



SENT TO COUNCIL:

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City Manager's Office

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: 2012 RATING AGENCY ACTIONS
RELATED TO REDEVELOPMENT
AGENCY DEBT OBLIGATIONS

DATE: June 8, 2012

Approved

Date

6/8/12

INFORMATION

This week, Fitch Ratings ("Fitch"), Standard & Poor's Ratings Services ("S&P"), and Moody's Investors Service ("Moody's") took rating actions on the Redevelopment Agency of the City of San José (the "Agency") tax allocation bonds ("TABs"). Copies of the rating reports are attached to this memorandum.

The Agency 80% Merged Area TABs are secured by a pledge of tax increment revenues from the redevelopment project areas, net of the 20% tax increment and other statutory deductions. The Housing 20% Set-Aside TABs are secured by a pledge of the 20% tax increment revenue set aside for the Low- and Moderate Income Housing Fund.

FITCH RATINGS

On Tuesday, June 5, 2012, Fitch took the following rating actions:

- A downgrade on the Agency 80% Merged Area TABs without cash-funded reserves to "BB-" from "BB+".
- A downgrade on the Agency 80% Merged Area TABs with cash-funded reserves to "BB" from "BBB-".
- All of the Agency 80% Merged Area and Housing 20% Set-Aside TABs are placed on Rating Watch Negative.

The rationale provided by Fitch for the various rating actions included:

- *The downgrades on the merged area bonds reflect information received from the Successor Agency to the San Jose Redevelopment Agency (RDA) that it currently has insufficient funds on hand to make its Aug. 1, 2012 debt service payments in full. The*

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shortfall results from Santa Clara County's (the county) interpretation of the state law dissolving RDAs (AB X126).

- *According to the RDA, the county contends that an annual 'pass-through' payment due to the county which was contractually subordinated to debt service is now in a senior position under AB X126 (\$15.7 million). An additional \$3.6 million was withheld because the county ceased to include tax revenues from pre-1989 tax over-rides as part of the tax increment pledged to bondholders. A material event notice confirms that approximately \$20 million has been withheld by the county from the June 1 payment to the RDA.*

STANDARD & POOR'S RATINGS SERVICE

On Wednesday, June 6, 2012, S&P placed the Agency 80% Merged Area and Housing 20% Set-Aside TABs on CreditWatch with negative implications. S&P cited the following rationale for the action:

The CreditWatch placements reflect our view of actions taken by Santa Clara County that could result in materially lower tax increment revenue available to the successor agency to pay the TABs. In the case of the nonhousing TABs, the successor agency's June material event notice to Electronic Municipal Market Access dated June 4, 2012 indicates that there could be a potential event of default due to insufficient revenues to make a full debt service payment on Aug. 1, 2012.

We have learned through the material event notice made by the City of San Jose as successor agency that Santa Clara County intends to withhold approximately \$20 million from the tax increment revenue for the repayment of debt service on the TABs. The county interprets Assembly Bill 1X 26 as making senior certain passthrough payments that were formerly paid subordinate to tax increment revenues for debt. In addition, as described by the successor agency, the county is no longer considering revenue from certain pre-1989 tax overrides as being tax increment due to the successor agency to pay debt service. The successor agency had been counting on these revenues to make its Aug. 1, 2012 debt service payments.

MOODY'S INVESTORS SERVICE

On Friday, June 8, 2012, Moody's took the following rating actions:

- A downgrade on the Agency 80% Merged Area TABs without cash-funded reserves or below investment grade surety to "Ba3" from "Baa3".
- A downgrade on the Agency 80% Merged Area TABs with cash-funded reserves or investment grade surety to "Ba2" from "Baa2".

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- A downgrade on the Housing 20% Set-Aside TABs to “Baa2” from “A3”.
- The ratings remain under review for further possible downgrade.

Moody’s provided the following rationale for the rating actions:

The downgrade of the non-housing bonds reflects the potential default indicated by the notice filed by the City of San Jose on June 4 2012. According to the notice, the potential default has arisen as a result of the Santa Clara County’s notification of its intent to withhold of approximately \$20 million in former tax increment revenue on June 1. This could lead to a default as the “Successor Agency” for San Jose’s redevelopment agency will have insufficient funds for full debt service payments due on August 1, 2012. The Successor Agency is disputing the actions of the county.

