CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

COUNCIL AGENDA: 8/20/13
ITEM: 9.1

Memorandum

TO: HONORABLE MAYOR, CITY COUNCIL AND SUCCESSOR AGENCY BOARD

FROM: Julia H. Cooper

SUBJECT: **SEE BELOW**

DATE: July 29, 2013

Approved [signature] Date 8/5/13

SUBJECT: MERGED AREA REDEVELOPMENT PROJECT TAXABLE SUBORDINATE HOUSING SET-ASIDE TAX ALLOCATION VARIABLE RATE BONDS, SERIES 2010C – EXTENSION OF MANDATORY PURCHASE DATE

RECOMMENDATION

It is recommended that the Successor Agency to the Redevelopment Agency of the City of San José (the "Successor Agency"), adopt a resolution:

a. Authorizing, subject to the approval of the Oversight Board of the Successor Agency (the "Oversight Board") and review by the State Department of Finance ("DOF"), the execution and delivery, in substantially final form, of a First Supplement to Fiscal Agent Agreement between the Successor Agency and Wells Fargo Bank, National Association, as Fiscal Agent (the "Fiscal Agent") relating to the Redevelopment Agency of the City of San José Merged Area Redevelopment Project Taxable Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds, Series 2010C (the "2010C Bonds");

b. Authorizing, subject to the approval of the Oversight Board and review by DOF, the execution and delivery, in substantially final form, of an Amended and Restated Continuing Covenant Agreement with Wells Fargo Bank, National Association ("Wells Fargo" or "Bank Bondholder"), as initial bondholder of the 2010C Bonds; and

c. Authorizing the Executive Officer and Chief Financial Officer of the Successor Agency, or their designee, to take any actions and execute any and all documents necessary to complete this transaction.

OUTCOME

Approval of these recommendations will result in the extension of the mandatory purchase date for the 2010C Bonds to April 29, 2016, with Wells Fargo remaining as the Bank Bondholder. With the extension of the mandatory purchase date, debt service on the 2010C Bonds in Fiscal Year 2013-14 will be approximately \$5.45 million (\$2,740,000 of principal and approximately \$2.7 million of interest). Without the extension, \$83,590,000 of outstanding 2010C Bonds would become due on September 30, 2013, with interest accruing on the unpaid principal at 11% (approximately \$9.19 million per year). Failure to obtain an extension, then, would delay payment of enforceable obligations (other than senior housing and non-housing tax allocation bonds, junior lien non-housing tax allocation bonds) rather than continue an orderly repayment of such obligations – to the detriment of the other taxing entities in the County.

EXECUTIVE SUMMARY

Approval of the recommendations, subject to approval by the Oversight Board and the State Department of Finance, will allow for the extension of the mandatory purchase date on the Redevelopment Agency of the City of San Jose Merged Area Redevelopment Project Taxable Subordinate Housing Set-Aside Tax Allocation Variable Rate Bonds, Series 2010C. The interest rate on the 2010C Bonds will be fixed at a rate equal to three-year LIBOR plus a spread. The new mandatory purchase date will be April 29, 2016.

BACKGROUND

In July 2011, the State Legislature enacted, and the Governor signed ABX1 26, which, together with certain reformations by the Supreme Court, and additional amendments by the legislature in July 2012 by AB1484, is referred to herein as the "Dissolution Law". On January 24, 2012, the City of San José, pursuant to Resolution No. 76132, elected to become the Successor Agency to the Redevelopment Agency of the City of San José ("Successor Agency") as provided for in the Dissolution Law. On February 1, 2012, the Redevelopment Agency of the City of San José (the "Agency"), by operation of law, was dissolved, and the Successor Agency was established and began the process of winding down the affairs of the former Agency including the payment of enforceable obligations. The enforceable obligations include the 2010C Bonds.

Outlined below is the history of the indebtedness and agreements between Wells Fargo and the Agency. This chronology highlights the increasing complexity of managing a long-term bond issue where the bondholder's obligation to hold such bonds is limited to a period that does not extend to the final maturity.

