



Memorandum

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

FROM: Matt Cano
Julia H. Cooper
Margaret McCahan

SUBJECT: SEE BELOW

DATE: April 18, 2019

Approved

D. DSL

Date

4/19/19

**SUBJECT: ISSUANCE OF CITY OF SAN JOSE FINANCING AUTHORITY'S
COMMERCIAL PAPER NOTES FOR FULL BUILD OUT AT THE 4TH
STREET AND SAN FERNANDO GARAGE FOR OFFICE SPACE FOR
THE SAN JOSE COMMUNITY ENERGY DEPARTMENT AND OTHER
CITY OPERATIONS**

RECOMMENDATION

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

- (1) Conduct a public hearing concerning the approval of the issuance by the City of San Jose Financing Authority (the "Authority") of City of San Jose Financing Authority Lease Revenue Commercial Paper Notes ("CP Notes") in order to finance certain public capital improvements of the City of San José, consisting of a full build-out of existing space within the 4th and San Fernando Garage for office space which will initially be occupied by the San José Community Energy Department (the "SJCE Department") and other City operations.
- (2) Adopt a resolution to approve the issuance of CP Notes to provide financing for the construction of a full build-out of existing space within the 4th and San Fernando Garage for office space which will initially be occupied by the SJCE Department and other City operations in an amount not to exceed \$6.5 million.
- (3) Adopt the following Fiscal Year 2018-2019 Appropriation Ordinance and Funding Sources Resolution amendments in the General Fund:
 - (i) Increase the Other Revenue estimate by \$4,800,000; and
 - (ii) Establish the City Hall Campus Expansion capital project appropriation to the Public Works Department in the amount of \$4,800,000.

- (b) It is recommended that the City of San José Financing Authority Board (the "Authority Board") adopt a resolution to approve the issuance of the CP Notes to provide financing for the construction of a full build-out of existing space within the 4th and San Fernando Garage for office space which will initially be occupied by the SJCE Department and other City operations in an amount not to exceed \$6.5 million.

OUTCOME

Approval of these recommendations, both by the Authority Board and by two-thirds majority approval by the City Council, will allow the issuance of the CP Notes to finance construction costs for the City Hall Campus Expansion project, the build out of existing space within the 4th and San Fernando Garage facility to include office space that will be used to house the SJCE Department and other City operations.

BACKGROUND

In May 2017, City Council approved the establishment of a San José Community Choice Energy program, referred to as San José Clean Energy (SJCE), for the provision of electrical power in the City. On August 8, 2017, the City Council 1) approved an ordinance establishing San José Clean Energy (SJCE), 2) amended the Municipal Code to add the new SJCE Department, and 3) approved the use of CP Notes as a mechanism to fund the SJCE start-up costs.

The City Hall campus does not have sufficient space to house the new SJCE Department once it ramps up its staffing levels. To address this need, staff evaluated options to expand the City Hall campus by converting space at the 4th and San Fernando Garage or to lease space Downtown. Based on this evaluation, staff recommends expanding the City Hall campus and using Commercial Paper to complete the necessary space renovations.

Commercial Paper Program

The Commercial Paper Program utilizes a lease revenue financing structure. Under this program, the Authority can issue CP Notes at prevailing interest rates for periods of maturity not to exceed 270 days. Although the maturity of a Note may not exceed 270 days, the Authority may issue CP Notes to pay off the maturing CP 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 ("State Street") and U.S. Bank (together, the "Banks") and are additionally secured by a pledge of lease revenues from various City assets. Both LOCs expire on February 23, 2022. See Attachment A for a description of the structure of the Authority's Commercial Paper Program along with a summary of the program amendments since inception in 2004. See Attachment B for the technical aspects of how commercial paper works.

ANALYSIS

Build-Out of City Hall Campus/San José Clean Energy Department Relocation Project

The SJCE Department is currently located on the 14th floor of City Hall Tower building and has a current staff of 21. The SJCE Department space is borrowed and shared with the Finance Department (Purchasing Division). To accommodate the anticipated growth of SJCE to 28 positions in 2019-2020, the Finance Department will need to reconfigure its existing footprint. The SJCE Department projects a staff increase to 50 employees by 2024-2025 – a level that cannot be accommodated by the space restrictions of the 14th floor.

