File #: 14-0850, **Version:** 1

REPORT TO COUNCIL

SUBJECT
Adopt a Resolution Approving the Refinancing of the 2003 and 2007 Solid Waste Revenue Bonds

BACKGROUND
In February 2003, the City of Sunnyvale (City), in partnership with the cities of Mountain View and Palo Alto, issued $20,575,000 of Solid Waste Revenue Refunding Bonds, Series 2003 (2003 Bonds). The 2003 Bonds refinanced the Sunnyvale Finance Authority's Utilities Revenue Bonds, 1992 Series B (Solid Waste Materials Recovery and Transfer Station), which had been issued to finance the original construction of the Sunnyvale Materials Recovery and Transfer Station (SMaRT Station). In November 2007, again in partnership with Mountain View and Palo Alto, the City issued its $8,130,000 Solid Waste Revenue Bonds, Series 2007 (the 2007 Bonds with the 2003 Bonds are the "Prior Bonds") to finance the cost of replacing processing system equipment at the SMaRT Station. The 2007 Bonds were issued on parity with the 2003 Bonds. The 2007 Bonds differed in that Mountain View elected to pay its share of the cost in cash as opposed to financing the expense and therefore is not party to the 2007 Bonds.

At the time of this City Council meeting, $5,375,000 of 2003 Bonds and $4,635,000 of 2007 Bonds will be outstanding. The 2003 Bonds carry an interest rate of 5.50 percent through 2017 (final maturity); the 2007 Bonds carry an interest rate of 4.0197 percent through 2021 (final maturity). At the present time, bond interest rates are significantly lower than when the 2003 Bonds and 2007 Bonds were issued. The lower interest rates present the opportunity for the City to substantially reduce annual debt service on the Prior Bonds and to shorten the final maturity on the 2007 Bonds.

EXISTING POLICY
Council Fiscal Policy F.2.5 Revenue Bonds - All City utility-related improvements shall be funded only from revenues of the respective utilities.

Council Fiscal Policy 7I1.1b.1 Capital improvements associated with the existing infrastructure of a utility should be primarily funded from two sources: rate revenue and debt financing.

ENVIRONMENTAL REVIEW
N/A

DISCUSSION
To take advantage of interest rate savings, staff is proposing to refinance the Prior Bonds with the issuance of a City of Sunnyvale Solid Waste Revenue Refunding Note, Series 2014 (2014 Note).

Today's interest rates remain at historically low levels. Five and Ten-year Treasury interest rates are at approximately 1.70 percent and 2.50 percent; California tax-exempt bond yields for the expected final maturity (October 1, 2020) of the 2014 Note are under 2 percent.

The interest rate on the 2014 Note would be set when the loan agreement under which the 2014 Note would be issued (2014 Loan Agreement) is executed - anticipated in mid-October. Interest rates may change between the writing of this report and mid-October. The City, therefore, would not know the precise savings until the 2014 Loan Agreement was executed. The City would not execute on the 2014 Loan Agreement unless it achieves at least 3 percent present value savings.

In addition to the considerable savings to be realized, refinancing the Prior Bonds will enable the following efficiencies: (1) the existing restricted debt service reserve funds (an aggregate of $2.7 million) will be used to reduce the amount of the 2014 Note that will be outstanding after bond issuance, (2) the final maturity will be shortened by one year to 2020 and (3) two bond issues will be consolidated into one, reducing the administrative impact on staff.

When selling debt, there are two basic approaches that the City can take: a public offering (which was used in connection with the 2003 Bonds) or a direct purchase/loan (which was used in connection with the 2007 Bonds).

In a public offering, the City would obtain a rating and prepare an Official Statement that describes the terms of the offering and relevant security features. Publicly offered bonds can be sold on a competitive or negotiated basis. In a competitive sale, the bonds would be offered for sale on a predetermined date and time; any firm could bid, with the award being made to the firm bidding the lowest true interest cost. In a negotiated sale, the City would work with an underwriter to prepare the bonds for sale. The advantage of a public offering is the potential for a lower interest rate. The 1992 Bonds and the 2003 Bonds were publicly offered via negotiated sale and are rated.

With a direct purchase/loan, a bank would purchase the debt from, or make a loan to the City without the need for an Official Statement, underwriter, disclosure counsel, or a rating. The rate is initially determined through a request for proposal (RFP) process. The advantages of a direct purchase/loan are lower transaction costs, shorter timeframe for implementation, greater administrative ease and no need for a trustee bank.
Once the bank is selected, the entire transaction takes about four to six weeks. By contrast, a publicly offered transaction typically requires approximately 2 ½ to 3 months. The 2007 Bonds involved a direct purchase.

