



Executive Director's
Report to the
Board of Harbor Commissioners

DATE: JULY 2, 2014

FROM: DEBT & TREASURY MANANGEMENT

SUBJECT: RESOLUTION NO. _____ AUTHORIZING THE BOARD OF HARBOR COMMISSIONERS TO APPROVE THE ISSUANCE OF UP TO \$200 MILLION OF CITY OF LOS ANGELES HARBOR DEPARTMENT REVENUE BONDS, AND UP TO \$198 MILLION OF CITY OF LOS ANGELES HARBOR DEPARTMENT REFUNDING REVENUE BONDS

SUMMARY:

This proposed Resolution authorizes the Board to: (1) issue up to \$200 million of City of Los Angeles Harbor Department (Harbor Department) Revenue Bonds (Revenue Bonds), the proceeds from which will be used to finance the design, planning, constructing and/or equipping of Harbor Department related Capital Improvement Program (CIP) projects and the acquisition of capital assets, and (2) issue Refunding Revenue Bonds in order to refund all or portions of the \$73.6 million Harbor Department's 2006 Series D Bonds (Refunded Bonds) as well as \$100 million of outstanding Commercial Paper (CP) notes that are not subject to the alternative minimum tax (non-AMT).

RECOMMENDATION:

It is recommended that the Board of Harbor Commissioners:

1. Authorize the issuance of the City of Los Angeles Harbor Department Revenue Bonds, in one or more series, through negotiated sale, in a combined principal amount of up to \$200 million;
2. Authorize the refunding of all or portions of the Harbor Department's outstanding \$73.6 million 2006 D Revenue Bonds with the proceeds of the Refunding Revenue Bonds, subject to the parameters set forth in this Resolution;
3. Authorize the refunding of all of the Harbor Department's outstanding \$100 million of non-AMT Commercial Paper notes with the proceeds of the CP Refunding Revenue Bonds, subject to the parameters set forth in this Resolution;
4. Find that the Harbor Department advertised on June 26, 2014 and held a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing by Department staff at 8 AM on July 10, 2014. Pursuant to Section 147(f) of the Internal Revenue Code of 1986, there

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must be a Public Hearing for the financing or refinancing of Capital Improvement Program (CIP) projects with proceeds from the sale of tax-exempt obligations;

5. Appoint the team of underwriting firms, as identified herein from the authorized and Board approved pool of underwriters, for the negotiated sale of the 2014 Revenue Bonds, and Refunding Revenue Bonds;
6. Approve the principal financing documents related to the transaction which include the Indenture of Trust, Continuing Disclosure Certificate, Purchase Agreement, and the Preliminary Official Statement;
7. Ratify actions taken by officers, employees, and agents of the Harbor Department prior to the date the Resolution becomes final, including but not limited to the publication of the Notice of Intention to Sell, and printing and distribution of the Preliminary Official Statement, consistent with the Board action;
8. Adopt Resolution No. _____; and
9. Direct the Board Secretary, pursuant to Charter Section 609 and the Bond Procedural Ordinance (LAAC Sections 11.28.1 through 11.28.9) to certify that the Board has adopted the Resolution and, on behalf of the Board, immediately transmit for further processing certified copies of the Resolution and copies of the Board item and all related documents to the Mayor, to the City Administrative Officer, and to the City Council.

DISCUSSION:

Background and Context – Section 609 of the City of Los Angeles Charter (Charter) and (Section 609) and the Charter implementation ordinance (Procedural Ordinance) gives the Harbor Department the power to borrow money, to issue bonds, and to refund bonds, notes and other evidences of indebtedness for any purpose relating to the Harbor Department payable from its operating account, the Harbor Revenue Fund, in the form and manner approved by the Board.

Current Market Environment – The Harbor Department is seeking to issue securities into a favorable financing environment offering a combination of strong investor demand and low interest rates. Although medium and long-term interest rates have risen in the last year, they remain at historical lows providing the Harbor Department with advantageous costs as it issues bonds. While factors that keep interest costs low include modest inflation, and weak wage growth, there are signs of Federal Reserve actions and an improved economy that are putting upward pressure on rates.

The current supply and demand situation for municipal bonds is also favorable to an issuer as purchasers of municipal bonds remain plentiful, helping drive down bond

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interest costs. Staff anticipates that the proposed bond issues will see strong demand in the marketplace and enjoy favorable rates appropriate to its "AA" credit ratings and low frequency of debt issues.