IMPACT OF RATING DOWNGRADE

While S&P took a more “wait and see” approach by placing the bonds on CreditWatch with negative implications, the downgrade actions by Moody’s trigger significant events on the Agency 80% Merged Area subordinate bonds secured by the JPMorgan letter of credits and the Housing 20% Set-Aside subordinate bonds in a private placement with Wells Fargo Bank. Staff is commencing discussions with both JPMorgan and Wells Fargo Bank. JPMorgan is examining the documents to see if there is any latitude in the Letter Agreement which requires an increase in the Letter of Credit fee from 2.25% to 3.00%. The downgrades trigger increases the annual fees paid to JPMorgan by approximately \$725,000 per year and to Wells Fargo Bank by approximately \$530,000.

SUMMARY OF RATINGS

The current ratings from Moody’s, S&P, and Fitch are summarized below for your reference:

	<u>Moody’s</u>	<u>S&P</u>	<u>Fitch</u>
Agency 80% Merged Area TABs	Range from “Ba3” to “Ba2”	BBB	Range from “BB-” to “BB+”
Housing 20% Set-Aside TABs	Baa2	A	A

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As required by the Agency's continuing disclosure agreements, which were entered into pursuant to the Securities & Exchange Commission's Rule 15c2-12, notification of the rating agency actions will be provided to the financial markets within the deadlines specified in the continuing disclosure agreements.

/s/

JULIA H. COOPER

Acting Director of Finance

For questions, please contact Julia H. Cooper, Acting Director of Finance at (408) 535-7011.

Attachments



Fitch Downgrades San Jose Redevelopment Agency, CA's TABS to 'BB' on Rating Watch Negative [Ratings](#) [Endorsement Policy](#)

05 Jun 2012 6:11 PM (EDT)

Fitch Ratings-San Francisco-05 June 2012: Fitch Ratings has downgraded the following San Jose Redevelopment Agency, CA tax allocation bonds (TABs):

- \$235.3 million merged area redevelopment projects TABs, series 2003, 2008A and 2008B, to 'BB' from 'BBB-';
- \$1.6 billion merged area redevelopment projects TABs, series 1993, 1997, 1999, 2002, 2004A, 2005A, 2005B, 2006B, 2006A-T, 2006C, 2006D, 2007A-T, 2007B, to 'BB-' from 'BB+'.

All of the merged area TABs are placed on Rating Watch Negative. In addition, Fitch has placed \$247.5 million in housing set aside TABs, rated 'A', on Rating Watch Negative.

SECURITY

- The merged area TABs are secured by gross tax increment revenue from the project area net of certain senior pass-throughs and the 20% set-aside for housing. The housing TABs are secured by the 20% housing set aside.
- All TABs are also secured by debt service reserve funds; however, only the merged area redevelopment project TABs, series 2003 and 2008A and 2008B benefit from a cash-funded reserve.

KEY RATING DRIVERS

POTENTIAL PAYMENT INSUFFICIENCY: The downgrades on the merged area bonds reflect information received from the Successor Agency to the San Jose Redevelopment Agency (RDA) that it currently has insufficient funds on hand to make its Aug. 1, 2012 debt service payments in full. The shortfall results from Santa Clara County's (the county) interpretation of the state law dissolving RDAs (AB X126).

COUNTY WITHHOLDING FUNDS: According to the RDA, the county contends that an annual 'pass-through' payment due to the county which was contractually subordinated to debt service is now in a senior position under AB X126 (\$15.7 million). An additional \$3.6 million was withheld because the county ceased to include tax revenues from pre-1989 tax over-rides as part of the tax increment pledged to bondholders. A material event notice confirms that approximately \$20 million has been withheld by the county from the June 1 payment to the RDA.

STATE GUIDANCE SOUGHT: The city has requested that the State Controller review the county's actions under the provision in AB1x26 requiring three days before actions become effective. During this time, the controller or State Department of Finance can request that the county reconsider its action.

LITIGATION POSSIBLE: In the absence of a favorable outcome with the state, the city is likely to sue the county, prolonging the uncertainty as to the disposition of funds needed for debt service.

RAPIDLY EVOLVING SITUATION: The Rating Watch Negative is based on the limited information currently available and the high degree of uncertainty about actions to be taken by the city, county, and state to resolve the issue at hand. Fitch plans to continue to gather and review information as it becomes available and to take further action as appropriate.

