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OFFICE OF THE CITY CLERK
OAKLAND

2012 APR 27 AM 10:41

CITY OF OAKLAND

AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Katano Kasaine

SUBJECT: INTEREST RATE SWAP
(GOLDMAN SACHS & CO.)

DATE: April 25, 2012

City Administrator Approval		Date	4/27/12

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Staff recommends that the City Council adopt a resolution authorizing the City Administrator to negotiate and terminate the City's interest rate Swap Agreement with Goldman Sachs & Co., to the extent that the City is able to do so, at a below market value cost and not later than the end of the next Fiscal Year, June 30, 2013, and report back to the City Council with the final results of the termination.

EXECUTIVE SUMMARY

When the City of Oakland (the "City") restructured the City of Oakland, California Special Refunding Revenue Bonds (Pension Financing) 1988 Series A (the "1988 A Bonds") in 1998, it entered into a forward-starting synthetic fixed rate swap agreement (the "Swap") with Goldman Sachs Mitsui Marine Derivatives Products, U.S., L.P. (the "Goldman Sachs") in connection with the issuance of Oakland Joint Powers Financing Authority (the "Authority") Lease Revenue Bonds, 1998 Series A1/A2 (the "1998 Bonds"). The original series of bonds was fied to the Swap were fixed in 2008, the Swap no longer serves its original purpose, which was to mitigate interest rate risk. As of March 30, 2012, the notional amount on the swap is $68.9 million and the Swap does not expire until 2021. Due to changes in interest rates since the execution of the Swap, as of April 19, 2012, the Swap had a negative market value of approximately $15.57 million.

The Swap is a contractual arrangement under which the City is obligated to make payments based on a fixed rate equal to 5.6775% to Goldman Sachs until 2021. Similarly, Goldman Sachs is obligated to make payments to the City based on short term floating rates which, in light of current market conditions, are currently below the fixed rate and expected to remain so. The City pays approximately $4 million annually in interest on the Swap (net of Goldman Sachs payments).

There have been many speculations and misleading information in the public regarding the City's Swap, therefore, the City contracted an outside consultant, BLX Group LLC ("BLX") to review the terms and prepare various analyses to determine the City's net benefit relating to the Swap. The analyses conducted by BLX will help clarify the Swap structure and assist the City in evaluating the available options such as, 1) terminating, 2) refinancing or 3) leaving the Swap in place unfil 2021. BLX's analysis consisted of the following:

- Retrospective analysis of the original bonds and the cash flow impact of the subsequent series of refunding bond issues, including the Swap.
- Evaluation of the counterparty fees that were charged on both the original execution date of the swap (1997) and the restructuring date (2003) to ensure proper pricing.
- Evaluation of the economics of terminating, refinancing, and continuing with the Swap under current market conditions.

Overall, the City has realized a net benefit of approximately $37.5 million in present value savings from the Swap, even with the various refinancings that occurred. The analyses also indicates that the pricing levels at the time of execution in 1997 and the 2003 restructuring was in line with the current market at that time.

Below is a chart summarizing the analysis conducted to calculate the net present value savings for the three options noted above: [1) Terminating (2013 Termination with Cash), 2) Refinancing (2013 Termination Financed at an estimated interest rate of 4%), 3) Leaving the Swap in place until 2021]

Summary of Savings (in 000s)

	1985A Debt Service	Ref. Bonds Debt Service (1)	1998A Swap/Note & DSRF	Total Adjusted Debt Service	Gross Savings(2)	FV'd Savings (4/1/12)(3)	PV of Future Savings	NPV(4)
1	$521,565	$491,899	$46,917	$538,817	($17,251)	$87,604	($50,072)	$37,532
2	$521,565	$491,899	$48,287	$540,186	($18,621)	$87,604	($51,074)	$36,530
3	$521,565	$491,899	$47,241	$539,140	($17,575)	$87,604	($50,072)	$37,532

(1) The debt service is adjusted to captures savings in the various refundings
(2) The difference between 1985A Debt Service and Total Adjusted Debt Service
(3) Future value savings
(4) The difference between the FV'd Savings and PV of Future Savings

Currently, the City has three options; 1) terminate the Swap, 2) refinance the Swap or 3) take no action (continue the Swap pursuant to the contract). After evaluating the options, Staff recommends that to the extent that the City is able to do so, the City should terminate the Swap at a below market value cost to achieve economical benefits.

OUTCOME

Approval of this recommendation will result in authorizing the City Administrator to negotiate and terminate the City's Swap with Goldman Sachs at a below market value cost, to the extent the City is able to do so, by the end of FY 2012-13 and report back to the City Council with the final results of the termination. By terminating the Swap today or in the near future at a below market value, the City will realize economic savings.

BACKGROUND/LEGISLATIVE HISTORY

The Swap is related to one in a series of refunding bond issues related to the $221,540,000 Redevelopment Agency of the City of Oakland, Cahfomia 1985 Series A Bonds (the "1985A Bonds"). The primary purpose of the 1985A Bonds was to purchase life insurance annuity contracts, the receipts of which were to be applied toward pension obligations. The 1985A Bonds were fixed rate bonds.