Required TEFRA Hearing – Internal Revenue Service (IRS) regulations require a TEFRA hearing prior to the final approval and issuance of any proposed tax-exempt financing. Section 147(f)(2) of the Internal Revenue Code of 1986 requires that, in order for the interest on the Bonds to be excluded from gross income for federal income tax purposes, an "applicable elected representative" of the host governmental unit must approve the issuance of the bonds. Such approval must follow a public hearing, which has been preceded by reasonable public notice of public hearing scheduled at 8 AM on July 10, 2014. The notice of the hearing was published in the *Los Angeles Daily News*, the *Daily Breeze* and the *Los Angeles Metropolitan New-Enterprise*, all newspapers of general circulation within the City of Los Angeles (City). The TEFRA hearing will be held in the Board Room of the Harbor Administration Building prior to the Board meeting.

Proposed Transactions

New Bonds – This Resolution provides for the issuance of Harbor Revenue Bonds, in principal amount not-to-exceed \$200 million with a maximum term of 30 years. The proceeds from the Revenue Bonds will partially finance the budgeted \$281 million FY2014/15 CIP projects.

Refunding Existing Bonds – This Resolution provides for the issuance of Refunding Revenue Bonds, in principal amount not-to exceed \$198 million for the current refunding of the Harbor Department's CP notes and 2006 Series D Revenue Bonds, with a final maturity no later than August 1, 2044. A bond refunding is similar to refinancing a loan in which higher interest rate costs are replaced with a loan with lower interest rates. No changes are made to the principal or maturity. In the case of a bond refunding, the Harbor Department issues new bonds to retire bonds that are currently outstanding and have higher interest rates. The Refunding Revenue Bonds will only be sold in such an amount necessary to fund the principal and accrued interest on the Refunded Bonds, any premiums, to pay for costs of issuance, and to fund the debt service reserve fund. The existing maturity schedules of the existing bonds will be maintained. It is anticipated that the Harbor Department will save approximately \$7.3 million or about 9.9% in net present value savings by refunding the 2006 Series D Bonds. On an actual dollar basis, the Harbor Department will save approximately \$335,000 on average per year in debt service cost.

Refunding Commercial Paper – The Harbor Department issues commercial paper notes, a short-term borrowing instrument in order to temporarily fund CIP projects during early stages of construction with the intent to convert such notes to long-term bonds to better match the useful life of the asset. The Harbor Department currently has \$125 million of CP notes outstanding, of which \$100 million were issued as notes not

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subject to the Alternative Minimum Tax (non-AMT) in 2009/2010. The Harbor Department issued the notes during the peak of the Great Recession (2009-2010) to take advantage of an Alternative Minimum Tax (AMT) "holiday" in which all debt related to capital activity were issued as non-AMT or tax-exempt debt, regardless of whether they were private activity projects such as terminal expansion, and deemed "subject to the AMT" (AMT) or "not subject to the AMT" (non-AMT) as in public usage projects such as Channel Deepening, under the traditional IRS definitions. Because non-AMT borrowings enjoy lower costs of borrowing, the Harbor Department categorized what normally would be deemed AMT borrowing as non-AMT, following the rules instituted during the "holiday". Bond counsel has advised that for commercial paper programs for new money projects which started after December 31, 2008, the rules allow that the CP notes may continue to be sold after December 31, 2010 or to be refunded with long-term bonds after that date without triggering AMT status. Section 57(a)(5)(C)(iv) of the IRS Code treats the issue date of a refunding issue as the issue date of the bonds or commercial paper being refunded. Thus, so long as the CP qualifies for the AMT exception, so will the refunding bonds, whenever issued. Given the CP notes are designated "non-AMT", the Harbor Department will be able to refund the bonds on a non-AMT basis, despite the assets being normally ineligible for non-AMT funding. Issuing on a non-AMT versus AMT basis reduces the cost of long-term borrowing by approximately 0.40%.

