CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL AND CITY OF SAN JOSE FINANCING AUTHORITY BOARD

FROM: Julia H. Cooper
Lori Mitchell
Jim Shannon

SUBJECT: SEE BELOW

DATE: June 18, 2021

Approved D. DSyL   Date 06/18/21

SUBJECT: ISSUANCE OF CITY OF SAN JOSE FINANCING AUTHORITY COMMERCIAL PAPER NOTES FOR SAN JOSE CLEAN ENERGY OPERATIONS; APPROVAL OF THE SECOND AMENDMENT TO THE REVOLVING CREDIT AGREEMENT; AND RELATED BUDGET ACTIONS

RECOMMENDATION

1. It is recommended that the City Council “(Council”) take the following action:

   a. Adopt a resolution authorizing the issuance by the City of San José Financing Authority (the "Authority") of City of San José Financing Authority Lease Revenue Commercial Paper Notes ("CP Notes") to finance the purchase of power and other operating costs of San José Clean Energy (“SJCE”) in an amount not to exceed $95.0 million, subject to the satisfaction of certain conditions.

   b. Adopt a resolution authorizing the City Manager and the Director of Finance, or their authorized designees, to negotiate, execute and deliver a Second Amendment to the Revolving Credit Agreement with Barclays Bank PLC amending certain terms and provisions of the Revolving Credit Agreement in connection with the issuance of CP Notes secured by General Fund lease payments to finance the purchase of power and other operating costs of SJCE.

   c. Adopt the following 2020-2021 Funding Sources Resolution and Appropriation Ordinance amendments in the San Jose Clean Energy Fund:

      i. Increase the estimate for Financing Proceeds by $15,000,000;
      ii. Decrease the estimate for Fees, Rates and Charges by $13,050,000;

iii. Increase the Cost of Energy appropriation to the Community Energy Department in the amount of $22,925,000; and
iv. Decrease the Unrestricted Ending Fund Balance by $20,975,000.

2. It is recommended that the City of San José Financing Authority Board (the "Authority Board") adopt a resolution authorizing the issuance of CP Notes to finance the purchase of power and other operating costs of SJCE in an amount not to exceed $95.0 million, subject to the satisfaction of certain conditions.

OUTCOME

Approval of these recommendations, both by the Authority Board and by two-thirds majority approval by the Council, will allow the issuance of commercial paper notes to finance the purchase of power and other operating costs of SJCE. The CP Notes draws will take place in 2020-21 and 2021-22 to keep SJCE financially sound. SJCE's existing revolving credit agreement with Barclays is not sufficient to meet the current financial needs of the program and the mechanics of drawing on the line of credit make its use impractical under the current circumstances. Additionally, the commercial paper interest rates are significantly lower than the existing credit facility.

BACKGROUND

San José Clean Energy – A Community Choice Aggregation Program

On November 17, 2020, the Council approved SJCE to establish a power mix of between 53-92% carbon-free energy with at least 40% renewable energy for the GreenSource product starting January 1, 2020. Pricing of SJCE's GreenSource product was set at 0.25% below PG&E generation rates, after accounting for the Power Charge Indifference Adjustment and Franchise Fee Surcharge across all rate classes for 2021, with flexibility to vary the discount between 0.0% and 1.0%.

PCIA Assessment. The Power Charge Indifference Adjustment (PCIA) is a fee assessed by investor-owned utilities (IOUs) on all electric customers to cover above-market generation costs for legacy energy resources. Community Choice Aggregator ("CCA") customers, like SJCE's customers, only pay for above-market costs attributable to generation acquired prior to a customer's change in service provider. SJCE customers pay the PCIA fee for their share of above-market energy resource costs previously incurred by PG&E on their behalf. As forecasted in the Community Energy Department's Council memo dated October 26, 2020, PG&E's PCIA rose dramatically in 2021 to $45 per megawatt hour (MWh) for the E-19S (large industrial) rate[1].

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[1] For customers who started SJCE service prior to July 1, 2019 ("2018 PCIA vintage") which most SJCE customers have).

This is 41% more than the 2020 PG&E PCIA for the E-19S rate and slightly worse than staff had expected. PG&E's PCIA has risen over 900% between 2013 and 2021 and 41% from 2020 to 2021. In 2021, SJCE customers will pay an extra $51 million in PCIA fees to PG&E for a total of $176 million in PG&E PCIA fees in 2021 alone. Rising PCIA fees negatively affect SJCE's revenue and hamper the ability to maintain and build financial reserves.

Recent SJCE Rate Changes

On May 11, 2021, Council approved adjusting SJCE's 2021 service offerings and rates to alleviate financial impacts from the increasing PCIA. As part of this action, rates for GreenSource, SJCE's default product, were adjusted to 8% above PG&E generation rates, inclusive of the PCIA and Franchise Fee Surcharge (PG&E added fees). In addition, a new low-cost product called GreenValue was created, with rates set at parity with PG&E generation rates, inclusive of the PCIA and Franchise Fee Surcharge. While GreenSource remains SJCE's default product, any customer can enroll in GreenValue. SJCE continues to offer its 100% renewable TotalGreen product, which costs $0.005-$0.01 per kWh more than GreenSource.

