sublease are: the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communications Center, and the South San José Police Substation.
June 17, 2014	Authorized the Fifth Amendment to the Site Lease, a Fifth Amendment to the Sublease, and other related actions in order to provide for the addition of a component of property (the Tech Museum) under the Site Lease and the Sublease in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Program to provide additional security.
September 15, 2015	Authorized the issuance of CP Notes in an amount not to exceed \$3.5 million to provide funding for the Municipal Water System's Water Meter Replacement Project.
June 21, 2016	Authorized the issuance of CP Notes in an amount not to exceed \$10.0 million to provide funding for Energy Conservation Projects.
January 31, 2017	Authorized the issuance of CP Notes in an amount not to exceed \$15.0 million to provide funding for the Convention Center Exhibit Hall Project.
August 29, 2017	Authorized the issuance of CP Notes in an amount not to exceed \$10.0 million to provide financing for start-up costs for the San José Clean Energy Project.
February 13, 2018	Authorized the issuance of CP Notes in an amount not to exceed \$21.0 million to provide financing for the Flood Recovery Project.



## **Attachment B**

### **Technical Aspects of Commercial Paper**

#### **The Mechanics of Commercial Paper**

Commercial paper is debt that is sold with a maturity of between 1 and 270 days. The maturity of an individual commercial paper note is determined by the commercial paper dealer and the issuer at the time it is sold. Each commercial paper note bears interest at a fixed rate for the 1-270-day period of time it is outstanding; or is sold at a discount, and such interest or discount is payable when the note matures. (The procedures for the payment of interest on the commercial paper are described below under "Payment of Principal and Interest on Commercial Paper".)

Municipal commercial paper programs typically require the issuer to obtain credit support through one or more letters of credit provided by a commercial bank. Upon each note maturity, the paying agent is authorized and required to draw on the supporting letter of credit in the amount of principal and interest due on that date. The issuer may then "roll over" the commercial paper notes by issuing renewal notes and using the proceeds of the renewal notes to reimburse the draw on the letter of credit. To the extent that the commercial paper dealer is unable to find an investor for the renewal notes, the draw on the letter of credit remains unreimbursed and the issuer is responsible for repaying the bank or banks that provided the letter of credit. The terms and conditions governing the letter(s) of credit and the reimbursement process are memorialized in a reimbursement agreement entered into by and between the issuer and the bank or bank(s) that provided the letter of credit.

The renewal notes may be sold through a commercial paper dealer either to a new investor or to the investor who held the maturing note. The process of rolling over commercial new paper is not considered to be the issuance of additional debt as long as the amount of commercial paper outstanding is not increased as a result of the "roll over." Through the "roll over" mechanism, commercial paper can be kept outstanding indefinitely, as individual commercial paper notes continually mature and new commercial paper notes are issued.

Commercial paper is considered a form of variable-rate debt. Even though the interest rate on each commercial paper note is fixed at the time such note is issued, the rate on each commercial paper note will be based on market conditions at the time. The rates on new commercial paper notes will thus vary from one week or month to another. The actual cost of the program to the issuer will be the average rate on all of its outstanding commercial paper notes over time. Most issuers project such average rates on a quarterly or annual basis. Overall, commercial paper rates tend to be among the lowest available in the tax-exempt and taxable markets for municipal debt.

The buyers of commercial paper are considered short-term investors because their investments in commercial paper mature in 270 days or less. One of the attractive features commercial paper offers to an investor is that the maturities can be matched to the specific timing needs of an investor (such as 27 days, or 112 days). This helps an investor invest amounts for a very precise period of time until such funds are needed for a specific known payment obligation in the future. Buyers of commercial paper include major corporations and money market funds. Commercial paper is attractive to money market funds because it complies with the maturity limitations imposed on such funds, and the flexibility in setting the maturity of commercial paper may help the fund achieve or maintain the average maturity it is seeking. Money market funds are likely

to continue to buy a given issue of commercial paper as it rolls over, and thus may own an issue for an extended period of time.

### **Payment of Principal and Interest on Commercial Paper**

Commercial paper is not sold with a fixed principal repayment schedule. Instead, the issuer maintains almost complete flexibility with respect to the timing and amounts in which the principal amount of commercial paper will be repaid. The issuer can repay commercial paper on any date on which a commercial paper note is scheduled to mature by providing the funds to repay such note to the paying agent for the issue. The paying agent uses such funds to pay the holder of the commercial paper. At the same time, the issuer instructs its commercial paper dealer not to attempt to sell new commercial paper to roll over the paper that is maturing. Hence, when such steps are taken, the amount of commercial paper outstanding at the end of the day is reduced.