Staff recommends refunding these short-term notes with long-term debt at this time as refunding these notes with long-term debt more appropriately matches the productive life of the Harbor Department's financed capital assets, a structure reflecting prudent financial control and consistent with the Harbor Department's high ratings and financial policies. The refunding will also create more room for borrowing under the CP program to allow better management of debt. The \$100 million of CP financing originally were matched to projects that included the wharf upgrades at China Shipping and Alternative Maritime Power (AMP) installations at the terminals. Most of the projects have been completed.

Selling the Bonds – In compliance with the Los Angeles Administrative Code (LAAC) Section 11.28.4, the Chief Financial Officer has determined that a negotiated sale of the 2014 Revenue Bonds and Refunding Revenue Bonds would be a benefit to, and in the best interest of, the Harbor Department and recommends that such sale be authorized by the Board.

Although the Charter specifies that bonds will be sold through a competitive bidding process, it does allow for other forms of issue such as negotiated sales subject to the approval of the Board and the City Council. An underwriter may sell bonds either in a competitive or negotiated manner. In a competitive sale, the investment bank advertises the bonds including the terms of the sale and the bond issue. The bonds are sold to the bidder offering the lowest interest cost. In a negotiated sale, the underwriter must purchase the bonds to be issued. The terms of the bonds are tailored to meet the

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needs of the issuer as well as the investors at the time of pricing the bonds. There are advantages and disadvantages to each method. For example, often smaller investment banks are unable to participate in a competitive bond transaction due to lack of capital and the inability to outbid the larger banks on this type of transaction. Therefore the Harbor Department establishes a pool of investment banks every three years inclusive of both large and small banks from which a team will be selected prior to a bond transaction.

Given that the Harbor Department is an infrequent issuer, it is important for both the Harbor Department and the underwriters to market the Harbor Department bonds to a wide audience, in particular to the retail investor market, in order to drive the overall cost of the bonds lower. A negotiated sale also allows flexibility in terms of the pricing date and helps reduce risk to underwriting firms because of their ability to solicit orders in advance of the sale, all in support of obtaining the lowest cost of issuance for the Harbor Department. The various agencies of the City, including the City Administrative Office, the Department of Water and Power, and the Airport issue bonds on a negotiated basis approximately 90% of the time.

The Financing Team

Investment Banks – Investment banks play a key role in Harbor Department's financing team, acting as underwriters to assist the Harbor Department in the structuring, marketing and distributing the bonds. The banks' market reach, access, and understanding of the needs of the investor base provide a direct benefit to the Harbor Department in the form of wide distribution and efficient cost of borrowing. Based on the nature of the work to be completed, market conditions, and the financial risk associated with large-scale financing transactions, using investment banks to aid the Harbor Department to meet its debt needs is an absolute requirement.

In January 2012, the Board approved Resolution No. 12-7248, which established a pool of 15 bond underwriters valid for three years. The 15 firms of underwriter banks comprised of large, small, and local firms are Backstrom McCarley Berry, Barclays, Bank of America Merrill Lynch (BoAML), Cabrera Capital Markets, Citigroup Global Markets, Estrada Hinojosa, Goldman Sachs, JP Morgan, Loop Capital Markets, Morgan Stanley, Ramirez & Company, RBC Capital Markets, Siebert Brandford Shank, De La Rosa & Company (which subsequently was acquired by Stifel Nicolaus) and Wells Fargo.

For the contemplated transactions, staff recommends Wells Fargo, based in San Francisco, California to act as the senior managing underwriter. It will underwrite 40% of the total transaction. Siebert Brandford Shank, also a California based bank, as well as Minority and Women Owned Business Enterprise (MBE and WBE) to act as co-senior managing underwriter and will underwrite 20% of the transactions. The co-managing underwriters are BoAML a large bank with wide retail access for distribution

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of the securities, Cabrera Capital Markets an MBE bank, RBC Capital Markets a large bank, and Stifel (De La Rosa & Company a Los Angeles based MBE was acquired by Stifel Nicolaus in March 2014) will act as co-managing underwriters for the transactions, with each participating at the 10% level.

The above team was selected from the existing pool of underwriters based on their responses to a questionnaire that was distributed among the 15-firm pool members. There were five questions in the survey focusing on (1) ideas about refunding or redemption of the 2006D Bonds; (2) strategies on retail distribution of the bonds; (3) ideas and analyses presented to the Harbor Department since the establishment of the pool; (4) team members to be assigned to the transaction; and (5) the proposed fees. Each of the questions was assigned 20 points. A panel comprised of three Harbor employees reviewed and selected the team based on the above criteria included in the questionnaire. Furthermore, based on the size and complexity of the transaction, and the proposed fees, it was determined that a six-member team would be the optimal size for the transaction.

