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ITEM: 2

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

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

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: April 23, 2018

Approved D.DSyC Date 5/4/18

SUBJECT: ACTIONS RELATED TO THE CITY OF SAN JOSE FINANCING AUTHORITY LEASE REVENUE BONDS, SERIES 2008CD (HAYES MANSION REFUNDING PROJECT)

RECOMMENDATION

It is recommended that the City Council:

(a) Adopt a resolution approving and authorizing the negotiation, execution, and delivery of a Second Amendment to the Continuing Covenant Agreement with U.S. Bank National Association relating to the City of San José Financing Authority Lease Revenue Bonds, Series 2008C (Hayes Mansion Refunding Project) and the City of San José Financing Authority Taxable Lease Revenue Bonds, Series 2008D (Hayes Mansion Refunding Project), and authorizing other related actions.

It is recommended that the City of San José Financing Authority Board:

(a) Adopt a resolution approving and authorizing the negotiation, execution, and delivery of a Second Amendment to the Continuing Covenant Agreement with U.S. Bank National Association relating to the City of San José Financing Authority Lease Revenue Bonds, Series 2008C (Hayes Mansion Refunding Project) and the City of San José Financing Authority Taxable Lease Revenue Bonds, Series 2008D (Hayes Mansion Refunding Project), approving and authorizing the execution and delivery of a Fourth Amendment to the Amended and Restated Indenture of Trust, and authorizing other related actions.

OUTCOME

Approval of these recommendations will result in the extension of the ownership by U.S. Bank National Association ("U.S. Bank" or the "Bank") of the City of San José Financing Authority Lease Revenue Bonds, Series 2008C and Taxable Series 2008D (Hayes Mansion Refunding Project) (the "2008C Bonds" and the "2008D Bonds, collectively the "Bonds") for 179 days with the authority to subsequently execute and deliver such documentation as is necessary to extend the Initial Bank Purchase Date as extended, by additional increments of up to 180 days per extension with minor changes to the terms of the existing agreement.

EXECUTIVE SUMMARY

The agreement with U.S. Bank, for the direct purchase (private placement) of the Bonds, which financed projects at the Hayes Mansion Hotel and Conference Center ("Hayes Mansion" or the "Property"), expires on June 8, 2018. Staff has negotiated a short-term extension of the agreement with the Bank to continue ownership of the Bonds until December 3, 2018. In anticipation of the sale of the Hayes Mansion in June 2018 or thereafter, this extension request also provides for the ability to subsequently execute and deliver such documentation as is necessary to extend the Initial Bank Purchase Date of December 3, 2018, by additional increments of up to 180 days per extension. The extension of the agreement with U.S. Bank regarding the Bonds beyond the June 8, 2018 expiration date is necessary given that the sale of the Hayes Mansion is planned to occur subsequent to June 8, 2018.

In coordination with the extension, some minor amendments are being made to the transaction documents to clarify terms and to reflect increased pricing. The fixed fee component of the interest rate associated with the outstanding Bonds will increase from 39 basis points ("bps") to 43 bps for the tax-exempt 2008C Bonds and remain at 47 bps for the taxable 2008D Bonds. The variable component of the interest rates on the Bonds will continue to be determined by the commonly accepted market rate indices. Absent a sale of the Property, the last payment on the Bonds is scheduled for June 2027. Sales proceeds from the Hayes Mansion would provide for a full repayment of the Bonds at time of close.

BACKGROUND

In December 2013, the City executed a direct purchase of the Bonds by U.S. Bank for a three-year period. To effectuate the agreement, an Amended and Restated Indenture of Trust (the "Indenture") and a Continuing Covenant Agreement ("CCA") were executed. Additionally, in order to make technical changes to conform the terms of the leases with the Indenture, amendments were made to the Site and Facility Lease and the Project Lease. At the end of the three-year period in December 2016, the Director of Finance as Treasurer of the Authority, as previously authorized, extended the term of U.S. Bank's ownership of the Bonds to June 15, 2017 by executing a First Amendment to the Indenture. Since then, the Bank's ownership of the

Bonds has been extended twice. The Second Amendment to the Indenture and First Amendment to Continuing Covenant Agreement were executed on June 15, 2017 to extend the Bank's ownership to December 11, 2017. The Third Amendment to the Indenture was executed on December 1, 2017 to extend the Bank's ownership to June 8, 2018.

Since December 2013, the Bonds have been in an "Index Mode," whereby the interest rate on the 2008C Bonds is based on the Securities Industry and Financial Markets Association (SIFMA) index, a tax-exempt weekly index, plus a specified spread and the interest rate on the 2008D Bonds is based on 1-month LIBOR, a taxable index, plus a specified spread. On June 15, 2017 the spread was lowered from 53 bps to 39 bps for the 2008C Bonds and from 53 bps to 47 bps for the 2008D Bonds.

