City of Gainesville

City Hall
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Legislation Text

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Refunding of Certain Outstanding Bonds, and Restructuring of Certain Interest Rate Swaps (B)

The City Commission: 1) Authorize the refunding of all or a portion of the outstanding Utilities System Revenue Bonds, 2005 Series B (Federally Taxable), 2005 Series C, 2006 Series A, 2008 Series A (Federally Taxable), and 2010 Series C through the issuance of variable-rate, tax-exempt bonds; 2) Authorize the refunding of all or a portion of the outstanding Utilities System Revenue Bonds, 2003 Series A and 2005 Series A through the issuance of fixed-rate, tax-exempt bonds; 3) Approve the selection of one or more Senior Managers for the refunding bonds referenced in 1 and 2 above and authorize the appointment of additional Co-Managers if, upon the advice of Public Financial Management (PFM), our Financial Advisor, doing so would enhance the distribution of the refunding bonds; 4) Authorize the restructuring of all or a portion of certain outstanding fixed payer CMS interest rate swaps with JPMorgan Chase Bank, N.A. and Goldman Sachs Mitsui Marine Derivative Products, L.P., either through the amendment of the existing swaps or through the entry into one or more additional swaps, in order to convert the payments to be received by the Utility under such swaps back to the original percentage of 1-month LIBOR formulation; 5) Authorize staff to negotiate and enter into an ISDA Master Agreement with Deutsche Bank in order to provide an additional potential swap counterparty to ensure GRU's ability to receive competitive market-based economics; 6) Authorize the utility to work with its Financial Advisor to select one or more counterparties to provide any additional swaps as described in 4 above; 7) Approve the designation of any such additional swaps as a "Qualified Hedging Contract" within the meaning of the City's Amended and Restated Utilities Bond Resolution; and 8) Authorize the Clerk of the Commission, the General Manager and other Authorized Officers of the City (as defined in the Utilities Bond Resolution) to execute such documents as may be necessary to proceed with the transactions authorized in 1-7 above (including such documents as are necessary or appropriate to evidence the amendment of the existing CMS swaps or the entry into additional swaps), subject to approval of the Office of the City Attorney as to form and legality, and to take such other actions as may be necessary or advisable to proceed with these transactions in accordance with this City Commission authorization.

In 2003, 2005, 2006, and 2010, the City issued its Utilities System Revenue Bonds, 2003 Series A (the "2003A Bonds"), 2005 Series A and 2005 Series C (the "2005A&C Bonds"), 2006 Series A (the "2006A Bonds"), and 2010 Series C (the "2010C Bonds"), respectively, to refinance certain bonds originally issued to finance or refinance certain of the Utility's capital projects. Since interest rates are lower now than when the 2003A Bonds, 2005A&C Bonds, 2006A Bonds, and 2010C Bonds were issued, we can refinance (refund) these Bonds with new debt and save money for our customers over time.

Also, in 2005 and 2008, the City issued its Utilities System Revenue Bonds, 2005 Series B (Federally Taxable) (the "2005B Bonds") and 2008 Series A (Federally Taxable) (the "2008A Bonds"), respectively, to finance the Deerhaven Environmental Controls (retrofit) project. Because the Deerhaven plant was subject to a Lease-In, Lease -Out (LILO) transaction, the 2005B Bonds and 2008A Bonds were required to be issued as taxable bonds. As such, the 2005B Bonds and 2008A Bonds have a shorter average life than would have been the case if those bonds had been issued as tax-exempt bonds, with larger principal and interest payments coming due through 2021. Subsequent to the issuance of the 2005B Bonds and 2008A Bonds, the LILO transaction was terminated. In 2010, the City refunded a portion of these bonds with tax-exempt bonds having a longer average life, similar to the life of the assets that were financed. Our recommendation is to again issue tax-exempt bonds to replace a portion of this higher cost taxable debt. The impact of replacing the shorter taxable debt amortization will be to reduce debt service in the fiscal years 2012 to 2020. Deferring the principal amortization on the refunding bonds to match the longer useful

life of the Utility's assets will result in an increase in overall total debt service, but an expected decrease in the present value of this debt service. The Utility will continue to target an overall level to declining debt service repayment schedule.

For the financings described above, the optimal structure will depend on market conditions existing at the time of execution. The structure will be designed to achieve expected net present value savings. The expected net present value savings calculation of the variable-rate portion of the refunding will be based on prevailing market conditions at the time of the sale of the refunding bonds, using a reasonable assumption of future variable rates. It is important to note that the expected net present value of the savings will be a function of both: (1) future interest rate assumptions for the variable rate bonds, and (2) the discount rate used to calculate the present value of future expected savings. PFM has recommended that the Utility use a future interest rate assumption for variable rate debt of 3.25%. This rate is 0.50% higher than the average variable rate for comparable variable rate debt programs over the past ten years, which has been roughly 2.75%, inclusive of all financing costs. PFM also has recommended an NPV discount rate of 4.00% be used to calculate the present value of expected savings. PFM believes that the Utility should use a discount rate that is roughly equal to the expected borrowing costs on the Utility's long term bond issues. The 4.00% rate is lower, and thus more conservative, than both the current and historical long term borrowing cost for the Utility. PFM believes that the 3.25% variable rate assumption and the 4.00% discount rate assumption are reasonable. However, PFM feels it is important to point out that the actual savings on the overall refunding will be a function of future interest rates. PFM cannot predict future interest rates, but does believe that the refunding transaction is an effective means by which the Utility can achieve its financial objectives. We recommend that our staff and Financial Advisor continue to monitor the market to select the best structure.

