



# City of Sunnyvale

## Agenda Item-No Attachments (PDF)

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File #: 17-1160, Version: 1

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### REPORT TO COUNCIL

#### SUBJECT

Approve Two Resolutions Authorizing the Advance Refunding of the City's Water Revenue Bonds, Series 2010 and Wastewater Revenue Bonds, Series 2010, Approval of the Official Documents Related to the Transactions, and Award a Contract in an Amount of \$193,000 plus Incidental Expenses to Jones Hall, A Professional Law Corporation for Bond and Disclosure Counsel Services, and Find that these Actions are Exempt from CEQA

#### REPORT IN BRIEF

Staff recommends that the City Council adopt a resolution which authorizes, including the approval of all official documents and related actions, the issuance of a City of Sunnyvale Water Revenue Refunding Bonds, Series 2017 (the "2017 Water Refunding Bonds") in an amount not to exceed \$20,000,000 and at an interest rate not to exceed 4.5%, to advance refund the City's outstanding Water Revenue Bonds, Series 2010 for debt service savings.

Staff also recommends that the City Council adopt a resolution which authorizes, including the approval of all official documents and related actions, the issuance of a City of Sunnyvale Wastewater Revenue Refunding Bonds, Series 2017 (the "2017 Wastewater Refunding Bonds" and, with the 2017 Water Refunding Bonds, the "2017 Refunding Bonds") in an amount not to exceed \$27,500,000 and at an interest rate not to exceed 4.5%, to advance refund the City's outstanding Wastewater Revenue Bonds, Series 2010 for debt service savings.

The City has one outstanding water revenue bond issue and one outstanding wastewater revenue bond issue. The City of Sunnyvale Water Revenue Bonds, Series 2010 (the "2010 Water Bonds") advance refunded the portion of the Sunnyvale Financing Authority Water and Wastewater Bonds issued in 2001 (the "2001 Water and Wastewater Bonds") that was allocable to Water System improvements, and financed new capital improvements to the City's Water System. The City of Sunnyvale Wastewater Revenue Bonds, Series 2010 (the "2010 Wastewater Bonds" and, with the 2010 Water Bonds, the "2010 Bonds") advance refunded the portion of the 2001 Water and Wastewater Bonds that was allocable to Wastewater System improvements, and financed new capital improvements to the City's Wastewater System.

The 2010 Water Bonds carry interest rates of 4.00% to 5.25% through April 1, 2040 (final maturity); the 2010 Wastewater Bonds carry interest rates of 5.00% to 5.25% through April 1, 2040. At the present time, interest rates are significantly lower than when the 2010 Bonds were issued. The lower interest rates present the opportunity for the City to substantially reduce annual debt service on the 2010 Bonds. Each of the 2010 Bonds is callable on or after April 1, 2020.

Based on interest rates as of November 30, 2017, (a) the 2017 Water Refunding Bonds will create annual cash flow savings of approximately \$180,000, aggregate debt service savings of

approximately \$4.1 million and net present value savings of approximately \$2.1 million and (b) the 2017 Wastewater Refunding Bonds will create annual cash flow savings of approximately \$250,000, aggregate debt service savings of approximately \$5.6 million and net present value savings of approximately \$2.8 million.

Staff is conducting an accelerated refunding process to close the refundings by the end of the calendar year. This is to capture savings prior to the passage of the proposed House's Tax Cuts and Jobs Act (HR-1), which would eliminate the ability of public agencies to issue tax-exempt advance refunding bonds, such as the 2017 Refunding Bonds, after December 31, 2017.

## **BACKGROUND**

On June 29, 2010, the City issued the 2010 Water Bonds in the amount of \$24,085,000. The 2010 Water Bonds refinanced, on an advance refunding basis, the portion of the 2001 Water and Wastewater Bonds that were allocable to Water System improvements, and financed various capital improvements to the City's Water System. Presently, \$18,550,000 of the 2010 Water Bonds remains outstanding. The 2010 Water Bonds are callable on or after April 1, 2020.

On June 29, 2010, the City also issued the 2010 Wastewater Bonds in the amount of \$35,380,000. The 2010 Wastewater Bonds refinanced, on an advance refunding basis, the portion of the 2001 Water and Wastewater Bonds that were allocable to Wastewater System improvements, and financed various capital improvements to the City's Wastewater System. Presently, \$26,005,000 of the 2010 Wastewater Bonds remains outstanding. The 2010 Wastewater Bonds are callable on or after April 1, 2020.