WHAT COULD TRIGGER A RATING ACTION

LACK OF FAVORABLE RESOLUTION FOR BONDHOLDERS: Fitch believes there are a number of ways in which a near-term resolution could insure full and timely debt service payment on Aug. 1. However, if such resolution is not forthcoming the ratings could change substantially.

For more information, please see 'Fitch Takes Various Rating Actions on San Jose Redevelopment Agency TABS', dated April 20, 2012.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 15, 2011);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 15, 2011).

Applicable Criteria and Related Research:

[Tax-Supported Rating Criteria](#)

[U.S. Local Government Tax-Supported Rating Criteria](#)

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Rating Action: Moody's Downgrades to Ba2 and Ba3, from Baa2 and Baa3, the Non-Housing Tax Allocation Bonds of the Former San Jose Redevelopment Agency, CA; Housing TABs Downgraded to Baa2 from A3

Global Credit Research - 08 Jun 2012

All Ratings Remain Under Review for Possible Downgrade

New York, June 08, 2012 -- Moody's Investors Service has downgraded the ratings of San Jose Redevelopment Agency Merged Project Area tax allocation bonds. The extent of the downgrades depends on each bond series' specific pledged revenues--whether housing or non-housing--and how the debt service reserve requirement is met. The Agency's non-housing tax allocation bonds with cash funded debt service reserves or reserves that are met with sureties from investment grade providers have been downgraded to Ba2 from Baa2. These include: Series 1993, Series 1997, Series 2003, Series 2004, Series 2005A, Series 2006C, Series 2008A, and Series 2008B, which total approximately \$1.08 billion in total outstanding debt. The Agency's non-housing tax allocation bonds with debt service reserve requirements met with below investment grade surety policies have been downgraded to Ba3 from Baa3. These include: Series 1999, Series 2002, Series 2005 B, Series 2006 A, Series 2006 B Series 2006 D and Series 2007, which total approximately \$670 million in total outstanding debt. Bonds benefitting from the pledge of low-and-moderate income housing tax increment revenues have been downgraded to Baa2 from A3. All ratings remain under review for possible downgrade.

RATINGS RATIONALE

The downgrade of the non-housing bonds reflects the potential default indicated by the notice filed by the City of San Jose on June 4 2012. According to the notice, the potential default has arisen as a result of the Santa Clara county's notification of its intent to withhold of approximately \$20 million in former tax increment revenue on June 1. This could lead to a default as the "Successor Agency" for San Jose's redevelopment agency will have insufficient funds for full debt service payments due on August 1, 2012. The Successor Agency is disputing the actions of the county. A default is not inevitable and several paths remain open for a resolution in time to prevent a debt service shortfall. The city of San Jose, as the Successor Agency, has requested that the State Controller to review Santa Clara County's action. Failing that, the city would likely pursue legal action to resolve the matter. There also remains the possibility of a negotiated resolution between the county and the successor agency, which would address the immediate cash flow needs of the Successor Agency caused by the county's intent to withhold the property tax receipts. And finally, while the city has no obligation to do so, given the relatively modest size of the potential shortfall, the City of San Jose could use its own resources to avoid a default.

All of the non-housing senior bonds benefit from a Bond Reserve Requirement which is met by either by a cash funded reserve or a surety. Although each outstanding series benefits only from its own debt service reserve, the aggregate amount of such reserves is approximately \$180 million, compared to annual debt service of approximately \$133 million.

The downgrade of the housing tax allocation bonds reflects the added uncertainty brought about by the county's decision to withhold property tax increment. While the Successor Agency does not expect a shortfall for the housing TABs, and sufficient funds are available for payment of debt service on August 1, 2012, the successor agency's overall shortfall of funds may adversely impact the cash flow for repayment of the housing TABs.

Key Credit Strengths

- -Very large project area tax base spanning most of downtown San Jose
- Very large total and incremental Assessed Value (AV)
- Incremental to total AV ratio is very high
- Largest tax payers are well known successful firms
- Signs of improving economy, including lower unemployment and higher sales tax receipts

Key Credit Weaknesses

--Santa Clara County Auditor's decision to withhold property tax increment from the Successor Agency may cause a near-term cash shortfall for repayment of non housing bonds.

-- For non-housing bonds, very narrow debt service coverage levels due to high leverage and AV declines in 2011 and 2012

-- High tax payer concentration

-- Most debt service reserves are non-cash sureties

The ratings remain under review for a possible downgrade, along with all other rated tax allocation bonds in the state, reflecting the uncertainties and cash flow risks inherent in implementing the new redevelopment agency dissolution law.