GRU staff and our Financial Advisor recommend that the transaction referred to above be accomplished through a negotiated sale of bonds following a competitive process to identify the firm(s) that bring the most value from a qualitative and quantitative perspective. While PFM recommends a negotiated sale process, the Utility will use a competitive selection process to determine which underwriting firm, or firms, are best suited to help the Utility carry out the financing in a manner that provides the best overall expected results.

Since all of the terms of the proposed financing have not yet been determined, the approval of the final terms of the bonds to be issued and the sale thereof is not being sought at this time; rather, Utility staff will seek City Commission approval of those bonds in or about June 2012 (which approval may be in the form of a delegation to the General Manager of the authority to determine, within pre-approved limits, the actual principal amounts and other terms and provisions of the bonds, similar to what the City Commission has approved for several previous Utility financings).

In 2006, GRU restructured certain interest rate swaps previously entered into with JPMorgan Chase Bank, N.A. and Goldman Sachs Mitsui Marine Derivative Products, L.P. ("GSMMDP") in order to synthetically fix the interest rates on the City's Variable Rate Utilities System Revenue Bonds, 2005 Series C and 2006 Series A. Under the original swaps, GRU received payments of 68% of the 1-month LIBOR rate. As restructured, the swaps were converted to "Constant Maturity Swaps" ("CMS"), pursuant to which GRU receives payments at a percentage of the 10-year LIBOR swap rate minus, in the case of the GSMMDP swap, a spread.

GRU originally restructured the swaps while the yield curve was flat, in anticipation that GRU would benefit once the yield curve returned to its historical steepness. Since 2006, the yield curve has steepened and the CMS swaps currently are more valuable than the original swaps would have been had they not been restructured. As a result, GRU can now convert the CMS swaps back to a percentage of 1-month LIBOR receipt swaps and capture this positive value in one of three ways: by decreasing the fixed payer swap rate paid by GRU, by receiving an upfront payment, or by receiving the value over a specific time period through a combination of a decreased fixed payer swap rate and an upfront payment; and the value can be realized either through an amendment of the existing CMS swaps or by entering into additional offsetting swaps.

We recommend that staff and our Financial Advisor continue to monitor and evaluate the available options to restructure the CMS swaps in order to determine the best alternative. If it is determined that the best alternative is to amend the existing CMS swaps, we recommend that the General Manager be authorized to negotiate and enter into such amendments upon such terms and conditions as he determines are necessary or desirable and commercially reasonable, such determination to be confirmed by our Financial Advisor, and subject to the approval of the Office of the City Attorney as to form and legality. Alternatively, if it is determined that the best alternative is to enter into additional swaps, we recommend that the General Manger be authorized (a) with the advice of our Financial Advisor, to select the counterparties for the additional swaps from among those firms with whom the Utility has International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreements (including Deutsche Bank, if and to the extent that the Utility enters into an ISDA Master Agreement with such Bank as described below) and (b) to enter into such documents evidencing the additional swaps (including, without limitation, a Confirmation under (and as defined in) the ISDA Master Agreement between the Utility and each selected counterparty) as he determines are necessary or desirable and commercially reasonable, such determination to be confirmed by our Financial Advisor, and subject to approval of the Office of the City Attorney as to form and legality.

In addition, since it may be advantageous to expand the number of potential counterparties, we recommend that the General Manger be authorized to negotiate and enter into an ISDA Master Agreement with Deutsche Bank AG, New York Branch in substantially the form of the ISDA Master Agreements to which the Utility currently is a party, and with such changes thereto as the General Manger shall determine are necessary or desirable and commercially reasonable, such determination to be confirmed by our Financial Advisor, and subject to the approval of the Office of the City Attorney as to form and legality. Deutsche Bank, with its strong credit rating, would complement the existing competitive pool of major municipal swap market counterparties.

To the extent that it is determined to be advantageous to enter into additional swaps as described above, we recommend that the City Commission approve the designation of any such additional swap as a "Qualified Hedging Contract" within the meaning of the Utilities Bond Resolution, and authorize the securing of such swap under the Utilities Bond Resolution.

The Clerk of the Commission, the General Manger or other Authorized Officers of the City may be required to take certain other actions and hire certain other professionals to proceed with these transactions. Therefore, we recommend that these officials be authorized to take such other actions as may be necessary or desirable to proceed with the transactions in accordance with this City Commission authorization.

Refunding existing debt and restructuring the CMS swaps as described above will help manage future debt service costs, as well as allow GRU to obtain debt service savings in the near term that are well above those we have utilized for our long-term financial projections.

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