The 2010 Water Bonds carry interest rates of 4.00% to 5.25% through April 1, 2040 (final maturity); the 2010 Wastewater Bond carry interest rates of 5.00% to 5.25% through April 1, 2040 (final maturity). Current interest rates are significantly lower than when the 2010 Bonds were issued. The lower interest rates present the opportunity for the City to substantially reduce annual debt service on the 2010 Bonds.

On November 2, 2017, the House Ways and Means Committee introduced the "Tax Cuts and Jobs Act" ("HR-1"). HR-1 contains a provision that eliminates the ability of local governments to issue tax-exempt advance refunding bonds after December 31, 2017. On November 9, 2017, the Senate Finance Committee issued its Chairman's Mark, which does not alter HR-1's prohibition against tax-exempt advance refunding bonds after December 31, 2017. On November 16, 2017, the full House of Representatives approved HR-1. On December 2, 2017, the Senate passed a similar tax reform measure. These two bills are now being reconciled and prepared for the President's signature.

## **EXISTING POLICY**

Sunnyvale Municipal Code Chapter 3.70 - Sunnyvale Municipal Utilities Revenue Bond Law authorizes the City Council to fund utility improvements through the issuance of utility revenue bonds.

Council Policy 7.1.8 - Debt Management, provides comprehensive guidelines for the issuance and financial management of debt issued by the City.

## **ENVIRONMENTAL REVIEW**

The proposed actions are exempt from environmental review under the California Environmental Quality Act (CEQA) pursuant to Section 15378(b)(4) of the CEQA Guidelines (fiscal activities that do

not involve commitment to any specific project that may result in a significant impact on the environment).

## **DISCUSSION**

### **Benefits of Refunding the 2010 Bonds**

Today's interest rates are lower than when the 2010 Bonds were issued. Ten-year and 30-year Treasury interest rates are at approximately 2.40% and 2.83%; California tax-exempt bond yields for the expected final maturity (April 1, 2040) of the 2017 Bonds are approximately 3.25%. These low interest rates present the opportunity to reduce annual debt service by refunding the 2010 Bonds.

In this case, the 2010 Bonds are eligible for an advance refunding. This is different than a current refunding. In a current refunding, all outstanding bonds are refunded within 90 days of the close of the refunding transaction. In an advance refunding, some or all of the outstanding bonds will remain in an escrow account until they are eligible to be refunded, secured by proceeds from the sale of the advance refunding transaction. In order to take advantage of savings now, staff is recommending the advance refunding of the 2010 Bonds.

Based on interest rates as of November 30, 2017, (a) the 2017 Water Refunding Bonds will create annual cash flow savings of approximately \$180,000, aggregate debt service savings of approximately \$4.1 million and net present value savings of approximately \$2.1 million and (b) the 2017 Wastewater Refunding Bonds will create annual cash flow savings of approximately \$250,000, aggregate debt service savings of approximately \$5.6 million and net present value savings of approximately \$2.8 million.

The interest rates on the 2017 Refunding Bonds will be set on the sale date anticipated to be on or about December 18, 2017. Interest rates may change between the date of this report and December 18, 2017, especially given the heavy issuance calendar for December. The City, therefore, will not know the precise savings until the 2017 Refunding Bonds are sold. Under City Policy, the City would not sell the 2017 Refunding Bonds unless it achieves at least 3% net present value savings. Currently the potential savings equal approximately 10% of the refunded principal amount.

### **Proposed Financing Approach**

There are two ways that the City can sell debt: public offering (which was used in connection with the 2010 Bonds) or a direct purchase/private placement (which was used most recently in 2014 in connection with the issuance of the City's solid waste refunding obligations (the "2014 Note")).

In a public offering, the City needs to obtain ratings 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 are offered for sale on a predetermined date and time; any firm can 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 over a direct purchase/private placement typically is a lower interest rate.

With a direct purchase/private placement, a bank would purchase the bonds 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/private placement are lower transaction costs and greater administrative ease.

According to the City's Municipal Advisor, Ross Financial, because of the length of the final maturity (2040) and the complexity of the 2017 Refunding Bonds (requires both tax-exempt and taxable series, as explained below), a public offering is more cost-effective than a direct purchase/private placement in the current market. Given the complexity of the 2017 Refunding Bonds and the expected surge in issuance volume in December due to HR-1's proposed elimination of advance refunding transactions after December 31, 2017, Ross Financial has recommended that the 2017 Refunding Bonds be sold through a negotiated sale. Staff recommends J.P. Morgan serve as underwriter for the negotiated sale. Although the December 31 issuance deadline did not provide sufficient time to undertake a formal request for proposal for underwriters for the 2017 Refunding Bonds, J.P. Morgan was selected in the City's most recent request for proposal process, which was made in connection with the issuance of the 2014 Note.