Energy Market Volatility and Financial Uncertainty

Recent market events have impacted SJCE's financial operations and reduced cash levels for the enterprise, creating a cash shortfall and need for cash flow borrowing. These market events include the following:

- <u>Delayed PG&E Rate Increase</u>. Because SJCE rates are linked to PG&E rates, the delay in PG&E rate increases from March to September, and now a potential delay to December 2021 has an adverse impact on SJCE revenues. It is expected that this rate increase will occur; however, the delay in revenue creates one of the needs for cash flow borrowing. The impact is approximately $9 million dollars.

- <u>Bad Debt Expense</u>. The COVID-19 pandemic and constraints placed on the ability of utilities to shut-off service for non-payment have increased bad debt expense three to five times when compared with pre-March 2020 levels. As with most industries, electric utilities have faced negative financial impacts due to the COVID-19 pandemic. The payments more than 90 days past due from SJCE customers currently total approximately $9.6 million and continue to grow.

- <u>High Market Prices.</u> The energy market experienced several disruptions which have increased forward prices. In particular, the forward prices for the Summer of 2021 have climbed steadily since the beginning of the year and are currently more than twice as expensive as compared to the last five years. The following is a list of recent disruptions impacting the energy procurement market:
    - Extreme weather -- The broad heat wave in August 2020 which impacted much of the Western U.S and led to rolling blackouts in California due to insufficient

supply and the extreme winter storm in Texas in 2021 creates a concern that one or more extreme weather events could occur this summer.

- The Diablo Canyon and Palo Verde nuclear plants experienced operational issues this spring.
- The drought in 2021 has limited the supply of hydro-electric generation turning some former exporters of powers into additional purchasing competitors in the power market, further driving up prices.

- Increased Collateral Requirements: Due to these recent events and increased market prices, some suppliers and the CAISO have increased SJCE's requirements for collateral and in some cases requested additional cash to be used as collateral.

Although the 2021 market prices are high, the forward curves show prices stabilizing into 2022 and 2023. Additionally, San José's energy risk management policy and regulations are designed to reduce the potential impact of these market disruptions on the SJCE program. For example, the regulations recommend that SJCE procure at least 70% of its electricity needs one year ahead on a rolling basis, and 80% of its electricity needs on a six month ahead rolling basis. Thus, SJCE bought a significant proportion of its 2021 power before August of 2020 when prices began rising dramatically. Moreover, with the oversight of the Risk Oversight Committee and to reduce the potential impact of market volatility in the "day ahead market" and the "real time market", SJCE has bought enough electricity to meet over 90% of its electricity needs the most expensive evening hours for 2021. These actions have moderated the impact of the increased prices; however, San José's average electricity costs for 2021 have nonetheless increased.

Commercial Paper Program

The City created its General Commercial Paper ("CP") Program to offer Departments a simple and low cost means of obtaining financing without having to negotiate new bank terms. The City's CP program is based on a lease revenue financing structure. Under this program, the Authority is able to issue commercial paper notes ("CP Notes") at prevailing interest rates for maturity periods not to exceed 270 days. The Authority may have CP outstanding longer for a project by issuing CP Notes to pay maturing CP Notes (and interest) instead of repaying the principal and interest owed on the maturing CP Notes (known as "rolling" the CP). Due to the short term of each CP Note, the current interest rates on this program are very low, with all-in costs and coupon of well under 1% for typical maturities of 90 days.[2]

The CP Notes are secured by two separate direct-pay letters of credit ("LOCs") provided by State Street Bank and Trust Company ("State Street") and U.S. Bank National Association (together, the "Banks"). The LOCs expire on February 23, 2022 and the City has engaged PFM Financial Advisors LLC to assist in renewing, replacing or expanding these facilities, together with various other facilities PFM is assisting in acquiring on behalf of various City departments, including

[2] As of the CP roll date on March 24, 2021 the all-in rate was approximately 67 basis points or 0.67%; the next roll is scheduled for June 23, 2021.

facilities for SJCE. See Attachment A for a description of the structure of the Authority's Commercial Paper Program along with a summary of the program amendments since inception in 2004. See Attachment B for the technical aspects of how commercial paper works.

Debt Management Policy and Municipal Code Requirements Related to Lease Financings

The plan to issue CP Notes to finance potential energy cost increases of the SJCE is subject to the City's Debt Management Policy, Council Policy 1-15 and San José Municipal Code Chapter 4.34 related to lease financings. Under Section III (D) of the Debt Management Policy, the Finance Department is required to conduct its due diligence for the proposed lease financing and identify a source of repayment. The Debt Management Policy's provision that requires a feasibility study be performed prior to the issuance of a lease financing is not applicable to the issuance of these notes as a feasibility study is required only when the revenues of the project being financed are the source of repayment. In this case, project revenues are not the source of repayment of the CP Notes. As discussed below, while the debt service on the CP is payable from the General Fund, the source of repayment for the proposed notes will ultimately be rate revenues received from SJCE customers. Interest and fee costs for the proposed notes will be funded by issuing additional notes (known generally as "capitalized interest"). In the event that SJCE cannot repay the CP Notes, the General Fund will be responsible for repayment.

