Request for City Council Committee Action From the Finance Department

Date: October 17, 2011
To: Council Member Betsy Hodges, Chair, Ways & Mean/Budget Committee
Referral to: Board of Estimate & Taxation

Subject: Modifications to City's currently outstanding variable rate general obligation debt, including replacement of Dexia Credit Local as the City's Liquidity Provider.

Recommendation: The Finance Department recommends the following actions to modify the structure and characteristics of the City's outstanding general obligation debt currently in variable rate mode ($129,225,000 as of 12/1), including replacing Dexia Credit Local (Dexia) as the liquidity provider:

1. Authorize early redemption of $129,225,000 of variable rate bonds on December 1, 2011 or as soon as the following actions can be executed.
   a. Authorize the Chief Financial Officer to prepay $2,975,000 of variable rate bonds on December 1, 2011 with resources on hand in debt service funds.
   b. Request the Board of Estimate and Taxation to issue $81,500,000 of fixed rate General Obligation Refunding bonds to redeem a like amount of variable rate bonds.
   c. Authorize the Chief Financial Officer to enter into a competitive process to replace the remaining $44,750,000 variable rate general obligation debt with a Direct Purchase Loan Agreement with a local bank and enter into a contract with the provider.
2. Authorize the Chief Financial Officer to enter into early termination agreements with Dexia for all currently outstanding Standby Bond Purchase Agreements (SBPA) as bond redemptions are executed and replacement provider contract is executed.

Previous Actions:
7/7/2003 Substitution of Liquidity Providers – replacing HypoVereinsbank with Dexia.

10/17/2005 Extended Dexia SBPA terms to October 31, 2012.

Prepared/Submitted by Michael Abeln, Director, Capital & Debt Management, 673-3496

Approved by: Kevin Carpenter, Chief Financial Officer ____________________

Steven Bosacker, City Coordinator ____________________

Presenters in Committee: Michael Abeln, Director, Capital & Debt Management

Financial Impacts:

- Action will redeem all outstanding variable rate bonds from eight bond series totaling $129,225,000 (as of 12/1) and result in termination of all SBPA's with Dexia.
- Action will reduce variable rate debt exposure by $84,475,000 and keep $44,750,000 in variable rate mode.
- $44,750,000 in debt remaining in variable rate mode.
- Action requires a technical appropriation increase to the 2011 Operating Budget to redeem variable rate bonds not previously budgeted in 2011:
  Dept Name: 1100100 Debt Service Bonds and Interest
  Account: 851001 Bond Principal
  Fund Name: 05900 Tax Increment Debt Service Fund by $5,820,000
  Fund Name: 07500 Municipal Parking Enterprise Fund by $39,580,000
  Fund Name: 05280 Library Referendum Debt Service Fund by $44,225,000
  Fund Name: 05300 Convention Center Debt Service Fund by $39,300,000
  Fund Name: 05F00 06/93 Improvement Bond Debt Service Fund by $300,000
- Request provided to the Finance Department.

Background:

In light of the historically low fixed interest rates, the Finance Department has been analyzing risks and opportunities in our debt portfolio and has determined that converting a portion of our variable rate debt to fixed rate debt would be prudent at this time, as it enables the City to lock-in interest costs at low levels and mitigate future interest rate uncertainty.

The City's current variable rate bonds are backed by Standby Bond Purchase Agreements (SBPAs) with Dexia which expire on October 31, 2012. Dexia is experiencing financial stress due to exposure to Greece and other European nations and has been downgraded by the credit rating agencies. The credit rating and financial situation of Dexia as the provider of the City's SBPAs directly affects the City's interest costs, as the variable rate paid is a market rate based largely on the market's assessment of the credit profile of the liquidity provider. To reduce our interest rate costs, Finance is recommending actions to terminate our existing agreements with Dexia as soon as practicable. The recommended solution to replace Dexia involves taking three actions to redeem all currently outstanding variable rate debt totaling $129,620,000 on December 1, 2011 or as soon as the recommended funding actions can be executed.

The first action is to prepay $2,975,000 of bonds using available excess resources in debt service funds resulting from interest savings realized in 2011 in addition to payment of the sinking fund payments already authorized and due December 1 of $395,000.

The second action involves converting $81,500,000 of variable rate bonds to fixed rate refunding bonds. This will be accomplished by selling fixed rate bonds on or about November 8, 2011 and using the proceeds to redeem a like amount of the 1999 and 2000 Convention Center and 2003 Library Referendum variable rate bond series on December 1, 2011. In addition to reducing interest rate risk, locking in fixed rates for these business functions allows for improved and more stable long-term financial plans versus allowing for the possibility of 5% interest on variable rate bonds, as is our current practice for debt management purposes. (To minimize costs of issuance, Finance intends to sell these fixed rate refunding bonds at the same time as the new $8,495,000 General Obligation Improvement Bonds, Series 2011).

The third action of the replacement strategy is to enter into a new bond financing agreement with a bank called a Direct Purchase Loan Agreement (DPLA) for $44,750,000. This amount will be used to redeem five series of variable rate bonds associated with various parking ramps and a portion of Block E financing. Unlike the City's existing variable rate debt structure (which uses a bank as a liquidity backup or buyer of last resort) if bonds cannot be successfully remarketed to the investing public, this arrangement functions as a direct tax exempt loan with a bank allowing the City to continue paying variable interest rates without either remarketing or bank credit risk. Under a DPLA, the interest rates are reset based on a published short-term tax exempt rate index plus an agreed upon spread. One significant advantage of the DPLA arrangement over an SBPA is that the City is not exposed to higher interest costs upon a credit downgrade of the provider bank. In addition, as the interest rate spread to the index is determined at the time of the agreement, there is no bond remarketing risk with a DPLA agreement.

DPLA arrangements have become a standard tool for municipal and other governmental units seeking to address dislocation in the variable rate market due to underlying credit issues with banks and liquidity providers.

To establish the DPLA arrangement, the Finance Department will conduct a competitive process with local banks. The Finance Department is recommending local banks due to the financial strength and quality of these banks and to build excellent banking relationships with current providers of other banking services. The department will work with the City Attorney and bond counsel to execute the agreement with the selected provider(s).

In summary, the Finance Department recommends passage of the attached resolutions to reduce the City's variable rate exposure and to replace our current liquidity provider Dexia as summarized below:

1. Authorize technical appropriation increases to redeem all variable rate bonds on December 1, 2011 using resources provided by the following sources:
   a) Resources on hand in debt service funds of $2,975,000
   b) Proceeds from the sale of refunding bonds of $81,500,000
   c) Proceeds of a new Direct Purchase Loan Agreement of $44,750,000

2. Request the Board of Estimate and Taxation to issue and sell $81,500,000 of fixed rate refunding bonds to redeem a like amount of variable rate bonds on December 1, 2011.

3. Authorize the Chief Financial Officer to conduct a competitive process and enter into a Direct Purchase Loan Agreement with one or more local banks to replace liquidity facilities with Dexia on $44,750,000 of existing variable rate bonds.

4. Authorize the Chief Financial Officer to enter into final termination agreements with Dexia for all outstanding SBPA's as soon as redemption actions can be completed and replacement agreements (where applicable) are executed.