



Memorandum

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

FROM: Rick Bruneau
Kerrie Romanow

SUBJECT: SEE BELOW

DATE: June 6, 2023

Approved

Date

6/8/2023

SUBJECT: ACTIONS AMENDING CERTAIN AGREEMENTS RELATED TO THE INTERIM FINANCING PROGRAM TO FINANCE CAPITAL IMPROVEMENTS AT THE WASTEWATER SYSTEM

RECOMMENDATION

- a) Adopt a resolution of the City of San José approving and authorizing the execution and delivery of a Fourth Amendment to Credit Agreement and a Fourth 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 for a term through October 16, 2026, in an aggregate principal amount outstanding at any time not to exceed \$300,000,000 until the effective date of the Fourth Amendment to Credit Agreement and up to \$200,000,000 thereafter, for the purpose of financing or refinancing Wastewater System Projects and authorizing other related actions in connection therewith.
- b) Adopt a resolution of the City of San José Financing Authority approving and authorizing the execution and delivery of a Fourth Amendment to Credit Agreement and a Fourth 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 for a term through October 16, 2026, in an aggregate principal amount outstanding at any time not to exceed \$300,000,000 until the effective date of the Fourth Amendment to Credit Agreement and up to \$200,000,000 thereafter, for the purpose of financing or refinancing Wastewater System Projects and authorizing other related actions in connection therewith.

SUMMARY AND OUTCOME

Approval of these recommendations will result in amendments to the existing Credit Agreement by and among the City of San José (City), City of San José Financing Authority (Authority)¹, and Wells Fargo Bank, National Association (Bank), and the associated Fee Letter Agreement, reduction of the facility amount from \$300 million to \$200 million, and extension of the Credit Agreement and Fee Letter Agreement for three years to October 16, 2026.

BACKGROUND

The Credit Agreement was established on October 19, 2017² among the City, the Authority, and the Bank as an interim financing facility (Facility) to bridge funding gaps for capital improvement projects at the Wastewater System. Under the Credit Agreement, the Authority may issue Subordinate Wastewater Revenue Notes from time to time in one or more series, with an aggregate principal amount outstanding at any one time not to exceed \$300 million. The Facility allows the City to borrow funds when needed, thereby lowering the interest expense as compared to a bond issuance which accrues interest on the full balance upon closing, whether the proceeds have been expended or not. As the projects progress and the funds are drawn on the Facility, it is anticipated the Authority will periodically pay off the Facility with long-term financing similar to the recent December 2022 issuance of the City of San José Financing Authority Wastewater Revenue Bonds, Series 2022B (Green Bonds – Climate Bond Certified). All obligations associated with the Credit Agreement and Fee Letter Agreement are payable by the pledged Wastewater Net System Revenues³ (system revenues less maintenance and operation expenses). There is no pledge of funds from the City's General Fund.

Since 2017, the City has amended the Credit Agreement and the Related Fee Letter Agreement three times.

In June 2018, the City and Authority approved the First Amendment of the Credit Agreement and Amended the Restated Fee Letter Agreement⁴ to adjust the calculation of interest and fees for tax-exempt notes to address increased borrowing cost under the terms of the agreement resulting from tax changes in the Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act, effective on December 22,

¹ The Authority was created by a Joint Exercise of Powers Agreement between the City and the Authority. The Authority was created for the purpose of facilitating the financing of public improvements and facilities within the City and is authorized to issue bonds and commercial paper notes for this purpose. The Authority is governed by an 11-member Governing Board, which consists of the members of the City Council and the Mayor.

² October 3, 2017, Joint City Council/Authority Meeting:
<https://sanjose.legistar.com/LegislationDetail.aspx?ID=3160813&GUID=4F5AB017-FAEA-40D4-88BD-929872E259CD&Options=&Search=>

³ Wastewater Net System Revenues is defined in the City [Council Resolution No. 80770](#), adopted on November 15, 2022.

⁴ June 26, 2018, Joint City Council/Authority Meeting:
<https://sanjose.legistar.com/LegislationDetail.aspx?ID=3523897&GUID=34807D4E-EE17-4390-BF06-2421483C15A4&Options=&Search=>

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2017, changed the federal corporate tax rate from 35% to 21%, and 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%.

In September 2020, the City and Authority⁵ 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 London Interbank Offered Rate (LIBOR) Floor of 0.50%.

In March 2022, the City and Authority approved the Third Amendment to the Credit Agreement and Amended and Restated Fee Letter Agreement⁶ to replace the benchmark index (Benchmark Index) from LIBOR to U.S. Secured Overnight Financing Rate (SOFR), amended various definitions, and made changes to the pricing that reduced the borrowing cost.