- <u>April 2010</u> – The Agency issued the 2010C Bonds in an aggregate amount of \$93,000,000 as multimodal taxable subordinate variable rate bonds. The 2010C Bonds were issued under a Fiscal Agent Agreement (the "Fiscal Agent Agreement"), dated as of

April 1, 2010, between the Agency and Wells Fargo as Fiscal Agent (the "Fiscal Agent") and placed directly with Wells Fargo under the terms of the Continuing Covenant Agreement (the "CCA"), dated as of April 1, 2010, between the Agency and Wells Fargo as Bank Bondholder.

The 2010C Bonds financed or refinanced loans made by the City, acting through the Housing Department, in connection with affordable housing developments. The 2010C Bonds are secured by a subordinate pledge of 20% housing set-aside revenues ("Housing Set-Aside Revenues") after payment of debt service on the Agency's senior lien housing-set aside bonds (the "Senior Housing Set-Aside Bonds"). Interest is payable quarterly on February 1, May 1, August 1 and November 1 of each year, with mandatory sinking fund payments of principal due on August 1 of each year.

The 2010C Bonds, the Fiscal Agent Agreement and the CCA also contained the following provisions:

(1) The interest rate on the 2010C Bonds is an Index Rate reset on a monthly basis at a rate (the "Index Rate") equal to 1 month LIBOR plus an initial spread of 172 basis points (1.72%) (the "Applicable Spread"). The Applicable Spread is dependent upon the ratings of the Senior Housing Set-Aside Bonds by Moody's Investors Service ("Moody's") and Standard & Poor's ("S&P"), respectively. The Applicable Spread would increase: (a) to 220 basis points (2.20%) if either the Moody's or S&P rating declined to "A3" or "A-", as the case may be; and (b) to 280 basis points (2.80%) if either the Moody's or S&P rating declined to "Baa1" or "BBB+", respectively. A downgrade of the Moody's or S&P rating below "Baa1" or "BBB+", as the case may be, would create a Special Termination Event, which would allow Wells Fargo, at its discretion, to declare the principal of and accrued interest on the 2010C Bonds to be immediately due and payable. When the 2010C Bonds were issued, the ratings on the Senior Housing Set-Aside Bonds were "A1" from Moody's and "A2" from S&P.

(2) The 2010C Bonds contained a mandatory purchase date of April 29, 2013 on which date, Wells Fargo was entitled to tender the 2010C Bonds for repayment. Absent a remarketing or refunding, the Agency would be required to (a) assuming no default has occurred, repay Wells Fargo the outstanding principal over a three year period in twelve equal installments, with interest accruing at an increased rate (minimum of 8%) or (b) if a default has occurred, repay Wells Fargo the outstanding principal in full on the mandatory purchase date, with interest accruing on unpaid 2010C Bonds at a default rate of 11%.

(3) The consent of Wells Fargo was needed for Housing Set-Aside Revenues to be used for non-housing purposes.

Subsequent to the issuance of the 2010C Bonds, the following events occurred:

- April 18, 2011 – Moody's downgraded the rating of the Senior Housing-Set Aside Bonds from "A1" to A2" reflecting declines in debt service coverage from Housing Set-Aside Revenues due to lower assessed valuation in the Merged Area Project. The Moody's downgrade did not change the Applicable Spread.

- January 17, 2012 – Moody's downgraded the rating of the Senior Housing Set-Aside Bonds from "A2" to "A3" reflecting risks arising from the pending Dissolution Law. The Moody's downgrade resulted in an increase in the Applicable Spread from 172 basis points (1.72%) to 220 basis points (2.20%).

- June 2012 – Moody's downgraded the Senior Housing Set-Aside Bonds twice in June 2012. On June 8, 2012, Moody's downgraded the Senior Housing Set-Aside Bonds from "A3" to "Baa2" due to the uncertainty created by the County of Santa Clara's decision to withhold $20 million in former property tax increment pursuant to its interpretation of the Dissolution Law. On June 14, 2012, Moody's downgraded all California tax allocation bonds rated "Baa3" or higher to "Ba1", reflecting its increased uncertainty over the impacts of the Dissolution Law. The Moody's downgrades triggered a Special Termination Event under the CCA. Wells Fargo, pursuant to its discretion under the CCA and Fiscal Agent Agreement, did not declare the 2010C Bonds to be immediately due and payable, but increased the Applicable Spread from 220 basis points (2.20%) to 280 basis points (2.80%).