#### Legal Structure of the Proposed 2017 Refunding Bonds

Both the 2017 Water Refunding Bonds and the 2017 Wastewater Refunding Bonds will be structured with two series: (a) a tax-exempt series and (b) a taxable series. The tax-exempt series will advance refund that portion of 2010 Water Bonds and 2010 Wastewater Bonds which financed new Water and Wastewater improvement projects (approximately 71% and 61% of each issue, respectively). The taxable series will refund the advance refunding portions of the 2010 Water Bonds and 2010 Wastewater Bonds (approximately 29% and 39%, respectively). Under current Federal tax law, the City may advance refund a prior bond on a tax-exempt basis only once; a second-time advance refunding would need to be implemented on a taxable basis. Under HR-1, that one time tax-exempt refunding ability would be eliminated.

#### Key Security Features

The security features of the 2017 Refunding Bonds remain very similar to those carried in the 2010 Bonds. The 2017 Water Refunding Bonds will be secured by and payable through a pledge of the City's Water System revenues. The 2017 Wastewater Refunding Bonds will be secured by and payable through a pledge of the City's Wastewater System revenues. These are the same pledges as with the 2010 Bonds.

Each of the 2010 Water Bonds and 2010 Wastewater Bonds were additionally secured by a debt service reserve equal to 50% of maximum annual debt service on the respective Bonds. Since their issuance, investors and rating agencies have placed less importance on reserve funds for utility revenue bonds. J.P. Morgan does not believe that the absence of a reserve fund will have an adverse effect on the marketing of the 2017 Refunding Bonds or the final interest rates. The existing reserve funds will be used to reduce the size of the 2017 Refunding Bonds, thereby increasing annual debt service savings.

To assure bondholders that the City will have adequate Net Revenues to pay annual debt service on the 2017 Refunding Bonds, the City will covenant to set Water System and Wastewater System rates so as to yield Net Revenues equal to at least 120% of annual debt service, and any parity obligations (e.g., the Clean Water State Revolving Fund Loan). These are the same rate covenants that pertain to the 2010 Bonds.

The City is permitted to issue additional bonds on a parity with the 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds (i.e., additional bonds that are paid on the same basis as the 2017 Refunding Bonds) subject to certain restrictions. The most important restriction is that at the

time of issuance of parity bonds, historical Net Revenues, with certain adjustments, must equal at least 120% of the aggregate maximum debt service on outstanding 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds, as the case may be, and the new proposed parity debt issue. These are the same additional parity debt provisions that pertain to the 2010 Water Bonds and 2010 Wastewater Bonds.

Under federal securities laws, the City is obligated to file annual reports with an electronic national repository selected by the Securities and Exchange Commission (the "S.E.C."), updating information on the Water System and Wastewater and other important relevant information relating to the 2017 Refunding Bonds.

#### Financing Team

Issuing bonds of any type requires the engagement of a specialized financing team to assist the City in both the analysis and sale of the bonds, as well as developing the complex legal documents required. Staff is recommending the following financing team, with the exception of the underwriter and verification agent is the same as used on the 2010 Bonds.

Bond Counsel and Disclosure: Jones Hall, A Professional Law Corporation  
San Francisco, CA

Municipal Advisor: Ross Financial  
San Francisco, CA

Underwriter: J.P. Morgan  
San Francisco, CA

Trustee/Escrow Agent: U.S. Bank National Association  
San Francisco, CA

Verification Agent: Causey, Demgen & Moore P.C.  
Denver, CO

#### Contracts

**Jones Hall.** Staff is recommending Council approval of a contract with the law firm of Jones Hall to serve as Bond and Disclosure Counsel in an amount not to exceed \$193,000 plus out-of-pocket expenses for Bond Counsel services for each of the 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds. Jones Hall's fee will be paid from the proceeds of each transaction and is contingent on its execution. Bond Counsel is responsible for drafting legal documents and ensuring that the 2017 Refunding Bonds are issued in compliance with all applicable state and federal laws. Bond Counsel will deliver an opinion that the 2017 Refunding Bonds are legally issued and that interest on the tax-exempt series of the 2017 Refunding Bonds is tax-exempt under Federal tax law. Disclosure Counsel is responsible for preparing the disclosure documents (the "Official Statements") for the 2017 Refunding Bonds. 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 2010 Bonds, the 2014 Note and other solid waste transactions, Certificates of Participation and Mello-Roos Bonds.