Council and the Authority initially approved actions related to the direct sale of the Bonds (along with bonds related to the Ice Centre) to U.S. Bank at the joint Council/Authority meeting on December 10, 2013 (Item #2). The 2013 staff memo includes information regarding the Bonds including (a) a history since 2008, (b) the lease-revenue financing structure, (c) technical aspects concerning multi-modal variable-rate demand bonds such as the Bonds, and (d) terms and covenants in the CCA. To review this additional information not provided in this memorandum, see the 2013 staff report: http://sanjoseca.gov/DocumentCenter/View/24272.

The table below provides a summary of the Bonds including the outstanding amount of each series. The total current outstanding amount is $31.6 million.

Project:	**Hayes Mansion**		
Bond Series:	2008C	2008D	Total
Tax Status:	Tax-Exempt	Taxable	
Principal Outstanding[(a)]:	$10,915,000	$20,640,000	$31,555,000
Bonds' Purchaser:	U.S. Bank		
Initial Agreement Expiration Date[(b)]:	12/03/2018		

(a) Principal payment of $3.1 million is scheduled for June 1, 2018 for the 2008D Bonds.
(b) As approved by Council, the authority to subsequently execute and deliver such documentation as is necessary to extend the Initial Bank Purchase Date as extended, by additional increments of up to 180 days per extension.

Sale of the Hayes Mansion

City staff issued a Request for Proposals for the sale of the Hayes Mansion and anticipate that the sale of the Hayes Mansion will be completed in calendar year 2018. As the proposed sale of the Hayes Mansion will not close prior to the June 8, 2018 expiration date the Bank's ownership of the Bonds, it is necessary to amend the Indenture to extend the period of the Bank's ownership.

The Hayes Mansion secures the Bonds, therefore, it is necessary for the Bonds to be fully repaid to allow for release of the Property to the buyer free of this secured lien. It is anticipated that the proceeds of the sale, along with debt service reserve funds on hand for the Bonds, are sufficient to pay off all the outstanding Bonds.

Bank Proposal

City staff requested a proposal from U.S. Bank to continue to own the Bonds for a short-term period that allows for the close of the anticipated sale of the Hayes Mansion after the expiration of the current agreement with the Bank. U.S. Bank offered to extend the term of its ownership of the Bonds for up to 179 days, with no "make-whole" fee period, subject to an increase in the spread on the 2008C Bonds (to the same applicable index) during such time from 39 bps to 43 bps. The spread for the 2008D Bonds will remain at 47 bps. Additionally, the Bank is willing to continue to waive the condition that the Bonds be redeemed on the first business day of a month, allowing for the optional redemption of the Bonds on any business day upon the sale of the Hayes Mansion. A potential "breakage fee," described in "*Continuing Covenant Agreement – Additional Terms and Covenants,*" below, remains applicable, however.

Other amendments, necessary to clarify and correct the existing terms, are limited to a change in the margin rate factor that coincides with the recent decrease in the Maximum Federal Corporate Tax Rate resulting in no interest penalty to the City. In consultation with Public Resources Advisory Group, the City's municipal advisor, staff elected to pursue an extension of the ownership of the Bonds by U.S. Bank. U.S. Bank is providing flexibility in its allowances surrounding the close of the sale of Hayes Mansion and repayment of the Bonds. It would not be feasible to procure a new bank to own the Bonds for the anticipated short period of time beyond the current expiration of the agreement on June 8, 2018.

ANALYSIS

Extension of Direct Purchase of the Bonds

City staff has negotiated an extension of the direct purchase of the Bonds by U.S. Bank for a 179-day period expiring on December 3, 2018. During this period the Bonds will continue be in an "Index Mode," whereby the interest rate on the bonds will continue to be based on the relevant floating rate index plus a spread of 43 bps for the 2008C Bonds and 47 bps for the 2008D Bonds, as further described in "*Continuing Covenant Agreement – Pricing*", below. The Bonds are not being remarketed during the Index Mode period, therefore, no public offering document is required in connection with this transaction, and no ratings are being procured. U.S. Bank has conducted its own analysis of the City's finances and City staff has provided information to U.S. Bank in order for the bank to make an informed investment decision to continue ownership of the Bonds.

