



CITY OF SANTA BARBARA CITY COUNCIL AGENDA REPORT

AGENDA DATE: March 12, 2013

TO: Mayor and Councilmembers

FROM: Administration Division, Finance Department
Water Resources Division, Public Works Department
City Attorney's Office

SUBJECT: Professional Services Agreements – Financial Advisory Services And
Bond Counsel And Disclosure Services

RECOMMENDATION: That Council:

- A. Authorize the City Attorney to execute an agreement with Orrick, Herrington & Sutcliff, LLP, for Bond and Disclosure Counsel services in an amount not exceed \$267,750 for the potential sale of Certificates of Participation (COPs) by the Water Fund, Wastewater Fund and Waterfront Fund to refinance existing debt and finance new capital projects, with the cost of the services payable from COP proceeds at such time as the COPs are issued; and
- B. Authorize the Finance Director to execute, subject to City Attorney review as to form, an agreement with KNN Public Finance for financial advisory services in an amount not to exceed \$75,000 for the initial sale of COPs and \$60,000 for each additional COP transaction, for a maximum not to exceed \$195,000, payable from COP proceeds if, and at such time as, the COPs are issued.

DISCUSSION:

Over the next year, City staff will be evaluating the feasibility of issuing certificates of participation (COPs) in the Water Fund, Wastewater Fund and Waterfront Fund. COPs are a type of debt similar to bonds, which, like bonds, are sold to finance capital projects or to refinance existing long-term indebtedness. In the case of the Water and Waterfront Funds, the purpose of such COPs would be to refinance existing long-term indebtedness primarily to capitalize on historically low interest rates. In the case of the Wastewater Fund, the purpose is twofold: first, to refinance existing debt; and second, to provide financing for a large capital improvement project at El Estero Treatment Plant.

The first potential COP City staff will be evaluating is for the Water Fund. Staff from the Public Works, City Attorney and Finance Departments have completed a preliminary analysis and it appears that the City could reduce its overall annual debt service costs. Additionally, the refinancing of existing debt will eliminate confusing and conflicting covenants among all outstanding debt, which will facilitate the sale of future debt.

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The Water Fund currently has five outstanding debt obligations, which include the 2002 Refunding Certificates of Participation, the 1994 Refunding Revenue Bonds and three separate loans from the State Department of Water Resources (DWR) through its revolving loan program.

In total, the Water Fund has \$79.4 million in outstanding long-term debt. It is unlikely that the most recent loan of \$29 million from the DWR will be included in the refinancing and the 1994 bonds may be cash refinanced from existing reserves rather than new bonds. As such, a total of \$48.3 million in debt would likely be included within the potential debt refinancing.

Whether staff ultimately recommends moving forward with debt refinancing in the Water Fund is dependent on what savings in debt service costs will actually be realized. The calculation of savings is impacted by the interest rate on the refunding COPs and to what extent they may rise as we move closer to the actual sale; and the costs to sell the COPs (i.e., legal and financial advisory costs, rating agency and underwriting costs that might be paid). With the exception of rating agency costs, all costs are payable solely from bond proceeds, and only if the COPs are actually sold; therefore, only minimal costs will be incurred up front and there is no commitment to incur other costs until these factors have been appropriately analyzed and the COPs are actually sold.

Based on the work done to date, staff is at a point where bond/disclosure counsel and a financial advisor should be retained to assist City staff with the analysis, gathering of appropriate documentation and preparation of the necessary documents for a potential sale. A description of the firms, their respective scope of services and related fees are provided below.

Financial Advisory Services

The City historically has used financial advisors with the issuance of long-term debt. For example, with the recent sale of Airport Certificates of Participation, the City used a financial advisor. For a number of years, the City has retained the services of KNN Public Finance for financial advisory services. KNN is a highly qualified firm with extensive knowledge of the City's operations and past bond sales. Staff believes this expertise and knowledge of the City is important to ensure any bond sale is based on a thorough understanding of the City's needs and the bond market.

In general, the role of a financial advisor is to serve as an independent advocate for the seller of bonds or other indebtedness and provide the seller with the information necessary to make intelligent, informed decisions. The sale of bonds is a highly specialized, complicated and nuanced transaction, requiring a level of expertise not generally held by municipal finance professionals within the City. Specifically, the financial advisor helps

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structure the financing to get the best rate for the City, reviews and give advice on the bond underwriter's proposals in a negotiated bond sale and reviews documents from bond counsel and disclosure counsel, and coordinates the bond issuance closing process. For a competitive sale of the bonds, the financial advisor structures the bond issue, conducts a public sale, identifies the winning bidder and coordinates the bond issuance closing process.