UNDER BOTH THE DEBT MANAGEMENT POLICY AND SAN JOSE MUNICIPAL CODE SECTION 4.34.200, APPROVAL OF THE ISSUANCE OF THESE NOTES REQUIRES A TWO-THIRDS VOTE BY THE CITY COUNCIL (8 VOTES).

ANALYSIS

On May 11th, Council approved a rate increase for SJCE in light of high PCIA charges and other regulatory pressures. As detailed above, various market changes have further eroded SJCE's cash position. Based on these changes, SJCE's base financial model now projects an ending cash shortfall of nearly $14.7 million at the end of the current fiscal year, growing to as much as $69.6 million by February 2022, but recovering modestly to $52.0 million by the end of the fiscal year 2022. It is important to note that SJCE believes these estimates are conservative projections and can be heavily influenced by SJCE's load and in particular any extreme weather events and market disruptions as well as changes in the PCIA due to these impacts.

Unlike most City services and enterprises, SJCE operates in a competitive market with complex pricing dynamics. Unlike other City franchises that operate on an exclusive basis, power purchasers have competitive options. And SJCE's costs are not driven by stable expenditures like payroll costs, but are largely driven by power purchase costs that can be driven by supply, demand, weather conditions, energy futures markets and the ebbs and flows of market confidence and fears. As a result, events in the Pacific Northwest or Arizona may affect the power purchasing costs of SJCE in San José.

While, as described above, SJCE purchases significant portions of its energy in advance thereby fixing a large portion of its costs ahead of time, a certain percentage of energy must be procured in the day ahead and in real time markets. This is because load (power demand) and resources (power supplies) deviate from forecasts, and certain deviations while known to happen cannot be predicted in a manner that permits 100% forward procurement. For example, SJCE can predict that its load will increase due to air conditioning use during high heat days but cannot predict before the beginning of the month on which days this will occur. Thus, all energy costs cannot be completely fixed in advance as it is unknown the exact days when these heat events will occur. SJCE is exploring additional risk mitigation products and programs to address these risks in the future. Moreover, SJCE has undertaken stress analyses to bookend the potential impact of high heat events.

Borrowing Need

The Finance Department, SJCE, the City Manager's Budget Office, and the City Attorney's Office have all worked together to assess the SJCE cash shortfall and borrowing options to help SJCE through this convergence of events.

SJCE has a revolving credit facility with a line of credit (up to $30 million) that expires on November 26, 2021, and a standby letter of credit (up to $65 million) that expires on November 27, 2023 with Barclays Bank PLC ("Barclays"). The combined facilities are subject to a joint limit of up to $80 million. The Barclays standby letter of credit facility is vital to SJCE operations in order to secure long-term power purchases. While SJCE had expected to use the Barclays line of credit for the small cash shortfall projected in the Spring, the larger cash flow shortfall that is now projected, exceeds the size of the Barclays credit facility. Together with mechanics of drawing on the line of credit under the revolving credit facility and the costs of such draw (LIBOR[3] + 2.90%; approximately 2.98% as of June 16, 2021); City staff determined drawing on the line of credit was not a practical solution for the current situation.

Instead, staff is recommending that Council and the Authority Board authorize the issuance of Commercial Paper Notes to cover SJCE's monthly cashflow needs for power purchases and other operating needs. SJCE currently expects to draw $15 million by the end of June 2021 and $54.6 million for Fiscal Year 2021-2022 to purchase power and capitalize interest and fees, for a total of approximately $69.6 million under the current assumptions.

It is important to highlight that these base case projections are based on assumptions about energy market pricing and weather. The base case projections assume the following:

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[3] Commonly used variable rate index; acronym for "London Interbank Offered Rate," which represents the average rate at which a leading bank can obtain unsecured funding in the London interbank market. LIBOR serves as a benchmark for various interest rates. While there are various LIBOR indices which are due to be phased out sooner, U.S. one month and three-month LIBOR are set to be phased out on June 30, 2023, long after the line is due to expire in November 2021.

1. PG&E generation rates for 2022 per PG&E's June Energy Resource Recovery Account (ERRA) filing[4]
2. No state or federal relief to SJCE for COVID customer delinquencies. . (There are multiple proposals for utility relief at the state level, in addition to potential federal funding. SJCE and City leadership are actively working to make sure CCAs and SJCE are included in final legislation and regulations).
3. No reduction in the PCIA in 2022 and a small PCIA reduction in 2023. (The CPUC approved PCIA calculation formula is such that higher actual market power prices in a given year reduce the above-market costs of the Investor Owned Utilities ("IOUs") that are recovered in the PCIA for the following year; therefore staff believes this is a conservative assumption).

Changes in these assumptions have a significant positive impact on SJCE balances, as shown in the table below. The "Improved Case" scenario below incorporates the PG&E rates in the ERRA filing; assumed State or Federal COVID delinquency relief for SJCE of $10 million; and a reduction in the PCIA in 2022 and a small PCIA reduction in 2023 based on the inverse relationship between PCIA charges and increased power costs.

