Agenda Report

AUGUST 14, 2000

TO: City Council
THROUGH: Finance Committee

FROM: Cynthia J. Kurtz, City Manager

SUBJECT: APPROVAL OF A RESOLUTION OF THE CITY COUNCIL ESTABLISHING COMPETITIVE FINANCING PROCEDURES FOR, APPROVING THE PUBLICATION OF NOTICE OF AND AUTHORIZING THE DISTRIBUTION OF A REQUEST FOR AN INTEREST RATE SWAP, APPROVING THE FORM OF AN INTEREST RATE SWAP AGREEMENT, AUTHORIZING THE ENTRY INTO ONE OR MORE INTEREST RATE SWAP TRANSACTIONS AND CERTAIN ACTIONS RELATING THERETO

RECOMMENDATION

It is recommended that the City Council approve a Resolution establishing competitive financing procedures for, approve the Publication of Notice of and authorize the distribution of a Request for an Interest Rate SWAP and approve the Form of an Interest Rate Swap Agreement, authorize the entry into one or more Interest Rate Swap transactions and certain actions relating thereto.

BACKGROUND

In August 1999, the City sold approximately $102 million in Pension Obligation Bonds (POB) and provided $100 million of the proceeds to the Fire and Police Retirement System. The City structured the sale of the POBs into two series. Series A was for approximately $51 million and was fully amortized through March 2015. Series B was also approximately $51 million and was interest only through March 2015. At that time, the City has the option of calling all of the outstanding bonds without paying any prepayment penalties or to remarket the bonds through 2022.

Prior to bringing the 1999 financing to market, the City evaluated the potential benefits of issuing the 1999 Bonds with a variable rate of interest rather than at a fixed cost to maturity. Potential benefits of variable rate debt include a lower expected cost of funds and increased financial flexibility. Given the costs associated with issuing variable rate debt versus where fixed rates were at, it was determined that it was in the best interest of the City to proceed with two fixed rates series.

Interest rate movements in 2000 now favor a type of transaction called "synthetic variable rate debt", or more specifically, a "fixed-to-floating" interest rate exchange agreement or "swap". This is similar to the transaction previously approved by the City Council relating to the Electric Revenue Bonds. This type of interest rate exchange agreement offers the City the interest rate benefits (and risks) of variable rate debt, at a lower cost.

DISCUSSION

Usually the advantages of variable rate debt are achieved by financing capital improvements with variable rate bonds, or by utilizing variable rate debt to refinance outstanding fixed rate bonds. Staff is now recommending, however, that the City Council approve the entering into a swap agreement(s) which will allow the City to benefit from a variable rate obligation.

The attached resolution will enable Pasadena to issue requests for bids and enter into agreements if certain target levels are achieved. Because of the nature of variable interest rates, there is no guarantee as to annual interest costs while the agreements are in place, and estimated annual cashflow savings may change depending upon actual variable interest rates experienced over time. If variable rates move significantly upwards, swap transactions can result in an increase in debt service costs from present levels. If this happens, future actions can be taken by the City to mitigate the impact.

In general, a swap is an agreement between parties to exchange interest rates paid on an agreed upon notional amount. For example, Pasadena would enter into an agreement with a counterparty (typically a commerical or investment bank). Under this agreement, the counterparty will pay the City a fixed interest rate on the agreed upon notional amount, and the City agrees to pay the counterparty a variable rate on the same agreed upon amount. The difference in interest rates between the fixed interest rate determined at the time the contract is signed, and the variable interest rate, which is determined by a published index on a monthly basis, determines the relative payments of the parties.

The following actions are required to implement the swap agreement:

Council approval of the attached Resolution
Finalize exchange agreement terms
Review with credit rating agencies and adjust terms as necessary
Prepare and issue bid requests
Determine winning bids
Execution of swap agreement by Director of Finance

The notional amount of the interest rate exchange agreements approximate the size of Series B POBs and will have a final maturity of December 2014. The resolution sets the maximum amount of the notional amount; the actual amount may be reduced. The terms and conditions of the agreement will be finalized, within the framework established by the resolution, and reviewed by the Director of Finance prior to execution of the agreement.

Additional information is attached to this Agenda Report which describe the features of a swap agreement in greater detail.

FISCAL IMPACT

The size of the recommended SWAP will be approximately $51 million. At current market levels, this additional variable rate debt would result in an annual debt service savings for the City's General Fund of nearly $500,000.

Respectfully submitted,

CYNTHIA J. KURTZ
City Manager

Approved:

JAY M. GOLDSTONE
Director of Finance