<u>Financing Team</u>
Under the City Manager’s award authority, staff has contracted with the law firm of Jones Hall to serve as Bond Counsel in an amount not to exceed $45,000 plus out-of-pocket expenses for Bond Counsel services. Jones Hall’s fee will be paid from the proceeds of the 2014 Loan Agreement and is contingent on its execution. Bond Counsel is responsible for drafting legal documents and ensuring that the 2014 Note is issued in compliance with all applicable state and federal laws. Bond Counsel will deliver an opinion that the 2014 Note is legally issued and that Note interest is tax-exempt under Federal tax law. Jones Hall is a leading California bond counsel firm and serves numerous local governments throughout the State. The firm served as Bond Counsel and Disclosure Counsel on the 2003 Bonds, the 2007 Bonds, the City’s Water and Wastewater revenue bonds, Certificates of Participation, and Mello-Roos Bonds. The City selected Jones Hall in this case again due to the unique and complex structure of this particular debt. The combination of the Prior Bonds, with the added complexity of the three-city credit structure requires a detailed understanding of the

transaction and the Prior Bonds in order to properly structure this refinancing.

Additionally, a contract in an amount not to exceed $45,000, plus expenses (not to exceed $1,000), has been awarded under the City Manager's award authority to Ross Financial to serve as the City's Financial Advisor. As with Bond Counsel services, this fee will be paid from the proceeds of the 2014 Loan Agreement and is contingent upon its closing. The Financial Advisor is responsible for developing the bond structure, running cash flow analyses, recommending the manner of sale, managing any RFP process, overseeing the rating agency process (if applicable), assisting in the drafting of the Official Statement (if applicable), overseeing the bond pricing and confirming its fairness and, in general, coordinating the transaction. Ross Financial is a San Francisco-based financial advisory firm that is focused solely on municipal bonds. Its principal, Peter Ross, has more than thirty-five years of experience in the municipal bond market, having served in the capacities of bond counsel, underwriter and financial advisor over the course of his career. Ross Financial served as Financial Advisor in connection with the 2003 Bonds and 2007 Bonds, as well as the 2010 Water and Wastewater Bonds, Certificates of Participation, and other City financings. The firm provides financial advisory services for many prominent municipalities in California, including the City of San Jose, the City and County of San Francisco, the City of Burbank, Santa Clara Valley Transportation Authority, San Mateo County Transit District and the Peninsula Corridor Joint Powers Board. As with Bond Counsel, Ross Financial's experience with the Prior Bonds is critical for this transaction due to its complexity.

<u>Legal Structure of the Proposed 2014 Refinancing</u>
Because of the small size and short remaining life of the Prior Bonds, staff directed Ross Financial to assess the overall cost-effectiveness of a direct purchase/loan approach through an RFP to be distributed to interested banks. On July 30, 2014, Ross Financial distributed an RFP to ten banks. On August 15, 2014, Ross Financial and the City received five proposals - from Bank of the West, Capital One, JP Morgan Chase Bank (JPMorgan), Union Bank and US Bank. JPMorgan's proposal contained the lowest interest rate among the five bidders. On the basis of the proposed rate versus prevailing market rates for publicly offered bonds, staff, in consultation with Ross Financial, determined that a direct purchase/loan with JPMorgan would provide the most cost-effective approach to refinancing the Prior Bonds.

<u>General Terms</u>
The refunding transaction will be structured as a tax-exempt fixed-rate loan that matures on October 1, 2020. The loan will be made by JPMorgan (as DNT Asset Trust, a Delaware business trust and wholly owned subsidiary of JPMorgan) directly to the City and will be evidenced by the 2014 Note. Interest on the 2014 Note will be paid semi-annually on April 1 and October 1 of each year, commencing April 1, 2015. Principal will be repaid annually on October 1 in each year, commencing October 1, 2015 in amounts that achieve debt service savings that are proportionate to the aggregate debt service on the Prior Bonds.

Key Security Features
Pledge. The 2014 Note will be secured by and payable from (a) solid waste system revenues with respect to the City's share of debt service and (b) payments made by the cities of Mountain View and Palo Alto under the Memorandum of Understanding, dated June 9, 1992, among the City, Mountain View and Palo Alto with respect to their share of debt service. This is the same pledge as with the Prior Bonds.