Renovated Space

Staff has identified existing space within the 4th and San Fernando Garage (88 S. 4th St. #130) that can be converted into office space. The former Redevelopment Agency entered into a lease for that space with the Downtown Association for approximately 6,075 square feet of unfinished commercial space. The Kaleid Gallery currently occupies as a sub-tenant to the Downtown Association and has occupied that space since 2006, initially for temporary use. The lease states that the City has the right to terminate within 30 days without cause. To provide Kaleid with a reasonable time to potentially find additional space, City staff recommends providing a six-month Notice of Termination to both the Downtown Association and Kaleid.

The plans of the facility renovation will include six hard wall offices, forty-four cubicle offices, gender neutral restrooms, an employee break area, and conference room space for the SJCE Department and other City operations. Staff analyzed alternative Downtown lease space for the SJCE Department but this option was not recommended due to the instability of leasing space and the continued support from other City departments, the interaction needed with various City departments in City Hall, and the potential for rising lease costs.

Construction Cost and Schedule

To fully develop the space for 50 employees, restrooms, a break area, and conference rooms, the estimated construction cost is \$3.8 million. There is an additional \$1.0 million in project delivery costs that will total the estimated project cost of \$4.8 million. Pending City Council approval, upon issuance of CP Notes, the project is expected to be completed in August 2020.

Funding Mechanism

To fund the space renovation, staff recommends the Authority to issue taxable CP Notes in an amount not to exceed \$6.5 million. This amount exceeds the estimated project cost of \$4.8 million to provide additional capacity should the project cost be higher than anticipated. The CP notes would be repaid in conjunction with the refunding of the Authority's Lease Revenue Bonds, Series 2006A (City Hall debt), during 2019-2020. Total City Hall debt service is allocated to the General Fund, special funds, and capital funds based on a methodology based on space utilization. A revision will include the addition of approximately 6,075 square feet of

space to the allocation methodology. The SJCE Department will be allocating debt service costs in the same manner as other City departments located in City Hall. The lease cost to SJCE Department for the full built-out space is estimated at \$304,000 annually beginning in 2020-2021. Leasing equivalent space downtown is estimated at approximately \$292,000 with the potential of continuous lease increases. Given the significant coordination between SJCE and other City departments (Finance, Budget, City Attorney's Office) relocation off the City Hall Campus would be challenging to the operations of the newly created department.

Debt Management Policy and Municipal Code Requirements Related to Lease Financings

The plan to issue CP Notes to finance the construction costs of the City Hall Campus Expansion 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. 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.

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

Source of Repayment

The CP Notes issued for the identified purposes are expected to be repaid through the refunding of the Authority's Lease Revenue Bonds, Series 2006A during FY 2019-20. All fees and interest costs that occur in 2019-20, associated with the CP Notes proposed to be issued, will be paid by the General Fund.

Kaleid Gallery Space (88 S. 4th Street #130). The former Redevelopment Agency entered into a lease and several amendments with the Downtown Association for approximately 6,000 square feet of unfinished commercial space. The Kaleid Gallery currently occupies as a sub-tenant to the Downtown Association and has occupied the space since 2006. The lease signed with the Redevelopment Agency stated that the use was intended to be temporary. The Downtown Association nor Kaleid pay rent for the space. The City pays for electricity and other associated maintenance costs for the space. Monthly PG&E costs currently range from \$800-\$900 per month. The lease agreement specifies that neither the Downtown Association or Kaleid are eligible for relocation assistance or benefits from the City. While the City does not have the responsibility to find relocation space for Kaleid, staff is reaching out to property owners to determine if any Downtown ground floor space could be available, likely for a short term. The lease agreement states that the Agency/City has the right to terminate within 30 days without cause. To provide the tenant with a reasonable time to potentially find additional space, City

staff recommends providing a six-month notice of Termination to the Downtown Association and Kaleid.

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. No later than 5 days before the public hearing to be held by the City Council on April 30, 2019, 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, space within the 4th and San Fernando Garage for office space which will initially be occupied by the SJCE Department and other City operations, 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. No amendments to any of the documents that established the CP Program are necessary, the Authority's issuance of CP Notes to finance the proposed project is less costly than any other form of financing available to the City.

Utilization of the CP Program

The amount of CP Notes currently outstanding is \$77.2 million of the total program capacity of \$125.0 million. The table below illustrates the current CP Notes outstanding by project along with projects approved for CP issuance but not yet issued.

