RIVERSIDE COUNTY TRANSPORTATION COMMISSION	
DATE:	March 14, 2018
TO:	Riverside County Transportation Commission
FROM:	Budget and Implementation Committee Theresia Trevino, Chief Financial Officer
THROUGH:	Anne Mayer, Executive Director
SUBJECT:	Refinancing of 2009 Series B and C Sales Tax Revenue Bonds and Termination of Swap

BUDGET AND IMPLEMENTATION COMMITTEE AND STAFF RECOMMENDATION:

This item is for the Commission to:

1) Receive and file the presentation regarding the refinancing of the 2009 Series B and C Sales Tax Revenue Variable Rate Demand Bonds (2009 B&C Bonds) with the issuance of the 2018 Series A Sales Tax Revenue Refunding Bonds (2018 Refunding Bonds) and termination of the Bank of America, N.A. (BANA) swap;
2) Approve the termination of the interest rate swap with BANA in the currently outstanding notional amount of $70.8 million at an estimated termination cost of approximately $7.4 million (as of February 14, 2018 market conditions);
3) Approve the refunding of the 2009 B&C Bonds, currently outstanding in the amount of $70.8 million which is integrated with the BANA swap;
4) Adopt Resolution No. 18-002, "*Resolution Authorizing the Issuance and Sale of Not to Exceed $70,800,000 Aggregate Principal Amount of Riverside County Transportation Commission Sales Tax Revenue Refunding Bonds (Limited Tax Bonds) in One or More Series, the Refunding of Outstanding Bonds, the Execution and Delivery of a Ninth Supplemental Indenture, a Purchase Contract, an Official Statement and a Continuing Disclosure Agreement, and the Taking of All Other Actions Necessary in Connection Therewith*";
5) Approve the proposed form of the Official Statement for the issuance of not to exceed $70.8 million in 2018 Refunding Bonds and authorize the Executive Director to approve and execute the printing and distribution of the final Official Statement;
6) Approve the proposed form of the Continuing Disclosure Agreement related to the 2018 Refunding Bonds, by and between the Riverside County Transportation Commission and Digital Assurance Certification, L.L.C., as dissemination agent, and authorize the Executive Director to approve and execute the final Continuing Disclosure Agreement;

7) Approve the proposed form of the Ninth Supplemental Indenture for the 2018 Refunding Bonds, by and between the Riverside County Transportation Commission and U.S. Bank National Association (US Bank), as Trustee, and authorize the Executive Director to approve and execute the final Ninth Supplemental Indenture; Approve the proposed form of the Bond Purchase Agreement between the Riverside County Transportation Commission and Merrill Lynch, Pierce, Fenner & Smith Incorporated (BofAML), as Underwriter Representative acting on behalf of itself and Goldman, Sachs & Co. (Goldman), (collectively the Underwriters), for the 2018 Refunding Bonds and authorize the Chief Financial Officer to approve and execute the final Bond Purchase Agreement;
8) Approve the estimated costs of issuance, including estimated underwriter's discount, of $517,000 to be paid from the bond proceeds;
9) Approve Agreement No. 04-19-029-12, Amendment No. 12 to Agreement No. 04-19-029-00, with Fieldman Rolapp & Associates, Inc. (Fieldman) for financial advisory services related to the issuance of the 2018 Refunding Bonds and the termination of the BANA swap for an additional amount not to exceed $67,500;
10) Approve Agreement No. 05-19-510-14, Amendment No. 14 to Agreement No. 05-19-510-00, with Orrick, Herrington, & Sutcliffe LLP (Orrick) for bond counsel services related to the issuance of the 2018 Refunding Bonds and the termination of the BANA swap for an additional amount of $115,000 and a total amount not to exceed $2,965,000;
11) Approve Agreement No. 09-19-072-12, Amendment No. 12 to Agreement No. 09-19-072-00, with Norton Rose Fulbright US LLP (Norton Rose) for disclosure counsel services related to the issuance of the 2018 Refunding Bonds and the termination of the BANA swap for an additional amount of $45,000 and a total amount not to exceed $857,600; and
12) Approve adjustments to the FY 2017/18 budget in the amounts of $74,930,000 to increase sources related to the issuance of refunding bonds and $78,763,000 to increase uses related to the use of the refunding bond proceeds.