On January 11, 1989, the City advance refunded the 1985A Bonds through the issuance of the 1988A Bonds. The 1988A Bonds were fixed rate bonds.

In 1997 the City executed the Swap as a hedge against changes in short term rates in connection with the 1998A Bonds, which were issued as variable rate demand obligations on July 16, 1998. Under the Swap, the City received floating amounts based on the Securities Industry and Financial Markets Association Index ("SIFMA Index") and is to pay fixed amounts based on a rate of 5.6775% through the end of the swap agreement in 2021. The SIFMA Index is a national rate based on a composite of approximately 250 Issuers of high-grade, seven-day tax-exempt variable rate demand obligafion issues of $10 million or more.

On March 21, 2003, the City restructured the Swap by changing the formula for the floating amounts from the SIFMA Index to 65% of the One-Month LIBOR and, in consideration for such change, received a one-fime upfront payment of $5,975,000. The Swap continued to act as a hedge on the 1998A Bonds.

On June 21, 2005, the City refunded the 1998A Bonds with the $126,975,000 Oakland Joint Powers Financing Authority Refunding Revenue Bonds 2005 Series A-1 and A-2 Auction Rate Securities (the "2005A Bonds"). The Swap remained in effect. No amendments were made at that time despite the fact that Goldman Sachs appeared to have had the right to terminate the Swap as a result of the redemption of the 1998A Bonds. The Swap served as a hedge to the floating rate interest of the 2005A Bonds.

On April 16, 2008, the City refiinded the 2005A Bonds with the $107,630,000 Oakland Joint Powers Financing Authority Refunding Revenue Bonds 2008 Series A-1 (the "2008A1 Bonds"). The 2005A Bonds were redeemed early due to the collapse of the auction rate market and to achieve interest rate savings. Contemporaneously with the Series 2008A1 Bonds, the City also issued its 2008 Series A-2 bonds, which along with the 2008A1 Bonds were fixed rate bonds. As of such date, the Swap was no longer serving as a hedge since the related debt was fixed rate.

For reference, the above bond financings have been summarized in ATTACHMENT A hereto.

ANALYSIS

The City has been actively exploring what options may be available to terminate or refinance the Swap, and whether any such options provide an economic benefit to the City. Absent a termination or refinancing, the City can be expected to continue to make net annual payments of approximately $4 million in 2013 and decreasing annually thereafter under the Swap until its scheduled maturity date in 2021. The Swap, in accordance with industry standard termination provisions, can be terminated prior to maturity by the City at its then current market value, plus transactional costs often referred to as the 'bid-ask' spread. Similar to a bond, as rates fall, the value of the Swap increases for the receiver of the fixed rate (i.e. City). As of April 19, 2012, the market value of the Swap is negative $15,570,000 and changes on a daily basis in accordance with changes in medium term interest rates (5-7 years).

Summary of Current Swap Options	
Terminate:	Terminate Swap by paying the market value of the Swap.
Refinance:	Finance the termination cost with a new obligation
No Acfion:	Continue to make payments pursuant to the terms of the Swap

In order for the City to better evaluate each option, the City needed to determine the net benefits, the expected cash flow and the present value impact of each option to make a sound decision. Therefore, the City hired BLX to review the terms of the Swap and to prepare various cash flow analyses, both retrospectively and prospectively, in the context of the various refunding bond issues. Among other things, BLX prepared analyses to determine if the City has received and will expect to receive a net benefit from the bond financings, including the impact of the Swap. These analyses provide the City a complete financial picture of the effect of the Swap and identify any issues that may be relevant to on-going negotiations with Goldman Sachs. Specifically, the analyses included:

- Historical analysis of the 1985A Bonds and the cash flow impact of the subsequent 1988A Bonds, 1998A Bonds (including the Swap and its 2003 restructuring), 2005A Bonds, and 2008A1 Bonds;

- The evaluation of the counterparty fees that were charged on both the original execution date of the swap (1997) and the restructuring date (2003) to ensure the City received proper pricing; and

- The economics of terminating the Swap and refinancing the Swap under today's interest rate and market conditions relative to taking no action (i.e., continuing with the Swap pursuant to the contract).

ANALYSIS CONCLUSIONS

Refunding Savings Analysis

The analyses indicate that, in the aggregate, the City will still realize a net benefit (i.e., a reduction from what the City would have otherwise paid) from the various refinancings, including the Swap, of the original 1985A Bonds despite the challenging market conditions and increased financing costs that have persisted since late 2007. More specifically, the analysis indicates that the various re-financings of the 1985A Bonds resulted in the City realizing approximately $41 million in present value savings at the end of the term (2021). See ATTACHMENT B hereto for further details.