ANALYSIS

The current Credit Agreement that allows borrowing up to \$300 million expires on October 18, 2023. City staff estimates that the City will need about \$200 million from the Facility to finance future Wastewater System capital improvements. Mindful of the market volatility and rising interest rates, in mid-April staff requested Public Resource Advisory Group, the City's municipal advisor, to inquire whether the Bank had any interest in extending the current Credit Agreement for three years with a reduced amount of \$200 million. The Bank responded with updated fee and interest rate spreads and some adjustments to the Credit Agreement terms. Additionally, the Bank offered to cover legal fees up to \$10,000 and waive the amendment fee of \$2,500.

As negotiated between the City and the Bank, the proposed Fourth Amendment to the Credit Agreement makes changes to various terms and reduces the Credit Facility commitment amount from \$300 million to \$200 million. The Stated Expiration Date for the Credit Agreement will be October 16, 2026.

The proposed amendment to the Fee Letter Agreement reduces the fee on the undrawn portion of the \$200 million credit facility (Commitment Fee) from 21 base points (bps) (or 0.21%) per year to 19 bps (or 0.19%). The total interest rate for tax-exempt draws is equal to 80% of the sum of (1) the Benchmark Index and (2) a tax-exempt spread (Tax-Exempt Rate Applicable Spread), which is determined based on the credit ratings of the Wastewater Revenue Bonds. The Tax-Exempt Rate Applicable Spread is increased from 37 bps (0.37%) to 42 bps (0.42%). The

⁵ September 29, 2020, joint City 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>

⁶ March 29, 2022, joint City Council/Authority Meeting:

<https://sanjose.legistar.com/LegislationDetail.aspx?ID=5526174&GUID=79A3BF0D-56F7-4D49-899E-4AF66B8EF236&Options=ID|Text|&Search=amending+certain+agreements+related+to+the>

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interest rate for taxable draws is equal to 100% of the sum of (1) the Benchmark Index and (2) a taxable spread (Taxable Rate Applicable Spread), which is determined based on the credit ratings of the Wastewater Revenue Bonds. The Taxable Rate Applicable Spread is increased from 45 bps (0.45%) to 52 bps (0.52%). All other key terms remain unchanged.

The proposed amendment would implement changes described below:

	Current Agreement	2023 Amendment
Facility Amount	\$300,000,000	\$200,000,000
Term	3 Years (expiring 10/18/2023)	3 Years (expiring 10/16/2026)
Commitment Fee (Undrawn)	0.21%	0.19%
Applicable Spread:		
Taxable Draw Fee	SOFR + 0.45%	SOFR + 0.52%
Tax-Exempt Draw Fee	80% of SOFR + 0.37%	80% of SOFR + 0.42%

Pricing Chart:

<i>Level</i>	<i>Ratings on Long-Term, Wastewater Revenue Bonds, (Moody's/S&P/Fitch)</i>	<i>Commitment Fee (Undrawn Amount)</i>	<i>Applicable Spread (Drawn Amount) [Taxable / Tax-Exempt]</i>
Level 1	Equal to Aa2/AA/AA	0.190%	0.520% 0.420%
Level 2	Equal to Aa3/AA-/AA-	0.215%	0.595% 0.495%
Level 3	Equal to A1/A+/A+	0.265%	0.745% 0.645%
Level 4	Equal to A2/A/A	0.305%	0.895% 0.795%
Level 5	Equal to A3/A-/A-	0.355%	1.045% 0.945%

EVALUATION AND FOLLOW-UP

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

COST SUMMARY/IMPLICATIONS

Costs for the proposed amendments to the Credit Agreement, which include the cost for professional services (Bank counsel, City's bond counsel, and the City's municipal advisor) is estimated to be approximately \$60,000 and will be paid from the current budget. The actions recommended as part of this memorandum will result in reductions to the commitment fee component associated with the reduced principal amount of \$200 million. Total financing cost will vary depending on the pace of capital project construction and current interest rates and will continue to be closely monitored. The estimated revenues and annual debt service payments related to the program will be included as a Proposed Budget action during the 2022-2023

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Annual Report that will be heard in October 2023 and is subject to appropriation of funds. Financing costs for both the interim financing program amended by this memorandum and the Wastewater Revenue Bonds, Series 2022B will continue to be included in the annual budget development and calculation of Sewer Service and Use Charge rates that are evaluated annually.

COORDINATION

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

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the June 20, 2023 City Council meeting, along with all the referenced financing documents.

COMMISSION RECOMMENDATION/INPUT

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

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.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/
RICK BRUNEAU
Director of Finance

/s/
KERRIE ROMANOW
Director of Environmental Services

For questions, please contact Qianyu Sun, Deputy Director of Finance, Debt and Treasury Management, at (408) 535-7832.