BACKGROUND INFORMATION:

At its December meeting, the Commission approved the advance refunding of a portion of the outstanding sales tax revenue bonds as a result of tax reform legislation that would, among other changes, no longer permit advance refundings of tax-exempt municipal debt after December 2017. On December 28, the Commission completed the issuance of $392.7 million of 2017 Series B Sales Tax Revenue Refunding Bonds (2017 Refunding Bonds) in order to advance refund $410.1 million of a portion of sales tax revenue bonds issued in 2010 and 2013. The result was $52 million in Measure A funds that will be available to the Commission through 2039 for critical transportation improvements in Riverside County rather than used for debt service. The net present value savings of $40 million was 9.74 percent of the principal amount of debt refunded, much higher than the 3 percent target required by the Commission's debt policy adopted in September 2016.

Following the advance refunding in December, the outstanding debt secured by Measure A sales tax revenues consists of the following:

Description	Final Maturity	Amount Outstanding
2005 Commercial Paper Series A Notes[1]	June 2039	$ 0
2009 Series B and C Variable Rate Bonds (Tax-Exempt)	June 2029	70,800,000
2010 Series B Bonds (Taxable Build America Bonds)	June 2039	112,370,000
2013 Series A Bonds (Tax-Exempt)	June 2039	89,755,000
2016 Series A Refunding Bonds (Tax-Exempt)	June 2029	73,240,000
2017 Series A Bonds (Tax-Exempt)	June 2039	158,760,000
2017 Series B Refunding Bonds (Tax-Exempt)	June 2039	392,730,000
		$ 897,655,000

[1]*Currently authorized to be issued up to a maximum par amount of $60 million*

President Trump signed the tax reform legislation known as the Tax Cuts and Jobs Act (Act) on December 22. The Act included a cut in the corporate tax rate from 35 percent to 21 percent beginning in 2018. While the municipal bond market is still adjusting for the new tax reforms, tax-exempt yields are expected to move higher relative to taxable yields to compensate for the lower after tax value of holding tax-exempt investments due to the lower corporate tax rate. An increase in tax-exempt yields exposes the Commission to some risks related to its variable rate debt and related swap as discussed in the following section.