Assuming the base case borrowing amounts are required, the fees and interest ($572,000) are included in the total amount of CP borrowed for FY2020-21 and FY2021-22. The utilization of CP funding and financing cost of CP is summarized in the table below:

	Base Case	**Improved Case**
20-21 Funding Needs		
Power Supply	$15,000,000	$15,000,000
21-22 Funding Needs		
Power Supply	54,028,000	43,000,000
CP Interest and Fees	572,000	500,000
Total Funding Needs	**$69,600,000**	**$58,500,000**
CP Payback Expected to Begin	FY 23-24	FY 22-23
CP Payback Expected to End	FY 25-26	FY 22-23

Although SJCE believes the Base Case assumptions are conservative based on current analysis and ensure that the SJCE is well-positioned to respond to market and weather-related conditions, SJCE has also modeled an even more pessimistic scenario that contemplates even more extreme heat events that pushes the total funding need to approximately $95 million. To account for this unlikely - though still possible - scenario, the recommended action provides the authorization to issue CP Notes of $95 million. If conditions worsen such that a total draw of $95 million becomes more likely, SJCE will return to the City Council with additional mitigation measures,

[4] https://www.pge.com/pge_global/common/pdfs/your-account/your-bill/understand-your-bill/bill-inserts/2021/0621-ERRA.pdf

that could also include rate increases to increase SJCE revenues. Finance staff is developing several contingency plans for expanding CP capacity, if needed.

Second Amendment to the Revolving Credit Agreement

Even though staff has determined it would be advantageous to use commercial paper instead of the Barclays credit facility, the Barclays facility must be amended. The proposed Second Amendment to the Revolving Credit Agreement is necessary to allow the issuance of CP Notes for cash flow needs for the benefit of SJCE.

A summary of key changes to the Second Amendment include:

- Ability to Loan Funds to SJCE - Permits the City to make loans from any fund, including the General Fund, to SJCE, including from proceeds of CP issued by the Authority in an amount not to exceed $100 million (previously limited to $10 million solely for the payment of start-up costs of SJCE). The City acknowledges and agrees that any such loans shall be subordinate to the City's obligations to Barclays under the Revolving Credit Agreement, as amended. Loans from the Authority to SJCE are not permitted unless the City first delivers to Barclays evidence that the Authority has agreed that such loans are subordinate to the City's obligations to Barclays under the Revolving Credit Agreement.

- Loan Repayment - Prohibits repayment of loans and other debt payable from Revenues or Net Revenues of SJCE unless, among other things, (i) the amount held in the Operating Reserve Account, together with the unrestricted cash of SJCE, as of the last day for the month immediately preceding the date of such payment and as of the last day of the month for at least 3 of the 4 months immediately preceding such month, has been, and after such payment will remain, equal to or in excess of $50 million (inclusive of the $20 million required to be on deposit in the Operating Reserve Account), and (ii) the Debt Service Coverage Ratio is not less than 1.25 to 1.00 as of the last day of the fiscal quarter most recently ended.

- Debt Service Coverage Ratio - Proposes to make the following amendments related to the Debt Service Coverage Ratio (or the ratio of "Net Revenues" to "Aggregate Annual Debt Service Requirement"), among others:

    - Extends the first date on which the City is required to comply with the Debt Service Coverage Ratio from March 31, 2020 to September 1, 2021.

    - Reduces the Debt Service Coverage Ratio required to be maintained from 2.00 to 1.00, to 1.25 to 1.00.

    - Amends the definition of "Aggregate Annual Debt Service Requirement" to (i) exclude any amounts payments of debt service to the City or the Authority that are not scheduled, including payments to the City from SJCE to repay amounts loaned by the City with proceeds of CP issued by the Authority, (ii) commencing December 31, 2022, gives the City credit for amounts on deposit in the Operating Reserve Account up to $20 million, and (iii) makes certain other amendments to clarify the debt service that is taken into account when calculating the Aggregate Annual Debt Service Requirement.

The proposed Second Amendment to the Revolving Credit Agreement will be posted to the agenda webpage for the joint meeting of the City and the Authority on or about June 18, 2021. Staff recommends that the Council approve the City's negotiation, execution and delivery of the Second Amendment in the form posted to the agenda webpage for this meeting of the City together with such additions thereto and changes therein as the City Manager, the Director of Finance, or their authorized designees (collectively, the "Designated Officers"), each acting alone, shall deem necessary, desirable or appropriate upon consultation with the City Attorney and members of the City's Community Energy Department.

Because of complexity and time constraints of this funding request, the City expects to come back to Council with another amendment to the Barclay's credit agreement to extend the expiration dates and/or expand the capacity of the credit facility to provide Community Energy the necessary resources to meet power purchase capacity, following further discussions among Barclays, the City and its legal and financial advisors.

Repayment Schedule

The CP Notes issued for the identified purposes in the base case are expected to begin to be repaid in FY 23-24 and with full repayment in FY 25-26. SJCE may begin repayment earlier if market conditions are better than expected. SJCE may also bring forward a rate recommendation later this year which could result in repayment beginning in FY 22-23. These recommendations are dependent on the October forecast of the PCIA and SJCE's summer 2021 actual power supply costs. This recommendation will include rate options to repay debt and build reserves to include 180 days of operating expenses over the next several years. All fees and interest costs associated with the CP Notes proposed to be issued will be capitalized (i.e., paid by issuing additional CP notes), which avoids General Fund expenditure. These fees and interest costs will also be paid back within seven years as well.