- August 15, 2012 – The Successor Agency and Wells Fargo entered into a Forbearance Agreement pursuant to which Wells Fargo agreed to forbear from exercising its rights and remedies under the CCA and Fiscal Agent Agreement, due to the Moody's downgrade, through November 15, 2012.

- November 15, 2012 – The Successor Agency and Wells Fargo entered into an Amendment to Forbearance Agreement pursuant to which Wells Fargo agreed to further forbear from exercising its rights and remedies under the CCA and Fiscal Agent Agreement, due to the Moody's downgrade, through April 29, 2013.

- April 29, 2013 – The Successor Agency and Wells Fargo entered into a Second Amendment to Forbearance Agreement pursuant to which Wells Fargo agreed to further forbear from exercising its rights under the CCA and Fiscal Agent Agreement, due to the Moody's downgrade, through July 29, 2013. Under an Extension of Mandatory Purchase Date, Wells Fargo agreed to extend the Mandatory Purchase Date for the 2010C Bonds from April 29, 2013 to July 29, 2013.

- June 27, 2013 – The Successor Agency and Wells Fargo entered into a Third Amendment to Forbearance Agreement pursuant to which Wells Fargo agreed to further forbear from exercising its rights under the CCA and Fiscal Agent Agreement, due to the Moody's downgrade, through September 30, 2013. Under a Second Extension of Mandatory Purchase Date, Wells Fargo agreed to extend the Mandatory Purchase Date for the 2010C Bonds from July 29, 2013 to September 30, 2013.

The extensions on April 29, 2013 and July 29, 2013, were interim measures that did not change any of the terms of the Fiscal Agent Agreement and CCA. Wells Fargo provided those extensions to allow sufficient time for Wells Fargo and the Successor Agency to negotiate the terms of a longer extension of the Mandatory Purchase Date to April 29, 2016.

Under the terms of the proposed extension, Wells Fargo has agreed to remain as Bank Bondholder through April 29, 2016. Interest would continue to be paid quarterly on February 1, May 1, August 1 and November 1. The principal amortization schedule for the 2010C Bonds would not change nor would the pledge under the Fiscal Agent Agreement change. The Index Rate would change from one-month LIBOR (reset monthly) to a fixed rate based on three-year LIBOR (currently 0.62%) plus an Applicable Spread of 260 basis points (2.60%) for an all-in rate of 3.22%, based on the current market.

To address certain new regulatory restrictions applicable to banks and to address concerns arising from the impacts of the Dissolution Law, Wells Fargo is requiring certain provisions to be included in (1) a supplement to the Fiscal Agent Agreement and (2) an amendment to the CCA. **None of these new provisions change the original pledge applicable to the 2010C Bonds.**

ANALYSIS

The analysis section of this report includes an overview of the Index Rate, overview of the modified bond documents, financing team participants and the financing schedule.

Overview of Interest Rate Mode

The 2010C Bonds were issued as multimodal bonds that were directly purchased by Wells Fargo as a private placement. The interest rate is reset monthly based on an Index Rate equal to one-month LIBOR plus the Applicable Spread. One-month LIBOR is currently 0.19% and the current Applicable Spread is 280 basis points (2.80%) – resulting in an all-in Index Rate of 2.99%.

The Index Rate based on one-month LIBOR currently is set to remain in effect until September 30, 2013, the current Mandatory Purchase Date for the 2010C Bonds. Upon the effective date of the extension[1] through April 29, 2016, the Index Rate for the 2010C Bonds will be a set interest rate equal to three-year LIBOR (currently 0.62%) plus a reduced Applicable Spread of 260 basis points (2.60%). Once fixed, the Index Rate will remain in effect until April 29, 2016, allowing the Successor Agency to benefit from the current low short-term market rate. In addition, a fixed

[1] Effective date may be sooner than September 30, 2013 if all approvals are received and documents are executed.

interest rate provides greater certainty and predictability for the purposes of budgeting and preparing subsequent ROPS.

Financial Analysis

The proposed supplements and amendments will preserve the structure of the 2010C Bonds and maximize the Successor Agency's ability to repay outstanding debt. The result of not entering into the proposed supplements and amendments would significantly increase the Successor Agency's liabilities under the 2010C Bonds, as explained below.