Commission's Variable Rate Debt and Interest Rate Swaps History

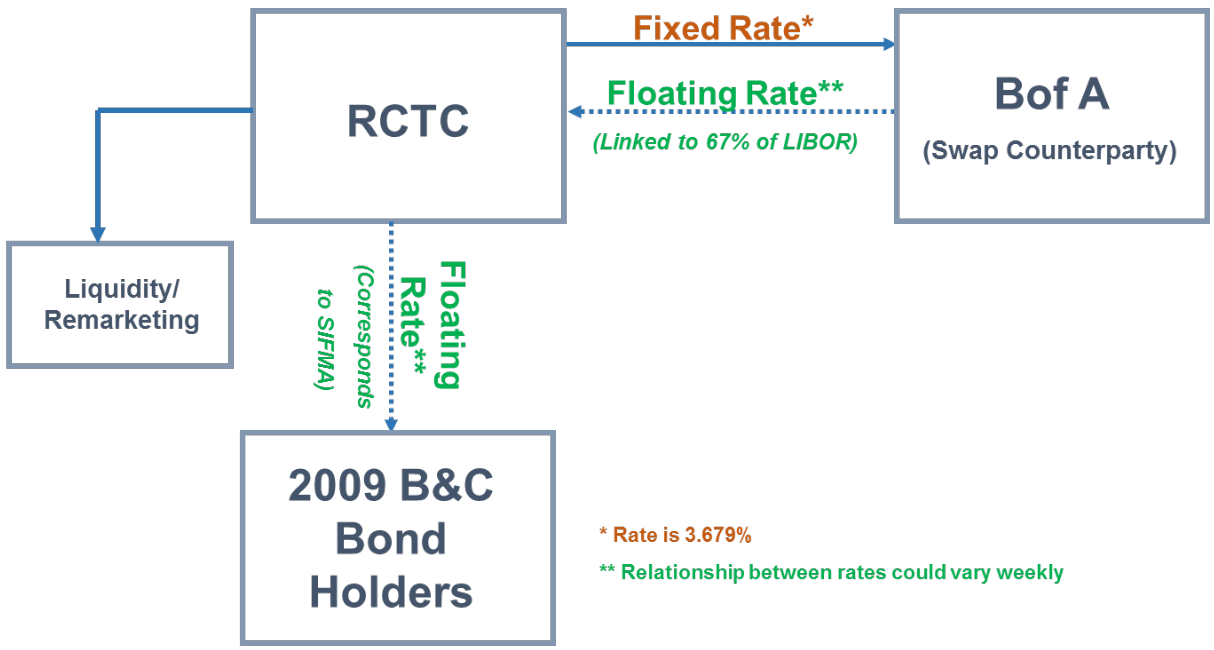
In 2006, due to the uncertainty of future interest rates in connection with anticipated long-term debt issuances related to the 2009 Measure A, staff in consultation with Fieldman recommended an interest rate swap strategy to insulate the Commission's 2009 Measure A financing program against future interest rate volatility. Other transportation agencies, such as the San Diego Association of Governments and Contra Costa Transportation Authority also pursued similar strategies. The Commission wanted to achieve a greater level of interest rate stability when it made this business decision; it was not a bet on the direction of future interest rates. While the swap has worked as intended, a swap transaction and the underlying variable rate bonds are complex and involve risks such as tax, basis (potential mismatch between rate indexes over time), rollover, liquidity, termination, counterparty or credit, and interest rate. The Commission understood these risks when it approved the swap strategy and realized it might need to have mitigation strategies available should one or more of the risks materialize in the future.

A chronological overview of the implementation of the swap strategy and subsequent variable rate sales tax revenue financings is presented below.

July 2006	Commission authorized the execution of swap transaction documents with counterparties.
August 2006	Commission awarded forward-starting interest rate swap agreements to BANA and Lehman Brothers Derivative Products, Inc. (LBDP) for $100 million and $85 million, respectively, to become effective on October 1, 2009. The Commission anticipated issuance of at least $185 million of variable rate long-term debt in 2009 (following the start of the 2009 Measure A) to refinance outstanding commercial paper. The Commission established the commercial paper program in March 2005 in order to advance 2009 Measure A project development. Under the swap terms, the Commission receives 67 percent of one month LIBOR (generally equivalent to the rate on floating rate bonds at the time) and pays 3.679 percent to the swap counterparty on the outstanding, or notional, amount.
May 2008	Commission authorized the issuance of bonds to refinance outstanding commercial paper.
June 2008	Commission issued $126.4 million of 2008 Bonds with the intent to refinance them with a bond issuance in October 2009. The 2008 Bonds were issued with a June 1, 2029 final maturity but were subject to mandatory tender on December 1, 2009.
September 2008	Lehman Brothers Holdings (Lehman) filed for bankruptcy as a result of credit crisis. Under the terms of the LBDP swap, Lehman's bankruptcy was a "trigger event" resulting in an early termination of the swap agreement. In accordance with the swap agreements and based on the fall in interest rates between August 2006 and September 2008, the Commission made a $3.45 million termination payment to LBDP. Commission authorized the Executive Director to enter into a replacement interest rate swap agreement. The Commission executed an agreement with Deutsche Bank (DB) at a fixed interest rate of 3.206 percent.
October 2009	Commission issued $185 million of 2009 Bonds in three series: A, B, and C. The bond proceeds refinanced the 2008 Bonds and $53.7 million of outstanding commercial paper. The 2009 Bonds were integrated with the interest rate swaps that became effective in October 2009, thereby creating synthetic fixed rate debt.
May 2016	Moody's Investors Service (Moody's) lowered DB's long-term rating to Baa2, resulting in a termination event under the swap agreement. This downgrade was the second downgrade by Moody's in 2016.
July 2016	DB did not assign the swap to another qualified counterparty, and the Commission gave notice to DB to reserve its rights to terminate the swap.
September 2016	Commission terminated the DB swap and negotiated a $10.3 million termination settlement payment.
October 2016	Commission issued $76.1 million of 2016 Refunding Bonds at a fixed interest rate to refund Series A of the 2009 Bonds, finance the swap termination payment, refund all outstanding commercial paper, and pay costs of issuance.