Utilization of the CP Program

The City's CP program is a dynamic program employed by multiple City departments for multiple projects on different time schedules. Currently insufficient capacity is available to meet the full potential SJCE need, and therefore staff is proposing a 'springing authorization' to permit borrowing as the capacity becomes available.

As amounts of prior projects funded with CP are either paid down by departments utilizing CP and/or deauthorized or the capacity of the CP program is expanded above $125 million, the amount of CP authorized for SJCE will increase. If additional CP capacity is needed in order for SJCE to borrow, Finance would plan to seek authorization to expand the current capacity of the CP program which is currently $125 million. In addition, Finance is planning refundings associated with several projects that would include refunding of associated CP Notes and therefore free up additional CP capacity.

Beginning in June 2020 and continuing in FY 2021-22, staff expects to initiate monthly CP issuances to fund SJCE power supply and operating costs. By February 2022, SJCE's conservative projection is a cumulative $70 million shortfall to be covered with proceeds of CP Notes. After February 2022, SJCE projects it will have sufficient funding to continue to purchase power supply and show a positive cash flow. While cash flow will be positive after February, SJCE will not be able to immediately repay its CP Notes. The Second Amendment to the Revolving Credit Agreement requires SJCE to demonstrate it has $50 million in unrestricted/restricted reserves. The $50 million is required to be maintained after CP repayments are made.

City staff across multiple departments reacted quickly to this dynamic situation not only developing a funding solution to use the City's commercial paper program to assist with the financial challenges of SJCE, but also working expeditiously with bond counsel, Jones Hall and the SJCE credit provider, Barclays, to draft the recommended amendments to the existing credit facility with the Bank.

The table below illustrates the current CP outstanding by project as of June 14, 2021, along with project amounts approved but not yet issued for CP issuance. The table also shows CP redemptions scheduled for June 2021, and deauthorization amounts for Parks Recreation Neighborhood Services and Public Works projects on June 22, 2021 as part of this Council recommendation.

Commercial Paper Notes Outstanding
(as of June 18, 2021)

	Amount ($ millions)		
Project	Issued	Authorized, Unissued	Total
ESCO Conservation Equipment	$7.6		$7.6
Central Service Yard Phase II	3.2		3.2
Convention Center Exhibit Hall	8.4		8.4
Convention Center - South Hall[5]	42.4		42.4
PW – Fire Training Center / CSY		19.2	19.2
PW – EOC at CSY		4.2	4.2
PRNS – Floods		15.1	15.1
Existing Program	$61.6	$38.5	$100.1
CP Program Issuance Capacity			$125.0
Current Unutilized Capacity			***$24.9***
Planned and Proposed Changes			
CP Notes Partial Redemption in June 2021 (CSY Phase II)	($1.2)		($1.2)
CP Notes to Be Issued in June 2021 (PRNS – Floods)	0.9		0.9
PRNS - Floods Deauthorized in June 2021		($7.8)	(7.8)
PW - Fire Training Center/CSY Deauthorized in Sept. 2021[6]		(19.2)	(19.2)
Redemption from LRB – FTC/CSY in October 2021	(2.7)		(2.7)
Potential Future Redemption of South Hall in December 2021	(42.4)		(42.4)
Anticipated Changes	($45.4)	($27.0)	($72.4)
TOTALS	$16.2	$11.5	$27.7
CP Program Issuance Capacity			$125.0
Projected Unutilized Issuance Capacity for SJCE			$97.3
Total Current Projected SJCE Need			$69.6

[5] The Finance Department has begun preliminary planning for South Hall refunding, in conjunction with Special Hotel Tax Bond refundings (Series 2011/2011A) scheduled for FY 2022 to free up additional capacity.
[6] Expected in conjunction with the issuance of new Lease Revenue Bonds to fund the project.

Risks associated with the CP Program

The CP Program is subject to the following risks:

- LOC Renewal Risk - Should the Banks decide not to renew the LOCs upon expiration in February 2022 and no replacement banks are identified, the CP Notes outstanding will need to be repaid in full. The General Fund is ultimately responsible for the repayment of outstanding notes. LOC fees are subject to change at future renewal dates based on market conditions.

- Interest Rate Risk - The interest rate for CP Notes may increase significantly depending on the overall financial market conditions.

- Downgrade Risk - The Banks' credit ratings may be downgraded in the future due to changes in the market's perception of the financial health of the Banks. To the extent a downgrade occurs, the CP Notes may become unmarketable. Additionally, if the City is downgraded by any of the credit rating agencies, the annual fees for the LOCs backing the CP Notes may be increased based on a schedule agreed to by the Banks, the Authority, and the City.

- Marketability Risk - If there is a lack of market demand for CP Notes, the notes may be tendered back to the Authority and the Authority may not be able to find buyers for these notes.

The LOC is backed by certain real properties pledged as leased assets by the City and Authority with a total insured building value of approximately $185.8 million[7]. If any of the underlying leased assets as described above are no longer available for the City's continued use and occupancy, replacement assets would need to be identified or the CP Program capacity may be adversely impacted. Replacement assets require approval by the Banks.