Financial Advisor – Montague DeRose and Associates (MDA), a firm based in Westlake Village, California, is the financial advisor to the Department in these transactions. Government entities use financial advisors as an independent third party in financial transactions as a check and balance to help manage the complexities of the financial markets. The City also uses MDA as the firm is part of its pool of financial advisors. The Harbor Department has three financial advisory firms in its pool. The selection of MDA was made based on a questionnaire distributed among the pool members focusing on their fees.

Attorneys – The two firms of Nixon Peabody LLP and Kutak Rock LLP are the bond and disclosure counsel, respectively, working on this transaction. These firms were selected with assistance from the City Attorney's Office from their pool of legal firms. The two firms were selected based on a questionnaire from a pool of three firms. The selection was based on fees. The City Attorney, Nixon Peabody and Kutak Rock have approved the documents transmitted to the Board for approval.

This Resolution authorizes the funding of a debt service reserve fund for the bonds since the rating agencies, as well as the investors, view having a debt service reserve fund favorably. It also authorizes paying the costs of issuance associated with the Revenue Bonds and the Refunding Revenue Bonds which is estimated to be approximately three to four percent of the total transaction amount.

Board approval of the Resolution and Financing Documents (Transmittal No. 1 through Transmittal No. 7) is subject to discretionary City Council review pursuant to LAAC Section 11.28.2. When such review is complete, either by the expiration of time or accelerated City Council review, the Board's approval becomes final. The pricing of the bonds would occur after such approval and period of time.

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ENVIRONMENTAL ASSESSMENT:

The proposed action is authorization to conduct a tax equity and financial responsibility hearing and to issue revenue bonds. As an administrative activity, the Director of Environmental Management has determined that the proposed action is exempt from the requirements of the California Environmental Quality Act (CEQA) in accordance with Article II Section 2(f) of the Los Angeles City CEQA Guidelines.

ECONOMIC BENEFITS:

This Board action will have no employment impact.

FINANCIAL IMPACT:

Based on current and expected levels of cash flows, the Harbor Department will need to borrow approximately \$200 million to help support its capital program in Fiscal Year (FY) 2014/15. In addition, there is an opportunity to refund approximately \$73.6 million in long-term bonds on their call date to reduce interest costs. Finally, matching the structure of the debt to the life of the asset that is being financed, drives the refunding of \$100 million of CP notes. Combining the three transactions together reduces the cost of issuance versus undertaking each transaction at different times.

Authorizing the issuance of up to \$200 million in Harbor Department's Revenue Bonds and refunding \$100 million of commercial paper notes will increase annual average debt service. Increased debt service in FY 2014/15 is estimated at approximately \$6.2 million, reaching \$71.3 million for the year, and rising approximately another \$14.7 million to \$86 million in FY 2015/16 resulting in total debt service reaching approximately \$91 million per year by FY 2016/17 and beyond through FY 2025/26. Current debt service is about \$65.1 in FY 2013/14. Authorizing the issuance of the Refunded Bonds relating to the approximate \$73.6 million 2006 Series D Bonds should generate an aggregate present value savings to the Harbor Department of approximately 9.9% of the principal amount of the bonds being refunded or about \$7.3 million or approximately \$335,000 in average debt service savings per year until the maturity of these bonds in 2037.

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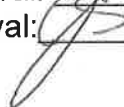
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CITY ATTORNEY:

The Office of the City Attorney has reviewed and approved as to form and legality the Resolution, Indenture of Trust, the Purchase Agreement, and the Escrow Agreement.

TRANSMITTALS:

1. Proposed Resolution
2. Form of Indenture of Trust
3. Form of Continuing Disclosure Certificate
4. Form of Purchase Agreement
5. Form of Preliminary Official Statement
6. TEFRA Approval Certificate
7. Escrow Agreement

FIS Approval:  (Initials)
CA Approval:  (Initials)



KARL K. Y. PAN
Chief Financial Officer



MOLLY CAMPBELL
Deputy Executive Director

APPROVED:



EUGENE D. SEROKA
Executive Director

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