Since issuance in 2009, repayment of each series of the 2009 Bonds has been secured by a separate standby bond purchase agreement (SBPA) with a bank as a liquidity facility and remarketed on a weekly basis by remarketing agents. The current SBPAs for the 2009 B&C Bonds were obtained from Bank of Tokyo-Mitsubishi UFJ, Ltd., acting through its New York Branch, and expire in March 2019. The current remarketing agent is Barclays Capital for the 2009 B&C Bonds.

As noted earlier, the 2009 B&C Bonds issued at a variable interest rate are integrated with the interest rate swap to create synthetic fixed rate debt, as illustrated in the graphic:



The variable rate on the bonds corresponds to the SIFMA rate and is based on the weekly remarketings by Barclays Capital; the floating rate on the payment received from the swap counterparty is based on 67 percent of LIBOR.

- The SIFMA Municipal Swap rate is the Securities Industry and Financial Markets Association 7-day high-grade market index comprised of tax-exempt variable rate debt obligations reset rates that are reported to the Municipal Securities Rule Making Board's reporting system.
- The London interbank offered rate, or LIBOR, is a global taxable bond benchmark based on estimates of interbank lending rates. Since LIBOR represents taxable rates, it historically has been a higher rate than that payable on tax-exempt debt.

The floating rate received under the swap was set at 67 percent of LIBOR to approximate tax-exempt rates based on historical models correlating LIBOR and SIFMA. In 2017 it was announced that LIBOR will be phased out by the end of 2021 because there wasn't sufficient meaningful data to maintain the benchmark; however, a replacement has not been identified creating uncertainty regarding LIBOR-based swap rates and resulting in increased volatility.

The goal of the two transactions is the netting out of the variable rate paid on the bonds and the floating rate received — leaving the Commission essentially with a fixed rate payment to create synthetic fixed rate debt in addition to liquidity and remarketing fees. Tax reform may impact prior assumptions about the correlation between LIBOR and SIFMA and tend to cause the variable rate on the bonds to exceed the floating rate received under the swap.

A swap is a derivative instrument that hedges identified financial risks, and if the derivative instrument is determined to be effective in reducing the identified exposure, hedge accounting provides that the changes in the fair value of the swap is reported in the government's statement of net position. In connection with the preparation of the Commission's annual financial statements, staff has obtained a swap valuation report from Fieldman to determine the effectiveness of the swap. Since implementation of the swap strategy and issuance of variable rate bonds, the analysis indicated that the swap has been effective as a hedging instrument. Additionally, the Commission has disclosed the credit risk, interest rate risk, basis risk, and termination risk in the financial statements.

The table below summarizes the average annual performance of the synthetic fixed rate debt related to the BANA swap for each year.