Commercial Paper Notes Outstanding
(as of April 30, 2019)

| <u>Project</u> | <u>Amount</u> <u>(in millions)</u> |
|--|---|
| <u>CP Notes Already Issued</u> | |
| ESCO Conservation Equipment | \$ 7.7 |
| Central Service Yard Phase II | 4.4 |
| Convention Center Exhibit Hall | 12.7 |
| Clean Energy | 10.0 |
| Convention Center - South Hall | 42.4 |
| Total Current CP Projects | \$ 77.2 |
| <u>CP Notes Authorized but not Issued</u> | |
| Flood Projects | \$ 18.9 |
| Total Outstanding and Committed | \$ 96.1 |
| <u>CP Notes Anticipated to be Issued</u> | |
| City Hall Campus Expansion Construction | \$ 6.5 |
| Grand Total | <u>\$ 102.6</u> |
| CP Program Issuance Capacity – Current | \$ 125.0 |
| Unutilized Issuance Capacity | \$ 22.4 |

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 a schedule agreed to by the Banks, the Authority, and the City.

- 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.

The LOC is backed by certain real properties pledged as leased assets by the City and Authority with a total insured replacement value of approximately \$178.5 million. If any of the underlying leased assets as described 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.

EVALUATION AND FOLLOW-UP

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

PUBLIC OUTREACH

The proposed resolutions of the City Council and the Authority Board will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about April 19, 2019. This memorandum will be posted for the April 30, 2019 City Council Agenda. In addition, Kaleid Gallery will be given notice immediately if the City Council approves this action.

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 the proposed issuance of commercial paper notes and repayment term is consistent with the City's Debt Management Policy's provisions concerning repayment. 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

Budget actions are recommended to appropriate \$4.8 million for the City Hall Expansion capital project, offset by the issuance of CP Notes. Actions are also recommended to authorize the use of up to \$6.5 million in CP for this project to allow capacity if the project costs exceed expectations.

CP Notes will be issued for the build-out of existing space within the 4th and San Fernando Garage facility (Kaleid Gallery space) to create office space for the SJCE Department and additional City operations. As described above, the CP Notes are expected to be repaid in conjunction with the refunding of the Authority's Lease Revenue Bonds, Series 2006A during 2019-2020. The revised debt service payments after this refunding will be based on the current methodology to allocate City Hall debt service with the addition of approximately 6,075 square feet of space. The SJCE Department will be allocated debt service costs in the same manner as other City departments located in City Hall. The lease cost to the SJCE Department is estimated at \$304,000 annually for full build-out space. It is anticipated that this payment will begin in 2020-2021 with the move of the SJCE Department into the new space.

BUDGET REFERENCE

The table below identifies the funding source and the appropriation adjustments recommended this memorandum.

| Fund # | Appn # | Appn. Name | Current Year Appn. | Rec. Budget Action | 2018-2019 Adopted Operating Budget Page | Last Budget Action (Date, Ord. No.) |
|---------------|---------------|----------------------------|---------------------------|---------------------------|--|--|
| 001 | R130 | Other Revenue | \$210,936,775 | \$4,800,000 | III-34 | 03/26/2019, Res. 79026 |
| 001 | TBD | City Hall Campus Expansion | NEW | \$4,800,000 | N/A | N/A |

CEQA

Categorically Exempt, File No. PP19-030, CEQA Guidelines Section 15301, Existing Facilities.

/s/

MATT CANO
Public Works Director

/s/

JULIA H. COOPER
Director of Finance



MARGARET MCCAHAN
Budget Director

I hereby certify that there will be available for appropriation in the General Fund in the Fiscal Year 2018-2019, monies in excess of those heretofore appropriated there from, said excess being at least \$4,800,000.



MARGARET MCCAHAN
Budget Director

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

Attachment A – Structure of the City of San Jose Financing Authority Commercial Paper Program and Summary of Program Amendments Since Inception in 2004

Attachment B – Technical Aspects of Commercial Paper

Attachment A

Structure 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 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 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 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.

| Date | City Council/City of San José Financing Authority Board Actions |
|-------------------|--|
| 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. |
| 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. |

| Date | City Council/City of San José Financing Authority Board Actions (cont.) |
|--------------------|---|
| 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. |

| Date | City Council/City of San José Financing Authority Board Actions (cont.) |
|-------------------|---|
| August 29, 2017 | Authorized the issuance of CP Notes in an amount not to exceed \$10.0 million to provide funding for startup costs relating to San Jose Clean Energy. |
| February 13, 2018 | Authorized the issuance of CP Notes in an amount not to exceed \$21.0 million to provide funding for the flood recovery and construction for parks and community facilities. |
| August 14, 2018 | Authorized the issuance of CP Notes in an amount not to exceed \$47.0 million to provide funding for the purchase of Convention Center - South Hall site and amendments of the two Letter of Credits and Reimbursement Agreements |
| August 14, 2018 | Authorized 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 |

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 of 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. That 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).