Continuing Covenant Agreement

Overview

The Continuing Covenant Agreement ("CCA") includes the financial terms and conditions related to U.S. Bank's purchase and ownership of the Bonds. The CCA describes the terms under which U.S. Bank purchased the Bonds and includes the interest rates that will accrue during the term of the agreement. Pursuant to the CCA, as amended, the Bonds will be subject to mandatory tender at the end of the initial 179-day extension period on December 3, 2018 (the "Mandatory Tender Date") (assuming that the sale of the Hayes Mansion and the resulting redemption of all of the Bonds has not occurred by such time), at which time the Authority has the obligation to purchase the Bonds unless the Authority and U.S. Bank negotiate a further extension. If an extension is not negotiated, the City may remarket the Bonds in a different mode or in an Index Mode with a different purchaser, or it may refund the Bonds in another variable rate mode or in a fixed rate mode. If the City fails to remarket the Bonds on the Mandatory Tender Date, and assuming no events of default have occurred, the CCA provides for a "term-out," as described below.

Pricing

The Bonds will accrue interest at an index rate, which is the sum of the relevant floating rate index and the Applicable Rate, which is 0.43% (or 43 bps) for the 2008C Bonds and 0.47% (or 47 bps) for the 2008D Bonds. The floating rate index varies depending on the tax status of the bonds: the tax-exempt 2008C Bonds are based on the SIFMA index, a tax-exempt weekly index, and the taxable 2008D Bonds are based on 1-month LIBOR, a taxable index. The Applicable Rate increases if the credit ratings on the Authority's rated lease revenue bonds are downgraded, as set forth in the following table:

Lease Revenue Bond Ratings (Moody's/S&P/Fitch)	**Applicable Rate**	
	2008C Bonds	**2008D Bonds**
Equal to Aa2/AA/AA or above	0.43%	0.47%
Equal to Aa3/AA-/AA- or above	0.58%	0.62%
Equal to A1/A+/A+	0.73%	0.77%
Equal to A2/A/A	0.87%	0.92%
Equal to A3/A-/A-	1.02%	1.07%
Equal to Baa1/BBB+/BBB+	1.17%	1.22%
Baa2/BBB/BBB or below	Default Rate	Default Rate

In the case of a split rating or differing ratings as between and among the rating agencies, for purposes of determining the Applicable Rate, (1) if three rating agencies then provide ratings on the Authority's lease revenue bonds, the middle of such ratings shall apply and (2) if two rating agencies then provide ratings on the Authority's lease revenue bonds, the lowest of such ratings shall apply. The credit ratings on the Authority's relevant lease revenue bonds are currently 'Aa3/AA/AA.' Although Moody's upgraded the Authority's rated lease revenue bonds one notch to 'Aa2' on October 3, 2016 for debt on essential assets, including City Hall and the Central Service Yard, it maintained its rating on bonds for non-essential assets at 'Aa3.' The Hayes Mansion is considered a non-essential asset.

Additional Terms and Covenants

The CCA and the Indenture include the following key terms and covenants that are briefly summarized below. Other than the extension of the Mandatory Tender Date and the elimination of the Optional Redemption or Conversion Fee period in the prior amendments, the terms described below remain the same as in the original transaction documents. A more detailed description of the CCA's terms is set forth in the memorandum linked above.

Mandatory Tender Date	Extended 179 days to December 3, 2018
Base Rate	Highest of (i) the Bank's prime rate + 1%; (ii) Fed Funds Rate + 2%; (iii) SIFMA Index Rate + 1%; and (iv) 8.0%. In the current interest rate environment, the highest of these four rates is the 8.0% per annum rate.
Purchaser Rate	Base Rate (1-30 days after Mandatory Tender Date) Base Rate + 1.0% (31-90 days after Mandatory Tender Date) Base Rate + 2.0% (91-180 days after Mandatory Tender Date) Base Rate + 3.0% (181+ days after Mandatory Tender Date) This interest rate is charged to the Authority when the Bonds have not been remarketed or the agreement with U.S. Bank has not been extended at the Mandatory Tender Date.
Unremarketed Bonds - Term-Out	Assuming no events of default have occurred and subject to the Authority making certain representations and warranties, if the Authority fails to pay the Purchase Price on the Mandatory Tender Date, the Unremarketed Bonds will carry the Purchaser Rate described above and will be amortized/repaid in equal quarterly installments over a period ending three years after the Mandatory Tender Date.
Default Rate	Base Rate + 4.0%. Applicable only in the event of a default.
Optional Redemption or Conversion Fee ("Make-Whole" Fee)	Bonds may be redeemed at par at any time, and are not subject to the Authority paying an Optional Redemption Fee or Conversion Fee that guarantees the Bank the Applicable Rate for a given period of time.