	6/30/2010	6/30/2011	6/30/2012	6/30/2013	6/30/2014	6/30/2015	6/30/2016	6/30/2017
RCTC receives 67% of LIBOR *(floating rate)*	0.1770%	0.1700%	0.1600%	0.1420%	0.1110%	0.1160%	0.1116%	0.5020%
RCTC pays SIFMA to bondholders *(floating rate)*	0.2350%	0.2400%	0.1400%	0.1430%	0.0650%	0.0409%	0.1207%	0.6447%
RCTC basis differential *Cost (Gain)*	0.0580%	0.0700%	-0.0200%	0.0010%	-0.0460%	-0.0751%	0.0091%	0.1427%
RCTC pays counterparty *(fixed rate)*	3.6790%	3.6790%	3.6790%	3.6790%	3.6790%	3.6790%	3.6790%	3.6790%
RCTC pays liquidity & remarketing fees *(fixed cost)*	1.0125%	1.3500%	1.00500%	0.8900%	0.8900%	0.5793%	0.4975%	0.4975%
RCTC net cost of funds for year	4.7495%	5.0990%	4.6640%	4.5700%	4.5230%	4.1832%	4.1856%	4.3192%

In past years, the Commission unfortunately experienced termination risk in connection with Lehman's bankruptcy and credit and termination risks as a result of DB's rating downgrades. Now the Commission faces unforeseen tax and basis risks anticipated from recent federal tax reform.

- With corporate tax rates decreasing from 35 percent to 21 percent (tax risk), the value to corporations (a majority of the purchasers of the bonds) of holding tax-exempt debt would decrease and they will require a higher tax-exempt rate to compensate.
- The municipal bond market expects that tax-exempt rates will increase and the difference or spread between tax-exempt and taxable rates will get tighter. As a result, the Commission may be paying more to the bondholders of the 2009 B&C Bonds than the 67 percent of LIBOR that it receives from BANA under the swap (i.e., basis risk). In the above table, basis risk is quantified as "RCTC basis differential Cost (Gain)."

The Commission will also be exposed to credit risk of BANA and liquidity providers, as well as renewal risk considering that the SBPAs expire in March 2019 and will need to be extended or replaced if the proposed refinancing does not occur. The future of LIBOR is uncertain, and the implication on LIBOR rates in the long run is unknown.

<u>Refunding Plan</u>

The proposed 2018 Refunding Bonds are fixed rate bonds with maturities through June 2029 to match the final maturity of the outstanding 2009 B&C Bonds. The issuance of the refunding bonds is not considered a complex transaction requiring significant financial development and modeling. Staff recommends a negotiated debt sales process rather than a competitive bid process, as permitted in the Commission's debt policy, in order to realize some efficiencies based on the recent refunding transaction and due to the swap termination negotiation process.

Staff recommends the selection of BofAML and Goldman, from the Commission's pool of qualified underwriters established in April 2015, to participate in a negotiated debt sales process. These two firms have participated as senior managing underwriters in recent Commission financings and provide frequent market updates and refunding overviews. Due to the modest size of the proposed transaction, a larger group of underwriters would not yield additional benefits to the Commission in terms of selling the bonds.

Fieldman prepared a cash flow analysis (Attachment 1) comparing the projected debt service on the existing bonds, including SBPA and remarketing fees, and the issuance of the 2018 Refunding Bonds at fixed interest rates. The projected refinancing, which incorporates an estimated termination cost of approximately $7.4 million as of February 14, 2018, results in a net present value savings of approximately $49,000, or 0.07 percent of the refunded bonds and a $6 million reduction in the amount of the outstanding sales tax revenue bonds from $70.8 million to $64,760,000. The reduction in the outstanding bonds amounts includes application of an estimated $3.8 million of debt service funds withheld by the trustee from monthly Measure A receipts as of financial close. These results will vary depending on the specific market conditions at the bond sale date. Changes in the LIBOR swap curve will result in changes in the swap termination value until the swap is officially terminated.