The proposed amendments will result in the Successor Agency's ability to maintain the 2010C Bonds as low interest rate obligations that amortize in accordance with the current redemption schedule. The amortization schedule is as follows:

Redemption Date (Aug. 1)	Principal Amount to be Redeemed	Redemption Date (Aug. 1)	Principal Amount to be Redeemed
2014	$2,740,000	2025	$4,630,000
2015	2,905,000	2026	4,910,000
2016	3,060,000	2027	5,210,000
2017	3,260,000	2028	4,205,000
2018	3,460,000	2029	4,385,000
2019	3,665,000	2030	3,745,000
2020	3,870,000	2031	3,970,000
2021	4,120,000	2032	4,205,000
2022	4,365,000	2033	2,750,000
2023	4,125,000	2034	2,920,000
2024	4,365,000	2035	2,725,000

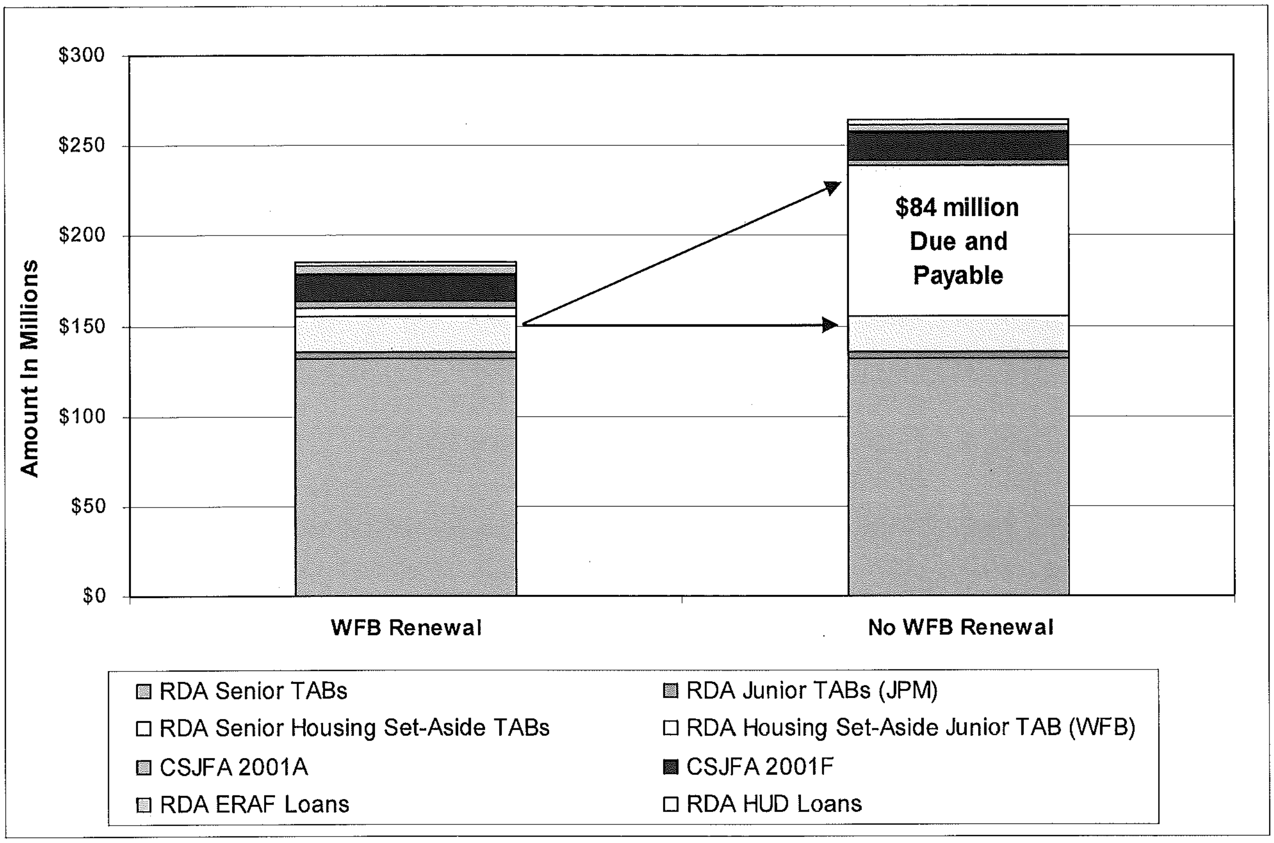
The failure to extend the Mandatory Purchase Date would result in all the outstanding 2010C Bonds ($83,590,000) becoming due and payable on September 30, 2013[2] with interest accruing on the unpaid principal balance at the default interest rate of 11% per annum (approximately $9.2 million per year)[3]. By contrast, with the extension, the Successor Agency would be obligated to pay only the scheduled principal due on August 1, 2014, ($2,740,000) and interest (approximately $2.7 million) on the outstanding 2010C Bonds at the Index Rate (approximately 3.22% following the extension).