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the Council and the Authority Board's approval of various actions related to the City of San José Financing Authority Lease Revenue Commercial Paper Program and amendment to the Revolving Credit Agreement with Barclays. These actions require no additional evaluation or follow-up to the Council or the Authority Board if conditions continue as assumed under the Base Case. If conditions worsen, staff will return to the Council and Authority Board with additional actions. As described in the Cost Summary/Implications section below, actions to adjust the 2021-2022 budget is anticipated later in the fall, likely as part of the 2020-2021 Annual Report that will be heard by the City

[7] As of August 2020, properties include Animal Care Center, Fire Station #1, Fire Station #3, Police Communications Center, South San Jose Police Substation, and Tech Museum.

Council in mid-October. Finally, an ongoing discussion on SJCE financials will be included in the Bi-Monthly Financial Report presented to the Public Safety, Finance, and Strategic Support Committee, as well as the Annual Report and Mid-Year Budget Review.

CLIMATE SMART SAN JOSE

The recommendation in this memorandum aligns with one or more Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

The proposed resolutions of the Council and the Financing Authority Board will be posted to the agenda webpage for the June 22, 2021 joint meeting of the City and the Authority Board.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

There is no commission recommendation or input associated with this action.

FISCAL/POLICY ALIGNMENT

As discussed above the proposed issuance of commercial paper notes and repayment term is consistent with the City's Debt Management Policy's provisions concerning repayment. The proposed financing plan is consistent with the City's Debt Management Policy which establishes objectives in order to obtain cost-effective access to the capital markets, which includes minimizing debt service and issuance costs; maintaining access to cost-effective borrowing; and ensuring compliance with applicable State and Federal laws.

COST SUMMARY/IMPLICATIONS

The CP Notes issued for the identified purposes are expected to be repaid over a three-year period, beginning in 2023-2024 and concluding in 2025-2026, solely from revenues of the SJCE enterprise. All fees and interest costs associated with the CP Notes to be issued will be capitalized (i.e., paid by issuing additional CP Notes), which has the effect of delaying repayment from SJCE revenues until 2023-2024. This gap in repayment allows for SJCE to rebuild sufficient reserve levels before needing to dedicate resources to pay down the CP Notes. The General Fund is not anticipated to be needed for repayment of CP Notes. The interest and fees on the CP Notes for $69.6 million are projected to total $572,000 in 2021-22, $870,000 in 2022-23, $1,044,000 in 2023-24, and $1,218,000 in 2024-25. This is only an estimated cost since the interest rate on CP is variable and will change over time. It is also important to note that the actual borrowing amounts may change based on SJCE's actual power costs.

The recommended 2020-2021 budget adjustments reflect the revised revenue and expenditure assumptions through June 30, 2021, including the issuance of $15.0 million in CP Notes. While future budget adjustments to Fiscal Year 2021-2022 will also be needed, staff will bring those changes forward in the fall, likely as part of the 2020-2021 Annual Report. At that time, the hottest months will have passed and the City will likely have additional information regarding Federal and State relief programs, PCIA changes, and future market conditions. In the interim, sufficient expenditure capacity is authorized with the currently approved 2021-2022 budget until later in the fiscal year.

BUDGET REFERENCE

The table below identifies the fund and appropriations impacted by the recommended actions included in this memo.

Fund #	Appn #	Appn. Name	Current Year Appn.*	Recommended Budget Action	2020-2021 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
501	R190	Financing Proceeds	$0	$15,000,000	X-87	6/23/2020, 3/2020, Ord. No. 79605
501	R120	Fees, Rates and Charges	$302,000,000	($13,050,000)	X-87	6/23/2020, Ord. No. 79605
501	202V	Cost of Energy	$272,074,395	$22,925,000	X-87	6/23/2020, Ord. No. 30437
501	8999	Unrestricted Ending Fund Balance	$26,882,733	($20,975,000)	X-87	5/18/2021, Ord. No. 30570

* *Assumes adjustments included in the Approval of Various Budget Actions for Fiscal Year 2020-2021 memorandum recommended for City Council consideration as part of Item 3.3 on June 22, 2021 are approved.*

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment.

/s/	/s/	/s/
JULIA H. COOPER	LORI MITCHELL	JIM SHANNON
Director of Finance	Director of Community Energy	Budget Director

For questions about commercial paper please contact Nikolai J. Sklaroff, Deputy Director of Finance, Debt and Treasury, at (408) 535-7832 and for questions about Clean Energy please contact Zach Struyk, Assistant Director of Community Energy, at (408) 535-4868.

Attachments

Attachment A

Structure of City of San José Financing Authority Commercial Paper Program and Summary of Program Amendments since Inception in 2004

The City leases to the City of San José Financing Authority (the "Authority") various City-owned facilities pursuant to a Site Lease (as amended, the "Site Lease"). The Authority subleased these same facilities back to the City pursuant to a Sublease (as amended, the "Sublease") in exchange for the rental payments which support repayment of the CP Notes. The facilities subject to the Site Lease and Sublease are the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communication Center, the South San José Police Substation, and the Tech Museum.