The projected net present value savings percentage of this refunding is lower than the debt management policy threshold of 3 percent of the par value of the refunded bonds. As permitted by the debt management policy, the Commission may approve the refinancing at a lower savings level based on proper justification. Staff submits the justification that the refinancing will eliminate the risks posed by maintaining the existing swap and 2009 B&C Bonds, including liquidity and remarketing costs, as a result of tax reform, at little or no net cost, and potentially a small gain.

Staff and Fieldman have commenced negotiations with BANA to achieve the lowest termination cost to the Commission. Due to the specialized nature of interest rate swaps, staff recommends that the Commission engage a firm with extensive swap experience to ensure the termination settlement is based on a fair market level based on independently verified information. In connection with the termination of the DB swap and issuance of refunding bonds in 2016, Riverside Risk, which is based in New York and serves clients across various industries across the world, provided similar services. Due to the time-sensitive nature of a swap termination and issuance of refunding bonds, staff recommended a sole source award to Riverside Risk for swap advisory services in the amount of $41,000, and an agreement was executed using the Executive Director's single signature authority.

The financing team that participated in the development of this proposed refunding plan and related documents is comprised of the following key members:

- Financial Advisor: Fieldman
- Underwriters: BofAML and Goldman
- Bond Counsel: Orrick
- Disclosure Counsel: Norton Rose
- General Counsel: Best Best & Krieger LLP
- Trustee: US Bank
- Rating Agencies: Fitch Ratings and S&P Global Ratings
- Swap Advisor: Riverside Risk Advisor

Draft documents for the issuance of the 2018 Refunding Bonds were submitted to the rating agencies in order to obtain updated long-term debt ratings on the Commission's sales tax revenue debt prior to the March Commission meeting.

The proposed documents for this transaction will continue to be reviewed and revised for any matters that arise as a result of the rating agency reviews and other matters. The preliminary official statement is expected to be posted on March 15 following Commission approval, and the sale of bonds is scheduled for the week of March 26. The swap termination cost negotiations are expected to conclude on or prior to the sale of the 2018 Refunding Bonds. Closing of this financing transaction is expected on April 12. The drafts of the documents for the proposed 2018 Refunding Bonds are attached for the Commission's adoption or approval consist of the following:

- Resolution No. 18-002 (draft) authorizing the issuance and sale of not to exceed $70.8 million aggregate principal amount of Riverside County Transportation Commission sales tax revenue refunding bonds (limited tax bonds) in one or more series, the refunding of outstanding bonds, the execution and delivery of a ninth supplemental indenture, a purchase contract, an official statement, and a continuing disclosure agreement; and the taking of all other actions necessary in connection with this transaction (Attachment 2);
- Preliminary Official Statement (draft) for the 2018 Refunding Bonds (Attachment 3);
- Continuing Disclosure Agreement (draft) between the Commission and the dissemination agent for the 2018 Refunding Bonds (Attachment 4);
- Ninth Supplemental Indenture (draft) between the Commission and the trustee regarding the terms and conditions of the issuance of the 2018 Refunding Bonds (Attachment 5); and
- Bond Purchase Agreement (draft) between the Commission and the underwriters regarding the purchase of the 2018 Bonds (Attachment 6).

Additionally, staff recommends approval of the estimated costs of issuance of $385,000 for the 2018 Refunding Bonds, as well as the execution of related agreements or amendments to agreements as the issuance of refunding bonds was not anticipated in the FY 2017/18 budget and/or there is not sufficient capacity in existing agreements for the additional fees. The costs of issuance, which exclude the underwriters' discount of approximately $134,000, are summarized as follows:

Role/Purpose		Amount
Bond counsel	$	115,000
Disclosure counsel		45,000
General counsel		20,000
Financial advisor		67,500
Swap advisor		41,000
Trustee		6,000
Rating agencies		67,000
Dissemination agent		2,500
Publication and printing		2,200
Other and contingency		18,800
Total	**$**	**385,000**