While staff is currently seeking financial advisory services in connection with the sale of refinanced Water COPs, the issuance of other COPs will be evaluated within the year. Therefore, the scope of services described below encompasses the full range of services that may be provided to the City.

The scope of KNN's service will include, but not be limited to, the following:

1. In conjunction with the Underwriter, as appropriate, City and the Rate Consultant develop a financing plan to meet the City's construction time line for new capital projects, capital plan, any additional covenants and projected cash flow needs.
2. Assist in the selection of other financing team members, such as underwriter, bond counsel, verification agent, trustee and Rate Consultant, as necessary.
3. Coordinate the efforts the underwriter, if any, city staff, bond and disclosure counsel, Rate Consultant, City Attorney, and City elected officials, with respect to the preparation and approval of the financing documents by the City Council.
4. In conjunction with the underwriter, if any, and bond counsel, recommend specific financial covenants, terms and provisions, including maturity schedules, timing of sale, call provisions and related matters.
5. Review and provide appropriate revisions and recommendations to legal documents, Rate Consultant report, the official statement and other documents.
6. Prepare and coordinate the appropriate presentation to the rating services and bond insurer.
7. Coordinate the sale and closing of the transactions.

KNN's fee for an initial bond sale is \$75,000. Their fees would be reduced to \$60,000 for any subsequent bond sale within 9 months of the closing of the first sale.

Bond and Disclosure Counsel Services

Staff recommends retaining Orrick, Herrington & Sutcliff, LLP (OH&S) for both bond counsel and disclosure counsel. OH&S has assisted the City with a number of bond sales over the years. They have a strong knowledge of City operations and have tremendous experience in the area of bond sales and public finance.

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As Bond Counsel, OH&S will provide the legal opinion delivered with the bonds confirming that the bonds are valid and binding obligations of the City and, customarily, that interest on the bonds is exempt from federal and state income taxes. For each bond the City sells, OH&S will provide the following services:

1. Consultation with representatives of the City, the underwriter and/or the financial advisor, consultants and others concerning the financing, its timing, terms and structure. Such consultation will include considerations of the California law, federal tax law and municipal bond law as they affect the proposed financing.
2. Preparation of legal proceedings for the authorization, sale and issuance of the Certificates of Participation; preparation of the proceedings for the execution, delivery and sale of the COPs and advice to the City concerning the terms thereof; preparation of other proceedings (including closing papers) required in connection with the issuance of the COPs. All legal proceedings for action by the City necessary for the execution and delivery of the COPs will be prepared by Bond Counsel and will be subject to the approval of the City Attorney.
3. The rendering of a final legal opinion on the validity of the COPs and exclusion from gross income for federal tax purposes of interest payable on the COPs.

As Disclosure Counsel, OH&S will advise the City with respect to compliance with federal and state securities laws in the course of the debt issuance process. Specifically, OH&S will provide the following services:

1. With the assistance of the City Attorney's Office and staff of the City, prepare disclosure documents including the Official Statement which shall contain disclosures relating to the City, the underlying funds and the COPs.
2. Examine the proceedings, participate in any conference calls, and attend all due diligence meetings of the financing teams and the City Council relating to the drafting and approval of the Official Statement.
3. Issue a "10b-5 opinion" in the Firm's customary form addressed to the City.

Fees for both bond counsel and disclosure counsel services will not exceed \$85,000, for the Water refinance, \$85,000 for the Waterfront refinance and \$97,750 for the Wastewater issuance, which could include refinancing of the existing debt and issuance of new debt.

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Finance Committee Review

On March 5, 2013, the Finance Committee heard a report from staff on the proposed hiring of consultants to assist staff in the potential sale of bonds. The Finance Committee unanimously to recommend Council's approval of the proposed agreements.