The graph on the next page shows the effect on the Successor Agency's overall debt service on its tax increment bond obligations (including non-housing bonds) if the Mandatory Purchase Date is not extended to April 29, 2016. The graph illustrates that an acceleration of the

[2] This analysis presumes that Wells Fargo will require the repayment of the 2010C Bonds in full rather than accept payment in twelve equal quarterly installments. Under Section 2.1(b)(ii) of the CCA, the quarterly installment approach is available only if no "Default" has occurred. In its Forbearance Agreement (and amendments thereto), Wells Fargo terms the Moody's downgrade an "Existing Default."

[3] The default interest rates consists of the Base Rate (minimum of 8.00%) + 3%.

outstanding 2010C Bonds would delay payment of enforceable obligations (other than senior housing and non-housing tax allocation bonds, junior lien non-housing tax allocation bonds) rather than continue an orderly repayment of such obligations – to the detriment of the other taxing entities.



Modified Bond Documents

To implement the extension of the Mandatory Purchase Date to April 29, 2016, the Successor Agency needs to modify the existing 2010C Bond documents. Staff recommends that the Executive Officer and Chief Financial Officer of the Successor Agency, or their designees (the "Successor Agency Designated Officers"), be authorized to execute these documents as posted, subject to the approval of the Oversight Board and review by the DOF, with such modifications as the Successor Agency Designated Officers determine to be desirable or appropriate, upon consultation with the City Attorney/Successor Agency General Counsel.

The forms of the proposed Amended and Restated CCA and the First Supplement to Fiscal Agent Agreement will be posted to the agenda webpage for the Successor Agency Board Meeting on or about August 8, 2013.

First Supplement to Fiscal Agent Agreement – The First Supplement to Fiscal Agent Agreement, dated as of September 1, 2013 (the "First Supplement"), is between the Successor Agency and Wells Fargo Bank in its capacity as the Fiscal Agent. The First Supplement supplements the Fiscal Agent Agreement as follows:

(1) The Mandatory Purchase Date is extended to April 29, 2016.

(2) The Index Rate through April 29, 2016 will be a set interest rate (to be based on the three-year LIBOR rate) plus the Applicable Spread.

(3) The Applicable Spread will be an initial spread of 260 basis points (2.60%), subject to increase in the event of a downgrade in the rating of the Senior Housing Set-Aside Bonds by either Fitch Investors Service ("Fitch")[4] or S&P as follows:

   a. Downgrade to "A-": Applicable spread will increase by 25 basis points (to 2.85%)

   b. Downgrade to "BBB+": Applicable spread will increase by an additional 50 basis points (to 3.35%)

   c. Downgrade to "BBB": Applicable spread will increase by an additional 75 basis points (to 4.10%)

   d. Downgrade to "BBB-": Applicable spread will increase by an additional 145 basis points (to 5.55%)

   The Senior Housing Set-Aside Bonds are currently rated "A" by both Fitch and S&P.

(4) Early Breakage Fee – Because the rate on the Bonds, subject to adjustment as provided above, will be fixed to April 29, 2016, the First Supplement also contains a redemption breakage fee formula in the event the Successor Agency decides to redeem all or part of the 2010C Bonds prior to April 29, 2016. This formula will reimburse Wells Fargo for lost interest earnings in the event the 2010C Bonds are redeemed and Wells Fargo is not able to reinvest the prepaid amount at a rate similar to the rate being paid by the Successor Agency. This type of "make-whole" redemption breakage fee is common for taxable municipal bonds.

The First Supplement does not change any other provisions of the Fiscal Agent Agreement, including the pledge of Housing Set-Aside Amounts.

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[4] Because Moody's rates the Senior Housing Set-Aside Bonds as "Ba1", the requirement of a Moody's rating was dropped and replaced by Fitch.