As part of the action to authorize the issuance of the 2018 Refunding Bonds, the Commission will approve the form of the preliminary Official Statement and authorize its distribution in connection with the sale of the refunding bonds, as well as the preparation of a final Official Statement once the bonds have been sold and priced. These offering documents are required under state and federal securities laws prohibiting the offer and sale of securities such as the 2018 Refunding Bonds, unless all matters that would be material to an investor in the bonds have been adequately disclosed and that there is no omission of material facts. Furthermore, under rules of the Securities and Exchange Commission, the underwriters cannot purchase the bonds unless they have received a substantially final offering document, which discloses all material information that they reasonably believe to be true and correct.

The Commissioners serving on the Board as the governing body of the issuer of the 2018 Refunding Bonds are expected to read and be familiar with the information described in the draft preliminary Official Statement included with this staff report. The Commissioners may employ the services of experts to take the lead in the drafting and review of the Official Statement and to provide financial projections included in the Official Statement; however, the Commissioners have the duty to review the information and bring to the attention of those responsible for the preparation of the offering document any material misstatements or omissions in the draft and to ask questions if they are unclear about the information or their role. Some members of the financing team will be available at the Commission meeting to respond to the identification of any misstatements or omissions or to such questions.

Required State Disclosures

Senate Bill 450 (SB450) was signed by the Governor in October 2017. For bonds with a term greater than 13 months, SB450 requires the governing body to obtain and disclose certain information in a public meeting. The information needs to come from a good faith estimate from an underwriter, financial adviser or private lender. The required information, as defined in SB450, is disclosed below and can be found in the analysis (Attachment 1) provided by Fieldman, the Commission's financial advisor, as a good faith estimate, assuming the 2018 Refunding Bonds are sold based on market interest rates prevailing at the time of preparation of this information, including anticipated original issuance premium.

Required Information	Amount	Attachment 1 Page
True interest cost of the bonds	2.389%	2
Finance charge of the bonds (sum of all fees and charges paid to third parties)	$519,359	1
Amount of proceeds received by Commission less the finance charge and any reserves or capitalized interest	$74,929,026	1
Total payment amount (sum of all debt service payments through the final maturity plus any amount of the finance charge not paid from proceeds of the bonds)	$86,003,228	9

Fiscal Impact

Staff recommends budget adjustments of $74,930,000 to increase the budget for debt proceeds, $78,243,000 to increase the budgets for debt service related to the payment to escrow agent for the refunded bonds and the swap termination cost, and $520,000 to increase the budgets for costs of issuance and professional services.

Financial Information						
In Fiscal Year Budget:		No	Year:	FY 2017/18	Amount:	$74,930,000 (proceeds) $70,800,000 (debt service) $7,443,000 (swap cost) $520,000 (issuance costs)
Source of Funds:	Measure A sales tax revenue refunding bonds				Budget Adjustment:	Yes
GL/Project Accounting No.:	309-31-59101 309-31-59103 309-31-96101 309-31-96103 309-31-65XXX 309-19-97201	$64,760,000 $10,170,000 $70,800,000 $135,000 $385,000 $7,443,000	(refunding bond proceeds) (premium from bond proceeds (payment to escrow agent for refunded bonds) (costs of issuance related to underwriter's discount) (costs of issuance related to professional services) (swap termination payment)			
Fiscal Procedures Approved:					Date:	02/16/2018

Attachments: Enclosed on CD

1) 2018 Refinancing Sources and Uses of Funds Analysis as of February 14, 2018
2) Resolution No. 18-002 (draft)
3) Official Statement (draft)
4) Continuing Disclosure Agreement (draft)
5) Ninth Supplemental Indenture (draft)
6) Bond Purchase Agreement (draft)
7) Orrick Agreement No. 05-19-510-14 (draft)
8) Norton Rose Agreement No. 09-19-072-12 (draft)
9) Fieldman Agreement No. 04-19-029-12 (draft)