**Ross Financial.** Additionally, a contract in an amount not to exceed \$27,500, 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 Municipal Advisor for each of the 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds (a total of \$55,000 plus expenses). As with Bond Counsel services, this fee will be paid from the proceeds of the 2017 Refunding Bonds and is contingent upon its closing. The Municipal Advisor is responsible for working with the Underwriter in developing the bond structure, reviewing cash flow analyses, recommending the manner of sale, overseeing the rating agency process, assisting in the drafting of the Official Statement, 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 nearly 40 years' 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 2010 Bonds, as well as the 2014 Note and other solid waste transactions, Certificates of Participation and other City financings. The firm provides municipal advisory services for many prominent municipalities in California, including the City of San José, 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 (Caltrain).

**J.P. Morgan.** J.P. Morgan is a leading underwriter of municipal securities nationwide. It most recently was the purchaser of the City's 2014 Note. J.P. Morgan is ranked third nationally in 2017, with managed transactions that aggregate \$24.1 billion. The City will contract with J.P. Morgan to purchase the 2017 Water Refunding Bonds and 2017 Wastewater Refunding via separate Bond Purchase Agreements (described below). J.P. Morgan is compensated in the form of an underwriter's discount, representing the difference between the price at which it will sell the 2017 Refunding Bonds to the public and the price at which it will purchase the 2017 Refunding Bonds from the City. Under the Resolutions for each of the 2017 Refunding Bonds, the underwriter's discount may not exceed 0.50% of the par amount of the respective 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds.

#### Documents to be Approved by the City *Resolutions*

For each of the 2017 Water Refunding Bonds and 2017 Wastewater Refunding Bonds, staff is recommending that the City Council adopt a resolution, which authorizes the execution and delivery of the documents described below and approve related agreements and actions.

#### *The Indentures of Trust*

The 2017 Water Refunding Bonds will be issued under an Indenture of Trust, dated as of December 1, 2017, between the City and U.S. Bank National Association as Trustee. The 2017 Wastewater Refunding Bonds will be issued under an Indenture of Trust, dated as of December 1, 2017, between the City and U.S. Bank National Association as Trustee.

The indentures set forth the terms under which the 2017 Refunding Bonds are issued and their repayment provisions, establishes funds and accounts to be held by U.S. Bank, creates the pledge of Net Revenues and the other security features described above, contains covenants relating to maintaining the Water and Wastewater Systems, establishes procedures for the legal defeasance of

the bonds, and miscellaneous other provisions. The Indentures are similar in substance to the Indentures under which the 2010 Bonds were issued, except with respect to the debt service reserve fund. The attached Indentures are in substantially final form, with only final pricing details needing completion. Staff is requesting the Council approve the Indentures in this form, subject to the parameters in the Resolution.

### *Escrow Agreements*

The Escrow Deposit and Trust Agreements, dated as of December 1, 2017, are between U.S. Bank, as escrow agent (the “Escrow Agent”), and the City. Under these agreements, the City will direct that a portion of the 2017 Refunding Bonds be deposited in irrevocable refunding escrows held by the Escrow Agent. The Escrow Agent will apply those funds to pay debt service on the 2010 Bonds through the April 1, 2020 call dates, at which time the remaining 2010 Bonds will be called and redeemed. Because of this arrangement, the 2010 Bonds will be considered legally “defeased” at the time the 2017 Refunding Bonds are issued. The attached Escrow Agreements are in substantially final form, with only final reinvestment details needing completion. Staff is requesting the Council approve the Indentures in this form, subject to the parameters in the Resolution.

### *Bond Purchase Agreements*

The Bond Purchase Agreements, to be dated as of sale date for the 2017 Refunding Bonds, are between J.P. Morgan and the City. The Bond Purchase Agreements set forth the final interest rates on the respective 2017 Refunding Bonds and the terms under which J.P. Morgan will purchase such 2017 Refunding Bonds. The attached Bond Purchase Agreements are in substantially final form, with only final pricing details needing completion. Staff is requesting the Council approve the Indentures in this form, subject to the parameters in the Resolution.