Amended and Restated Continuing Covenant Agreement – The Amended and Restated CCA, dated as of September 1, 2013, is between Wells Fargo, as Bank Bondholder, and the Successor Agency. The Amended and Restated CCA sets forth the terms under which Wells Fargo will agree to remain as Bank Bondholder through the extended Mandatory Purchase Date. The Amended and Restated CCA includes the following modifications:

(1) The Successor Agency will no longer need Wells Fargo's consent to use excess tax revenues once annual debt service on the Senior Housing Set-Aside Bonds and 2010C Bonds has been paid or provided for.

(2) The "Base Rate", which is incorporated within the definition of Default Rate, will decrease from a minimum of 8% to a minimum of 7%. The Default Rate will remain 3% over the Base Rate. In the current market, the Default Rate would be 10% rather than 11%.

(3) The Successor Agency will become subject to revised and more extensive reporting requirements reflecting, in part, the procedures and restrictions imposed on the Successor Agency by the Dissolution Act.

(4) The Successor Agency will become obligated to reimburse Wells Fargo as Bank Bondholder for "increased costs" due to a change in law that, for example, increases the capital or liquidity reserves requirement imposed on Wells Fargo by banking regulators or results in new or higher taxes. Such "increased costs" provisions have become standard in most types of bank agreements since the adoption of the "Dodd-Frank Wall Street Reform and Consumer Protection Act" in 2010.

(5) The Successor Agency will become subject to restrictions on the incurrence of additional indebtedness of the Successor Agency.

(6) The Successor Agency will be required to waive any defense of sovereign immunity to any claim by Wells Fargo.

(7) Events of Default will include a ruling by the California Supreme Court or an Appeals Court in California that disallows a pledge similar to the pledge of subordinated Housing Set-Aside Amounts contained in the Fiscal Agent Agreement.

(8) The Successor Agency will be required to agree to judicial arbitration and waive its right to jury trial.

Financing Team Participants

The financing team participants consist of:

- Financial Advisor: Ross Financial
- Bond Counsel: Jones Hall, A Professional Law Corporation
- Fiscal Agent: Wells Fargo Bank, National Association

Financing Schedule

The key dates in the balance of the financing schedule are as follows:

Successor Agency Board Approval	August 20, 2013
Oversight Board Approval	August 22, 2013
Extension of Mandatory Purchase Date Takes Effect	No later than September 30, 2013

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the Successor Agency's approval of changes to financing documents relating to the 2010C Bonds and requires no follow-up to the Successor Agency Board.

The proposed documents will also require approval of the Oversight Board of the Successor Agency. As part of its approval, the Oversight Board will need to make findings that the proposed amendments will have the effect of reducing the Successor Agency's existing liabilities, which are in the best interests of the taxing entities in Santa Clara County.

The Oversight Board approval is further subject to review by the DOF.

PUBLIC OUTREACH

The form of the proposed modified documents will be posted to the agenda webpage for the Successor Agency Meeting on or about August 8, 2013.

☒ **Criterion 1**: Requires Successor Agency Board action on the use of public funds equal to $1,000,000 or greater.

☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.

☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.

COORDINATION

This report has been prepared by the City's Finance Department in coordination with the Successor Agency and the City Attorney's Office.

COST IMPLICATIONS

The implementation of the proposed supplemented and amended documents will require the payment of certain transaction costs. The table below estimates the costs to be incurred:

Bank Counsel	$ 50,000
Bond Counsel	50,000
Financial Advisor	30,000
Elabra	3,000
Fiscal Agent/Counsel	1,000
Contingency	10,000
Total	**$144,000**

These and other related costs do not appear on the current Recognized Obligation Payment Schedule ("ROPS") and will initially be funded by the Successor Agency from amounts representing housing assets that were transferred by the City to the Successor Agency. The final costs to be paid in connection with the proposed amended documents will be reflected in the 2013-14 A ROPS as part of a "true up" process. These costs must be paid in order to prepare and execute the necessary supplemented and amended documents.

CEQA

Not a Project, File No. PP10-066(e), Services that involve no physical changes to the environment.

/s/
JULIA H. COOPER
Chief Financial Officer

For questions, please contact Arn Andrews, Assistant Director of Finance, at 408-535-7041.