SUBMITTED BY: Robert Samario, Finance Director
Sarah J. Knecht, Assistant City Attorney

APPROVED BY: City Administrator's Office



CITY OF SANTA BARBARA



Professional Services Agreements Related to Potential Issuance of Bonds

March 12, 2013



PRESENTATION OUTLINE

- ◆ Background
- ◆ Proposed Hiring of Professionals
 - Financial Advisor
 - Bond Counsel
 - Disclosure Counsel
- ◆ Recommended Consultants and Fees
- ◆ Key Steps in Bond Sales



Background

BACKGROUND

- ◆ Anticipate issuing refinancing Certificates of Participation (COPs) for the Water Fund to refinance existing debt:
 - 2002 Refunding COPs - \$10.6 million
- ◆ Will also consider refinancing State loans
 - 2002 State Revolving Loan - \$12.2 million
 - 2003 State Revolving Loan - \$15.1 million
- ◆ Capitalize on current low interest rates
 - Total savings estimated at ~\$1.6 over remaining term of 2002 COPs

BACKGROUND – Cont'd

- ◆ Other COP's may be issued within the year
 - Wastewater Fund
 - Funding needed for major capital improvements to El Estero Plant to replace aging infrastructure
 - ◆ Waterfront Fund
 - Refinance existing debt to lower annual debt service costs
 - 2002 Refunding COPs - \$13.9 million
 - 2008 State Dept of Boating and Waterways Loan - \$3.1 million



Proposed Hiring of Professionals

HIRING OF PROFESSIONALS

Timing

- ◆ Issuance of new refinancing COPs for Water Fund is highly likely
 - Market conditions are right
 - Fair amount of savings can be realized
- ◆ At a point when we need to formally hire consultants
 - Consultants needed to execute transaction
 - Services provided cannot be completed in-house
- ◆ Three distinct services needed
 - Financial Advisor
 - Bond Counsel
 - Disclosure Counsel

HIRING OF PROFESSIONALS

Role of Financial Advisor

- ◆ Independent expert advising, guiding and assisting the City through the bond financing process
- ◆ Benefits of Using a Financial Advisor
 - FA may help identify a refunding opportunity
 - FA helps guide us through the process
 - FA helps ensure we get a good price (the underwriter does not have a fiduciary responsibility to the issuer)

HIRING OF PROFESSIONALS

Role of Financial Advisor

◆ Key Services

- Recommend a financing structure
- Be the primary spokesperson on behalf of the issuer with the credit rating agencies
- Recommend the timing of sale of the bonds (e.g., Airport COPs)
- Conducts the competitive sale of bonds
- Assist bond counsel in organizing the closing

HIRING OF PROFESSIONALS

Role of Bond Counsel

- ◆ Two primary roles:
 - Gives the legal opinion delivered with the bonds that the bonds are valid and binding obligations of the issuer (i.e., the City)
 - Gives legal opinion that the bonds are exempt from federal and state income taxes

HIRING OF PROFESSIONALS

Role of Disclosure Counsel

- ◆ Prepares the following documents:
 - Draft Official Statement
 - Official Notice of Sale
- ◆ Issues “10b-5” Letter
 - For the benefit of prospective investors
 - Limited assurance that information contained in Official Statement is not inaccurate, misleading, etc. (ultimately, accuracy is the responsibility of the City).



Recommended Consultants and Fees For Services

RECOMMENDED CONSULTANTS

Financial Advisor

- ◆ KNN Public Finance (Oakland, CA)
- ◆ Have assisted the City with other COPs/bonds
 - Most recently the sale of the Airport COPs
- ◆ Fees:
 - \$75,000 for first deal (vs. \$115,000 for Airport COPs)
 - \$60,000 each for next two deals
 - Fees payable from proceeds and only if bonds/COPs are sold
 - Fees factored into overall savings calculations

RECOMMENDED CONSULTANTS

Bond and Disclosure Counsel

- ◆ Orrick, Herrington & Sutcliff, LLP (Los Angeles)
- ◆ Also knowledgeable of City's finances and operations
- ◆ Fees:
 - \$85,000 each for the Water and Waterfront COPs
 - Fees comparable to previous deals
 - \$97,500 for the Wastewater COP because of the extra complexity
 - New Money + Refinancing

KEY STEPS IN BOND SALE

- ◆ Drafting of documents
 - Official statement, trust agreement, installment sale agreement, etc.
- ◆ Staff secures ratings (e.g., Moody's & S&P)
- ◆ City Council adopts authorizing resolutions to issue COPs
- ◆ City goes into the marketplace to price and sell the bonds (Coordinated by Financial Advisor)
 - Awarded to lowest bidder based on “total interest cost” (TIC)
 - Requires calculations by FA
 - Bidders will consist of large investment bank, who will sell to investors
- ◆ The bond issue is closed (estimated May 2013)



QUESTIONS?