The Authority issues the CP Notes under the Marks-Roos Local Bond Pooling Act of 1985 pursuant to an Amended and Restated Trust Agreement between the Authority and Wells Fargo Bank, National Association (as amended and supplemented, the "Trust Agreement") and a Second Amended and Restated Issuing and Paying Agent Agreement between the Authority and Wells Fargo Bank, National Association. Barclays Capital, Inc. serves as the dealer for the CP Notes pursuant to an Amended and Restated Commercial Paper Dealer Agreement. The CP Notes are secured by two direct-pay letters of credit (LOCs) from State Street Bank and Trust Company and U.S. Bank, pursuant to a Letter of Credit and Reimbursement Agreement among each bank, the City and the Authority (as amended, the "Letter of Credit Agreements"). Under their respective LOCs, each bank is separately responsible for payments on all draws made on the applicable LOC. Each LOC is issued in the principal amount of $67,123,288 (half the program size of $125 million) plus interest calculated at the maximum rate of 12% for a period of 270 days.

The CP Program was established in January 2004 and has been amended, expanded and contracted through Council and Authority Board actions summarized below.

Date	**City Council/City of San José Financing Authority Board Actions**
January 13, 2004	Authorized the issuance of tax-exempt CP Notes in an amount not to exceed $98 million to finance public improvements of the City including the offsite parking garage for the new City Hall and non-construction costs for technology, furniture, equipment, and relocation services for the new City Hall.
November 9, 2004	Authorized the issuance of tax-exempt CP Notes to provide additional funding for the "Integrated Utility Billing, Customer Service and Performance Management System" (the "CUSP Project").
June 21, 2005	Authorized the issuance of taxable CP Notes, under the same $98 million not to exceed limitation as the tax-exempt notes. This subsequent authorization permits the Authority to issue taxable CP Notes to pay for expenses otherwise authorized under the CP Program, but ineligible to be paid from tax-exempt CP proceeds.
November 15, 2005	Authorized expanding the capacity of the CP Program from $98 million to $116 million and authorizing the issuance of CP Notes to pay a portion of the costs of the Phase II improvements at the City's Central Service Yard and a portion of the demolition and clean-up costs at the City's Main Service Yard.
May 22, 2007	Authorized the issuance of CP Notes in an amount not to exceed $8.25 million to pay for capital improvements at the City's HP Pavilion.

October 21, 2008	Authorized the issuance of CP Notes to refund bonds and other obligations of the City or the Authority pursuant to Government Code Sections 53570 et seq and 53580 et seq.
December 8, 2009	Authorized staff to amend and renew the Letter of Credit and Reimbursement Agreement supporting the CP Notes in order to extend the term to January 27, 2013.
April 20, 2010	Authorized the issuance of CP Notes to fund a loan to the low and moderate income housing fund and to fund short-term cash flow needs of the City.
March 15, 2011	Authorized the execution and delivery of a Third Amendment to the Site Lease, a Third Amendment to the Sublease, and other related actions pertaining to the Authority’s Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease.
June 19, 2012	Authorized the issuance of CP Notes in an amount not to exceed $10.0 million to provide funding for additional projects for the Convention Center Expansion and Renovation Project.
December 4, 2012	Authorized staff to amend and restate the Letter of Credit and Reimbursement Agreement supporting the CP Notes in order to extend the term to March 15, 2013.
February 12, 2013	Authorized staff to negotiate two new Letter of Credit and Reimbursement Agreements supporting the CP Notes; and authorized the execution and delivery of a Fourth Amendment to the Site Lease, a Fourth Amendment to the Sublease, and other related actions pertaining to the Authority’s Lease Revenue Commercial Paper Program in order to provide for the substitution of certain components of the property under the Site Lease and the Sublease. The facilities currently subject to the Site Lease and Sublease are: the Animal Care Center, Fire Station No. 1, Fire Station No. 3, the Police Communications Center, and the South San José Police Substation.
June 17, 2014	Authorized the Fifth Amendment to the Site Lease, a Fifth Amendment to the Sublease, and other related actions in order to provide for the addition of a component of property (the Tech Museum) under the Site Lease and the Sublease in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Program to provide additional security.
September 15, 2015	Authorized the issuance of CP Notes in an amount not to exceed $3.5 million to provide funding for the Municipal Water System’s Water Meter Replacement Project.
June 21, 2016	Authorized the issuance of CP Notes in an amount not to exceed $10.0 million to provide funding for Energy Conservation Projects.
January 31, 2017	Authorized the issuance of CP Notes in an amount not to exceed $15.0 million to provide funding for the Convention Center Exhibit Hall Project.
August 29, 2017	Authorized the issuance of CP Notes in an amount not to exceed $10.0 million to provide funding for startup costs relating to San Jose Clean Energy.
February 13, 2018	Authorized the issuance of CP Notes in an amount not to exceed $21.0 million to provide funding for the flood recovery and construction for parks and community facilities.

August 14, 2018	Authorized the issuance of CP Notes in an amount not to exceed $47.0 million to provide funding for the purchase of Convention Center - South Hall site and amendments of the two Letter of Credits and Reimbursement Agreements
August 14, 2018	Authorized the negotiation, execution, and delivery of amendments to two Letter of Credit and Reimbursement Agreements and authorizing other related actions in connection with the City of San José Financing Authority's Lease Revenue Commercial Paper Notes in order to increase the not-to-exceed aggregate principal amount thereof from $85 million to $125 million and to extend the stated expiration dates and commitments available under such Letter of Credit and Reimbursement Agreements
January 12, 2021	Authorized the issuance of CP Notes in an amount not to exceed $23.4 million to provide bridge funding for the Fire Training Center and Emergency Operations Relocation project.

