COUNTY OF SAN MATEO
Inter-Departmental Correspondence

County Manager's Office

DATE: July 21, 2003

BOARD MEETING DATE: August 5, 2003

TO: Honorable Board of Supervisors

FROM: Paul Scannell, Assistant County Manager Paul Scannell

SUBJECT: Resolution Authorizing the Issuance of Up to $170 million of 2003 Lease Revenue Bonds for the San Mateo County Youth Services Center through the County of San Mateo Joint Powers Financing Authority

RECOMMENDATION:

Adopt a Resolution authorizing the issuance by the San Mateo County Joint Powers Financing Authority of not to exceed $170 million aggregate principal amount of Lease Revenue Bonds (Youth Services Campus), Series 2003 and related swap; authorizing the forms of and directing the execution and delivery of a site lease, a facility lease, a bond purchase contract, a continuing disclosure agreement and an official statement; authorizing a lease financing with the San Mateo County Joint Powers Financing Authority; and approving the taking of all necessary actions in connection therewith.

BACKGROUND:

On July 30, 2002, the Board of Supervisors passed a resolution declaring the County's official intent to reimburse itself for the pre-design and design costs of the Youth Services Center (the "Project") through the issuance of lease revenue bonds in 2003. On October 22, 2002, the Board authorized the agreement with Turner Construction for architectural services and construction management. The Master Plan was presented to the Board of Supervisors in December 2002. The State Board of Corrections awarded the County a Federal grant of $21.1 million to assist in the construction of the Juvenile Hall portion of the project. With Schematic Design now complete and final design underway, the final estimated Project cost is $125 million and the bond amount has proportionately risen to an estimated $161.6 million. An $8.4 million contingency has been added to this estimate to allow County staff and its advisors to conduct negotiations with the bond insurers regarding the business terms of the financing (i.e. size of the debt service reserve fund and number of months of capitalized interest) as well as to adjust the financing to reflect the actual borrowing cost and investment rate earned on the borrowed funds when the bonds are sold.

In 2002, County retained Orrick, Herrington & Sutcliffe to act as Bond Counsel, California Financial Services to serve as financial advisor and, in late 2002, through a RFP process the County retained Salomon Smith Barney (now Citigroup) to act as underwriter. A second RFP for co-managers was conducted and Lehman Brothers was selected in July 2003. The financing team will also include U.S. Bank Trust, the County's current trustee for all outstanding financings and Sidley Austin Brown Wood as counsel to the underwriters. An insurance company will be selected through the RFP process to guarantee the County's bonds. The County has solicited bids from AMBAC, MBIA and FSA and expects to award a bid in the first week of August based on the best combination of insurance, cost and business terms.

Approval of the bonds is subject to the approval of the San Mateo County Joint Powers Financing Authority (JPA) following approval by the Board of Supervisors. In past financings, the JPA approved the financing first. Due to a change in State law, the JPA must now act after the Board of Supervisors.

DISCUSSION:

The County is planning a projected $162 million lease revenue bond based on current project estimates, conservative assumptions and current market conditions. The $125 million in project expenses includes the $21 million in federal grant funds that will be financed by the bonds and later reimbursed through the State. The grant is only reimbursable based on completion of the Project. The grant funds will be used to prepay a portion of the bonds upon completion of the Project. Including the grant amount in the bond issuance allows the County to make an investment profit on the grants funds of approximately $500,000 while conservatively budgeting for contingencies and reimbursement delays. The total bond provides $19.6 million in capitalized interest to pay investors interest payments through Project completion in November 2006 (six months beyond the anticipated Project completion) based on an assumed rate of 7.0% for the adjustable rate bonds (see below). A third or more ($6.5 million) of the capitalized interest should be available to prepay bonds upon completion of the Project. A mandatory debt service reserve fund in the amount of $16.1 million (which remains the County's asset until used to make the final payment in 2036) is also included in the financing. The costs of issuance in the amount of $1.6 million (underwriter, bond counsel, disclosure counsel, financial advisor, rating agencies, financial printer, title insurance, etc) and bond insurance in the amount of $1.3 million (to reduce interest cost through the use of a AAA/Aaa credit rating) are the final components of the $162 million bond issuance.

The bonds are anticipated to be sold in August 2003 and funds should be available by early September. The bonds will be sold as Adjustable Rate Securities (ARS) with interest rates being set each week by Citigroup and Lehman Brothers as co-remarketing agents. Current weekly rates are approximately 1.0%, a historic low. The twelve-year historical weekly rate has been approximately 4.125%. As a comparison current fixed rate lease revenue bonds would bear an interest of approximately 4.50%. The County last issued adjustable rate securities in 1985 and retired them in 1998. *The County has no outstanding adjustable rate debt at this* time. The rating agencies are comfortable with approximately 25% of County indebtedness as adjustable debt. The amount of bonds for the Project would not exceed that 25% guideline.

The 2003 Lease Revenue Bonds will be issued as adjustable rate bonds, but the County will limit its exposure to rate fluctuations by entering into an immediate swap agreement with Citigroup and Lehman Brothers that will provide the County with a source of funds to pay its variable rate debt that will mirror the County's varying rate. The County will pay a fixed rate of approximately 3.70% to the banks in exchange for a variable rate payment to be received as income by the County from the bank equal to 68% of a commonly used international taxable interest index, LIBOR. The County will use this income from the swap to pay its adjustable rate bonds. The LIBOR index approximates the fluctuations of municipal adjustable rate bonds and should move in tandem with the County's bond payments. During some periods, especially when interest rates are low (such as today), 68% of LIBOR will leave the County with a small payment of approximately .20% which, when added to the swap rate of 3.70%, would leave the County with a combined interest rate of 3.90%. In most cases the 68% of LIBOR index will produce enough income to pay the adjustable rate debt service and provide a surplus over payments on the adjustable rate bonds. Even the 3.90% rate that includes an additional payment on top of the LIBOR index is significantly better than today's fixed rate of 4.50% and provides the County with nearly $11.5 million in 2003 dollar savings or 7% savings over traditional fixed rate bonds. The swap exposes the County to a minor amount of interest rate fluctuations over fixed rate bonds but well less than ordinary adjustable rate bonds. The risk of fluctuating payments will be mitigated by designating a portion of the debt service reserve fund as available to make payments if necessary. This risk is acceptable in light of the likely rewards.

VISION ALIGNMENT:

The issuance of Lease Revenue Bonds for the San Mateo County Youth Services Center keeps the commitment of ensuring basic health and safety for all and goal numbers 7 and 8: Maintain and enhance the public safety of all residents and visitors and help vulnerable people – the aged, disabled, mentally ill, at-risk youth and others – achieve a better quality of life. It also keeps the commitment of responsive, effective and collaborative government and goal number 20: Government decisions are based on careful consideration of future impact, rather than temporary relief or immediate gain.

FISCAL IMPACT:

All payments on the Lease Revenue Bonds will be from bond funds until Project completion, November 2006. Annual payments are projected to be $9 million. Assuming that the federal grant of $21 million is used to prepay bonds in 2006, annual bond payments would be reduced to $7,775,000 per year. Assuming that $6.5 million of capitalized interest is not required (due to assuming a 7% interest rate, as required by insurers), debt service on the bonds would be further reduced to $7,400,000 annually. These funds would be payable from the County's General Fund, Proposition 172, Courthouse Construction Fund (new Courtrooms), Facilities Surcharge, Federal/State reimbursement for allowable Human Services Agency (new Receiving Home) and County Reserves. Swap profits and losses may cause some fluctuation in the actual annual payments but should, nonetheless, produce a lower cost of debt service than fixed rate bonds.