No Reserve Fund. JPMorgan, as well as the other banks that submitted proposals, agreed that there was no need for a debt service reserve fund to secure the City's repayment of the 2014 Note. As a result, the City intends to apply funds (approximately $2.7 million) held in the existing debt service reserve funds for the Prior Bonds to reduce the par amount of the 2014 Note and to shorten the final maturity to October 1, 2020 from October 1, 2021 on the Prior Bonds.

No Additional Parity Debt. Under the 2014 Loan Agreement, the City has agreed not to issue additional debt secured by revenues from the solid waste system on parity with the pledge securing the 2014 Note. The City does not anticipate any significant capital needs for its solid waste system until after October 1, 2020, the final maturity of the 2014 Note and therefore is agreeable to these terms. This provision does not preclude the City from issuing additional debt; however the debt would be in second position behind the 2014 Note.

Documents to be Approved by the City

Resolution

In order to proceed, the City Council would adopt a resolution (Attachment 1) which authorizes the execution and delivery of the documents described below and approving related agreements and actions.

2014 Loan Agreement

The proposed 2014 Loan Agreement (Attachment 2), dated as of October 1, 2014, is between the City and JPMorgan. The 2014 Loan Agreement provides for the loan of funds from JPMorgan to the City for the purpose of refinancing the Prior Bonds. The 2014 Loan Agreement would be evidenced by the 2014 Note, which the City would agree to repay on the dates and at the interest rate provided therein. The 2014 Loan Agreement provides for the Pledge described above and includes other covenants, detailed definitions, and certain miscellaneous provisions. The attached 2014 Loan Agreement is in its substantially final form, with only final details needing completion.

Escrow Agreement

The Escrow Agreement (Attachment 3), dated as of October 1, 2014, is between U.S. Bank, as escrow agent (Escrow Agent), and the City. The proposed agreement provides for the Escrow Agent to publish a redemption notice for the Prior Bonds and to hold the proceeds of the 2014 Note in a dedicated escrow account and to apply such funds for the repayment of principal of and accrued interest on the Prior Bonds on the redemption date, expected in mid-November 2014.

FISCAL IMPACT

Based on the estimated interest rate at the time this report was prepared, the 2014 Note will refund the Prior Bonds and result in total scheduled debt service savings of approximately $956,000 with present value savings of approximately $781,000, which represents approximately 7.8 percent savings based on the outstanding bonds. Because the refinancing eliminates the debt service reserve fund and therefore the reserve fund earnings, actual savings will be less.

Factoring in the loss of reserve fund earnings, net present value savings are estimated at $614,000, or 6.1 percent savings. It should be noted that due to the structure of the financing and with the application of the debt service reserve fund, annual debt service savings are higher in the first two years, estimated at approximately $174,000 in 2015 and 2016, and then taper down to an average of approximately $67,000 for the remaining four years. These savings are inclusive of all transaction costs and will be shared among the City, Mountain View and Palo Alto in proportion to their respective debt service obligations for the Prior Bonds.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

ALTERNATIVES

1. Adopt the resolution, presented as Attachment 1, authorizing the execution and delivery of a loan agreement to refinance outstanding solid waste revenue obligations of the City, and approving related agreements and actions presented as Attachments 2 and 3.
2. Do not adopt the Resolution and continue the current financing in place.
3. Do not adopt the Resolution and direct staff to pursue a public offering approach to refund the Prior Bonds

STAFF RECOMMENDATION

Alternative 1: Adopt the resolution, presented as Attachment 1, authorizing the execution and delivery of a loan agreement to refinance outstanding solid waste revenue obligations of the City, and approving related agreements and actions presented as Attachments 2 and 3.
Staff believes Alternative 1 to be the most fiscally responsible route as this action will result in substantial savings for the City.

Prepared by: Tim Kirby, Assistant Director of Finance
Reviewed by: Grace K. Leung, Director, Finance
Reviewed by: Robert A. Walker, Assistant City Manager
Approved by: Deanna J. Santana, City Manager

ATTACHMENTS

1. Resolution Authorizing the Execution and Delivery of a Loan Agreement to Refinance Outstanding Solid Waste Revenue Obligations of the City, and Approving Related Agreements and Actions
2. Draft Loan Agreement
3. Draft Escrow Deposit Agreement