The principal methodology used in this rating was Moody's Analytic Approach To Rating California Tax Allocation Bonds published in December 2003. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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June 6, 2012

Summary:

San Jose Redevelopment Agency, California; Tax Increment

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Rationale

Related Criteria And Research

Summary:

San Jose Redevelopment Agency, California; Tax Increment

Credit Profile

San Jose Redev Agy TABs (Merged Area Proj)

Long Term Rating

BBB/Watch Neg

On CreditWatch Negative

Rationale

Standard & Poor's Ratings Services placed its 'BBB' long-term rating and underlying rating (SPUR) on the San Jose Redevelopment Agency, Calif.'s senior nonhousing tax allocation bonds (nonhousing TABs) outstanding on CreditWatch with negative implications. At the same time, Standard & Poor's placed its 'A' long-term rating and SPUR on the agency's senior housing tax allocation bonds (housing TABs, and collectively with the nonhousing TABs, the TABs) outstanding on CreditWatch with negative implications.

The CreditWatch placements reflect our view of actions taken by Santa Clara County that could result in materially lower tax increment revenue available to the successor agency to pay the TABs. In the case of the nonhousing TABs, the successor agency's June material event notice to Electronic Municipal Market Access dated June 4, 2012 indicates that there could be a potential event of default due to insufficient revenues to make a full debt service payment on Aug. 1, 2012.

We have learned through the material event notice made by the City of San Jose as successor agency that Santa Clara County intends to withhold approximately \$20 million from the tax increment revenue for the repayment of debt service on the TABs. The county interprets Assembly Bill 1X 26 as making senior certain passthrough payments that were formerly paid subordinate to tax increment revenues for debt. In addition, as described by the successor agency, the county is no longer considering revenue from certain pre-1989 tax overrides as being tax increment due to the successor agency to pay debt service. The successor agency had been counting on these revenues to make its Aug. 1, 2012 debt service payments.

The city as successor agency has asked the California State Controller to review the county's actions.

During the next 90 days, we will continue to monitor the situation and attempt to obtain clarification regarding the specific impact on nonhousing and housing tax increment revenues and related debt service. After receiving additional information and analyzing the potential effect on repayment of the TABs, we could take a negative rating action. If the nonhousing tax increment revenues were significantly impaired, we could lower the rating on the nonhousing TABs to noninvestment grade. If the housing tax increment revenues were impacted but still provided at least adequate maximum annual debt service coverage, we could lower the rating on the housing TABs several notches.

For more information on our rating on the successor agency's tax increment debt, please see the nonhousing TAB and senior housing articles published Nov. 21, 2011 on RatingsDirect on the Global Credit Portal.

Related Criteria And Research

- USPF Criteria: Special-Purpose Districts, June 14, 2007
- Assessing The Credit Impact Of California's Redevelopment Agency Legislation, Oct. 24, 2011

Ratings Detail (As Of June 6, 2012)

San Jose Redev Agy tax alloc bnds ser 2002 dtd 01/24/2002 due 08/01/2003-2022 2024 2027 2032		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy tax alloc rfdg bnds (Merged Area Redev Proj) ser 2006C due 08/01/2023-2026 2028 2030 2032 ser 2006D due 08/01/2008-2023		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy tax alloc (Merged Area Redev Proj) (AMBAC) (ASSURED GTY - SEC MKT) (wrap of insured)		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy Tax-Exempt rfdg TABs (Merged Area Redev Proj Hsg Set-Aside) ser 2010A due 08/01/2035		
<i>Long Term Rating</i>	A/Watch Neg	On CreditWatch Negative
San Jose Redev Agy US\$135. tax alloc bnds (Merged Area Redev Proj) ser 2003 dtd 12/22/2003 due 08/01/2005-2025 2027 2030 2033		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj) tax alloc (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy tax incre		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy GO		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Proj)		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj)		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj) hsg set aside		
<i>Unenhanced Rating</i>	A(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj) hsg set aside Tax Increment		
<i>Unenhanced Rating</i>	A(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj) tax incre		
<i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	On CreditWatch Negative
San Jose Redev Agy (Merged Area Redev Proj) Hsg Tax Increment		
<i>Unenhanced Rating</i>	A(SPUR)/Watch Neg	On CreditWatch Negative

Many issues are enhanced by bond insurance.

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Summary: San Jose Redevelopment Agency, California; Tax Increment

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