The individual commercial paper notes are likely to have different maturities, so an issuer repaying a commercial paper program would do so in a series of steps as the individual notes mature. However, since each note would have a maximum maturity of 270 days, an entire program could be repaid at the option of the issuer in not more than 270 days from the time the issuer decided to commence such a repayment. It is likely that an issuer planning to pay a program off in the near future would instruct its commercial paper dealer to issue the paper with short maturities as it rolls over, so that the issuer could retire the commercial paper quickly when it begins the repayment process.

As noted above under "The Mechanics of Commercial Paper," interest or discount is payable on each commercial paper note as it matures. During the construction period for a project, the interest payable can be "capitalized" by adding the amount of interest due on the maturing commercial paper to the amount of new paper being sold. If this approach is used, the principal amount of paper outstanding over time will increase as additional interest is capitalized (subject to the maximum authorized amount of notes permitted to be outstanding at any one time under the program).

Interest on tax-exempt debt generally cannot be capitalized following completion of the projects financed with commercial paper. At that point, the issuer must provide to the paying agent the interest due at the time each note matures. The paying agent then pays such interest to the investor together with the proceeds received from rolling over the principal amount of the commercial paper. Since the interest at that point is being paid by the issuer, and not by increasing the amount of paper being rolled over, the principal amount of commercial paper outstanding will stay constant after the projects are completed. The principal amount outstanding could either be reduced in the future if the issuer decides to repay some, or all, of the program, or increased if the issuer decides to undertake additional projects (which may require an increase in the authorized amount of the program).

## Attachment C

### Letter of Credit Agreement and Fee Letter Terms

Material terms and covenants of The Letter of Credit Agreements and the Fee Letters that are not amended include the following:

Alternative Base Rate	Highest of (i) the Bank's prime rate + 1 %; (ii) Fed Funds Rate +2%; or (iii) SIFMA Rate + 1%; with a minimum Floor Rate of the greater of (a) 7.5% per annum and (b) the rate of interest accruing on the CP Notes.  In the current interest rate environment, the Floor Rate is the 7.5% per annum rate.
Advance Rate Alternative Base Rate	(1-30 days after Principal Advance) Alternative Base Rate + 1.0% (31-90 days after Principal Advance) Alternative Base Rate + 2.0% (91-180 days after Principal Advance) Term Loan Rate (181+ days after Principal Advance).  This interest rate is charged to the Authority when the commercial paper dealer is unable to find buyers for the outstanding commercial paper notes and the Banks are obligated to provide a Principal Advance to the Authority to purchase these notes from the note owners who no longer wish to hold the notes.
Term/Loan Rate	Each Principal Advance remaining unpaid by the Authority after 180 days or the Stated Termination Date, whichever comes first, will be converted to a Term Loan. Each Term Loan will bear interest at the Term Loan Rate. Alternative Base Rate + 3%.
Default Rate	Alternative Base Rate + 4.0%. Applicable in the event of a default.

Subordination of  
Swap/Termination Fees

If the City or Authority enters into any interest rate swap agreement or other derivative contract for any debt with a claim on the general fund, termination fees related to that debt will be subordinate to payment obligations under the Letter of Credit Agreements.

Waiver of Jury Trial

The City, the Authority and the Banks each waives its right to jury trial. Further, the City and the Banks agree that if a waiver of jury trial is unenforceable (which may be the case under California law), the dispute will be adjudicated by a judicial referee per the provisions of California law.

Increased Bank Cost and  
Capital Adequacy

Increased costs and changes in capital adequacy requirements include changes resulting from the Dodd-Frank Act and Basel III, regardless of the date of enactment.

Repayment of Banks/Plan of  
Finance Obligation

No later than three years after the Stated Termination Date, the of Finance Obligation City Manager and the Executive Director of the Authority shall use their best efforts to bring forward a plan of finance for the issuance of bonds or certificates of participation sufficient in value to reimburse the Banks for all obligations owed.

As is common in letter of credit agreements, the Current Letter of Credit Agreement requires the Authority to indemnify the Banks for claims filed by third parties. The Banks wish to continue this limitation of exposure to third parties for liability and damages including consequential damages under each Letter of Credit Agreement. Consequential damages, also known as special or indirect damages, are one land of two types of damages (the other being direct damages) that may be awarded to a plaintiff in a civil action, where plaintiff claims the terms of an agreement were not honored. Consequential damages include loss of profit or revenues and may be recovered if it is determined that such damages were reasonably foreseeable at the time of the making of the contract. The only exception to the Authority's obligation to indemnify each Bank for third party claims is where the liability or damages results from the Bank's willful misconduct or gross negligence in connection with the Bank's failure to honor a draw on the applicable Letter of Credit.