### *Official Statements*

The 2017 Refunding Bonds will be marketed to potential investors by means of separate Official Statements. Each Official Statement contains information on the terms of the 2017 Refunding Bonds, the security and sources of repayment, the Water System and Wastewater System, as applicable, and Bond owner risks. Prior to the sale of the 2017 Refunding Bonds, the Official Statements will be distributed by J.P. Morgan in “Preliminary” form. Following the pricing of the 2017 Refunding Bonds and the inclusion of final pricing information, the Official Statements will become “Final”.

The Official Statement is viewed by the S.E.C. as the City’s document, and each Councilmember is legally responsible for its contents. Each Councilmember is charged with the responsibility of reading the Official Statements prior to their distribution by J.P. Morgan in the marketing of the 2017 Refunding Bonds.

The attached Official Statements are in substantially final form, with only final pricing details needing completion. Staff is requesting the City Council approve the Indentures in this form, subject to the parameters in the Resolution.

### **FISCAL IMPACT**

The 2017 Water Refunding Bonds will refinance the 2010 Water Bonds to their final maturity of April 1, 2040. Based on interest rates as of November 30, 2017, the 2017 Water Refunding Bonds will

create annual cash flow savings of approximately \$180,000, aggregate debt service savings of approximately \$4.1 million and net present value savings of approximately \$2.1 million.

The 2017 Wastewater Refunding Bonds will refinance the 2010 Wastewater Bonds to their final maturity of April 1, 2040. Based on interest rates as of November 30, 2017, the 2017 Wastewater Refunding Bonds will create annual cash flow savings of approximately \$250,000, aggregate debt service savings of approximately \$5.6 million and net present value savings of approximately \$2.8 million.

As these funds are for each utility, the savings benefit the ratepayers of each utility by reducing the annual debt service expense in each utility enterprise fund. The value of the savings to utility rates from the 2017 Refunding Bonds is approximately 0.3% annually for water rates and 0.6% annually for wastewater rates.

### **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. Approve two resolutions authorizing the advance refunding of the City's Water Revenue Bonds, Series 2010 and Wastewater Revenue Bonds, Series 2010, and approval of the Official Documents Related to the Transactions and find the actions exempt from environment review under the California Environmental Quality Act pursuant to Section 15378(b)(4) of the CEQA Guidelines.
2. Authorize the City Attorney to execute an Agreement, in substantially the same form as in Attachment 11, in an Amount of \$193,000 plus Incidental Expenses to Jones Hall, A Professional Law Corporation for Bond and Disclosure Counsel Services
3. Do not adopt the Resolutions and continue the current financing in place. If H.R. 1, or similar legislation is adopted, the City would need to wait until April 1, 2020 before it could conduct a current refunding of the 2010 Bonds on a tax-exempt basis and do not authorize the City Attorney to execute an Agreement with Jones Hall for Bond and Disclosure Counsel Services.

### **STAFF RECOMMENDATION**

Alternatives 1 and 2: 1) Approve two resolutions authorizing the advance refunding of the City's Water Revenue Bonds, Series 2010 and Wastewater Revenue Bonds, Series 2010, and approval of the Official Documents Related to the Transactions and find the actions exempt from environment review under the California Environmental Quality Act (CEQA) pursuant to Section 15378(b)(4) of the CEQA Guidelines; and 2) Authorize the City Attorney to execute an Agreement, in substantially the same form as Attachment 11 to the Report, in an Amount of \$193,000 plus Incidental Expenses to Jones Hall, A Professional Law Corporation for Bond and Disclosure Counsel Services.

Prepared by: Timothy J. Kirby, Director, Department of Finance

Reviewed by: Teri Silva, Interim Assistant City Manager

Approved by: Kent Steffens, Interim City Manager



**ATTACHMENTS**

1. Resolution Authorizing the Issuance and Sale of Water Refunding Bonds
2. Water Refunding Bonds Indenture of Trust
3. Water Refunding Bonds Escrow Deposit and Trust Agreement
4. Water Refunding Bonds Preliminary Official Statement
5. Water Refunding Bonds Bond Purchase Contract
6. Resolution Authorizing the Issuance and Sale of Wastewater Refunding Bonds
7. Wastewater Refunding Bonds Indenture of Trust
8. Wastewater Refunding Bonds Escrow Deposit and Trust Agreement
9. Wastewater Refunding Bonds Preliminary Official Statement
10. Wastewater Refunding Bonds Bond Purchase Contract
11. Legal Services Agreement with Jones Hall, A Professional Law Corporation