Funding Indemnity ("Breakage Fee")	Opportunity costs, if any, incurred by the Bank as a result of the prepayment of the Bonds on a day that is not the first business day of the month are passed on to the City. For the remainder of a month after the Bonds are prepaid, if the applicable index rates fall in relation to the applicable index rates the Bank would have otherwise recognized under the agreement, the differential is billed to the City.

Amended and Restated Indenture of Trust

In order to facilitate the private placement of the Bonds in 2013, it was necessary to amend and restate the prior indenture of trust. The Amended and Restated Indenture of Trust between the Authority and the Trustee (the "Indenture") sets forth the obligations of the Authority with respect to payment of the debt service on the Bonds, the rights of the bondholders and the duties of the Trustee. The Indenture also specifies the mechanics of converting the Bonds from the Index Rate to another mode. These include variable rate modes such as the daily or weekly rate, or fixed rate mode. In connection with the proposed extension of U.S. Bank's ownership of the Bonds, the Authority and the Trustee will enter into a Fourth Amendment to the Indenture in order to extend the period of the Bank's ownership to December 3, 2018.

If, after the end of the extension period (assuming that the sale of the Hayes Mansion and the resulting redemption of all of the Bonds has not occurred by such time) the City and the Authority do not extend the current private placement with U.S. Bank or enter into a private placement with another bank, the City and the Authority would have the option of converting the bonds to a fixed rate mode or a variable rate mode remarketed to the public. In order to convert the Bonds to a variable rate mode marketed to the public, the Authority would need to obtain one or more letters of credit or another form of liquidity support and prepare a public offering document (i.e., official statement).

Authorization to Execute Documents

The Second Amendment to the Continuing Covenant Agreement with U.S. Bank, the Fourth Amendment to the Amended and Restated Indenture of Trust, 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 May 4, 2018. Staff recommends that the Executive Director or Treasurer of the Authority or their designees (the "Authority Designated Officers") be authorized to execute these agreements, 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 the Continuing Covenant Agreement, as posted, on behalf of the City, with such modifications as the Authority Designated Officers or the City Designated Officers determine 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 CCA, not to exceed 180 days, under substantially the same terms and conditions.

<u>Financing Team Participants</u>

The financing team participants consist of:

City Municipal Advisor:	Public Resources Advisory Group ("PRAG")
Bond Counsel:	Jones Hall, APLC
Purchaser/Bank:	U.S. Bank National Association
Trustee:	Wells Fargo Bank, N.A.

- <u>Municipal Advisor</u> – PRAG serves as the City's General Municipal Advisor and is also in the City's pool for municipal advisory services selected through a request for proposal ("RFP") process that concluded in August 2017 by the Finance Department.

- <u>Bond Counsel</u> – Jones Hall was selected through a RFP process by the City Attorney's Office.

- <u>Trustee</u> – Wells Fargo Bank, N.A. was previously selected to serve as Trustee for the Bonds in connection with the private placement of the Bonds with U.S. Bank in 2013.

<u>Financing Schedule</u>

The current proposed schedule is as follows:

Council/Authority approval of agreements:	May 15, 2018
Documents closing:	June 1, 2018
Effective date of extension of Bank ownership of Bonds:	December 3, 2018

<u>EVALUATION AND FOLLOW-UP</u>

This memorandum presents the set of recommendations related to the City Council and the Authority Board's approval of various actions related to the City of San Jose Financing Authority extension of ownership by the Bank of the Bonds, with minor changes to the terms of the existing agreement, and requires no additional evaluation or follow-up to the City Council or the Authority Board.

PUBLIC OUTREACH

The form of the proposed agreements will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about May 4, 2018.

COORDINATION

This report was prepared by the Finance Department in coordination with the City Attorney's Office, the City Manager's Office of Economic Development, and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

This recommendation has not been heard by any commission.

FISCAL/POLICY ALIGNMENT

The proposed financing plan is 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 recommended actions will result in reductions to the fixed fee components of the interest rates applicable to the Bonds pursuant to the documents being amended.

BUDGET REFERENCE

Compensation for bond counsel, bank counsel, trustee and the City's municipal advisor will be paid from Appropriation #7149 pursuant to the 2017-2018 appropriations, shown below, for debt-related and municipal advisory costs.

Fund #	Appn #	Appn. Name	Total Appn	2017-2018 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
422	7149	Debt Service Payments for the Hayes Phase III	$3,818,000	978	6/20/17, Ord. No. 29961

The cost for the professional services is estimated to be approximately $20,000.

CEQA

Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/
JULIA H. COOPER
Director of Finance
Treasurer of the Authority

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