Attachment B

Technical Aspects of Commercial Paper

The Mechanics of Commercial Paper

Commercial paper is debt that is sold with a maturity of between 1 and 270 days. The maturity of an individual commercial paper note is determined by the commercial paper dealer and the issuer at the time it is sold. Each commercial paper note bears interest at a fixed rate for the 1-270 day period of time it is outstanding; or is sold at a discount, and such interest or discount is payable when the note matures. (The procedures for the payment of interest on the commercial paper are described below under "Payment of Principal and Interest on Commercial Paper".)

Municipal commercial paper programs typically require the issuer to obtain credit support through one of more letters of credit provided by a commercial bank. Upon each note maturity, the paying agent is authorized and required to draw on the supporting letter of credit in the amount of principal and interest due on that date. The issuer may then "roll over" the commercial paper notes by issuing renewal notes and using the proceeds of the renewal notes to reimburse the draw on the letter of credit. To the extent that the commercial paper dealer is unable to find an investor for the renewal notes, the draw on the letter of credit remains unreimbursed and the issuer is responsible for repaying the bank or banks that provided the letter of credit. The terms and conditions governing the letter(s) of credit and the reimbursement process are memorialized in a reimbursement agreement entered into by and between the issuer and the bank or bank(s) that provided the letter of credit.

The renewal notes may be sold through a commercial paper dealer either to a new investor or to the investor who held the maturing note. The process of rolling over commercial new paper is not considered to be the issuance of additional debt as long as the amount of commercial paper outstanding is not increased as a result of the "roll over." Through the "roll over" mechanism, commercial paper can be kept outstanding indefinitely, as individual commercial paper notes continually mature and new commercial paper notes are issued.

Commercial paper is considered a form of variable-rate debt. Even though the interest rate on each commercial paper note is fixed at the time such note is issued, the rate on each commercial paper note will be based on market conditions at the time. The rates on new commercial paper notes will thus vary from one week or month to another. The actual cost of the program to the issuer will be the average rate on all of its outstanding commercial paper notes over time. Most issuers project such average rates on a quarterly or annual basis. Overall, commercial paper rates tend to be among the lowest available in the tax-exempt and taxable markets for municipal debt.

The buyers of commercial paper are considered short-term investors because their investments in commercial paper mature in 270 days or less. One of the attractive features commercial paper offers to an investor is that the maturities can be matched to the specific timing needs of an investor (such as 27 days, or 112 days). This helps an investor invest amounts for a very precise period of time until such funds are needed for a specific known payment obligation in the future. Buyers of commercial paper include major corporations and money market funds. Commercial paper is attractive to money market funds because it complies with the maturity limitations imposed on such funds, and the flexibility in setting the maturity of commercial paper may help the fund achieve or maintain the average maturity it is seeking. Money market funds are likely to continue to buy a given issue of commercial paper as it rolls over, and thus may own an issue for an extended period of time.

<u>Payment of Principal and Interest on Commercial Paper</u>

Commercial paper is not sold with a fixed principal repayment schedule. Instead, the issuer maintains almost complete flexibility with respect to the timing and amounts in which the principal amount of commercial paper will be repaid. The issuer can repay commercial paper on any date on which a commercial paper note is scheduled to mature by providing the funds to repay such note to the paying agent for the issue. The paying agent uses such funds to pay the holder of the commercial paper. At the same time, the issuer instructs its commercial paper dealer not to attempt to sell new commercial paper to roll over the paper that is maturing. Hence, when such steps are taken, the amount of commercial paper outstanding at the end of the day is reduced.

The individual commercial paper notes are likely to have different maturities, so an issuer repaying a commercial paper program would do so in a series of steps as the individual notes mature. However, since each note would have a maximum maturity of 270 days, an entire program could be repaid at the option of the issuer in not more than 270 days from the time the issuer decided to commence such a repayment. It is likely that an issuer planning to pay a program off in the near future would instruct its commercial paper dealer to issue the paper with short maturities as it rolls over, so that the issuer could retire the commercial paper quickly when it begins the repayment process.

As noted above under “The Mechanics of Commercial Paper,” interest or discount is payable on each commercial paper note as it matures. During the construction period for a project, the interest payable can be “capitalized” by adding the amount of interest due on the maturing commercial paper to the amount of new paper being sold. If this approach is used, the principal amount of paper outstanding over time will increase as additional interest is capitalized (subject to the maximum authorized amount of notes permitted to be outstanding at any one time under the program).

Interest on tax-exempt debt generally cannot be capitalized following completion of the projects financed with commercial paper. At that point, the issuer must provide to the paying agent the interest due at the time each note matures. The paying agent then pays such interest to the investor together with the proceeds received from rolling over the principal amount of the commercial paper. Since the interest at that point is being paid by the issuer, and not by increasing the amount of paper being rolled over, the principal amount of commercial paper outstanding will stay constant after the projects are completed. That principal amount outstanding could either be reduced in the future if the issuer decides to repay some, or all, of the program, or increased if the issuer decides to undertake additional projects (which may require an increase in the authorized amount of the program).