Swap Pricing

BLX reviewed and independently created a pricing model for the Swap to review the pricing/valuation levels of the Swap at the time of execution in 1997, the re-structuring in 2003, and at current market conditions. BLX did not find any evidence that the City was overcharged on the Swap. In addition, BLX has confirmed that the value of the Swap as reported by Goldman Sachs currently is substantially the same as BLX's valuation..

Swap Options

Over the course of the last several months, the City has undertaken the necessary steps to evaluate its current options under the Swap. More specifically, the City could Terminate, Refinance, or take No Action. As part of this effort, as noted above, BLX conducted an independent review of the savings and independently modeled the pricing of the Swap. These analyses were conducted in order to identify any potential issues that might assist the City in moving forward with negotiations with Goldman Sachs, among other things. Separately, the City has had on-going discussions with Goldman Sachs to explore the potential for terminating or re-financing the Swap [in effect, financing the market value of the Swap, currently valued at $15,570,000 (as of April 19, 2012)]. BLX assisted the City by evaluating, and confirming, the economics of each of the Termination, Refinance, and No Action options as follows:

Terminate and No Action Options. BLX has confirmed that the economics of Terminating the Swap at market value is economically equivalent to taking No Action. The reason for this is that mathematically, the market value of the Swap is, by definition, the present value of the expected future payments under the Swap. This is true so long as future interest rates are consistent with what is implied by today's interest rates. If, however, interest rates rise in the future by more than what is implied by today's interest rates, the cost of terminating the Swap will go down. Similarly, the cost will go up if interest rates fall. Since the City is not in the business of forecasting interest rates, the City should not view the possibility of future changes in the market value of the swap as supporting one option over the other.

Refinance Option. BLX has confirmed that there is no economic benefit to re-financing the Swap. While the nominal rate of a re-financing (likely in the three percent to four percent (3-4%) range) would be below the fixed rate on the Swap, the 'loan' amount would be equal to the current market value of the Swap, any re-financing would necessarily be more expensive to the City versus using funds on hand since the market value of the swap implies a discount rate of less than 3-4%.

There are benefits (not necessarily economic) of eliminating the Swap from the City's books, and therefore the City would prefer to terminate the Swap as soon as possible, all other variables being equal. However, for the reasons described above, taking No Action will likely produce the best economic result for the City, unless the City is able to Terminate at a below market value. In this regard, while Goldman Sachs has proposed options that attempt to minimize the costs that the City would incur in implementing a Termination or Refinancing Option, in the City's opinion, such amounts are not compelling enough to take action. Since discussions with Goldman Sachs continue, to the extent that more favorable terms for the City can be negotiated, the City would recommend terminating the Swap subject to available resources (funds) of the City.

Therefore, the City recommends and requests that City Council provide the City Administrator with the authority to terminate the Swap to the extent that the City is able to do so at a below market value cost and not later than the end of the next Fiscal Year (ending June 30, 2013). If by that time, the Swap has not been terminated, the City will update the City Council as appropriate

PUBLIC OUTREACH/INTEREST

This item did not require any additional public outreach other than the required posting on the City's website.

COORDINATION

This report has been prepared by the Treasury Division in coordination with City Attorney's Office, and Budget Office.

COST SUMMARY/IMPLICATIONS

Terminating the Swap at a below market value will generate savings to the City.

SUSTAINABLE OPPORTUNITIES

There is no impact to economic, environmental, or social equity opportunities following actions under this report.

CEQA

This report is not a project under CEQA.

For questions regarding this report, please contact Katano Kasaine, Treasury Manager, at (510) 238-2989.

Respectfully submitted,

Katano Kasaine

KATANO KASAINE
Treasury Manager

Prepared by:
Dawn Hort, Financial Analyst
Treasury Division

Attachments:
Attachment A: Flowchart of bonds Financings
Attachment B: Cashflow Saving Analysis

Attachment A

'1985A Bonds Issued:	$221,540,000 Redevelopment Agency of the City of Oakland, California 1985 Series A
1988A Bonds issued to refund the 1985A Bonds	$209,835,000 City of Oakland, California Special Refunding Revenue Bonds (Pension Financing) 1988 Series A
1998A Bonds issued to refund the 1988A Bonds. The City entered into the Swap approximately 1 ½ years earlier, on a forward starting basis.	$187,500,000 Oakland Joint Powers Financing Authority 1998 Series A-1 and A-2 Lease Revenue Bonds
	GS Financial Products US, LP *Interest Rate Swap*
2005A Bonds issued to refunded the 1998A Bonds	$126,975,000 Oakland Joint Powers Financing Authority Refunding Revenue Bonds 2005 Series A-1 and A-2
2008A1 Bonds issued to refund the 2005A Bonds.	$107,630,000 Oakland Joint Powers Financing Authority Refunding Revenue Bonds 2008 Series A-1

Attachment B

Total Annual Debt Service / *Savings Comparison*

Period Ending	1986A D/S	Refunding Bonds Series	Refunding Bonds Debt Service	1998A Swap	DSRF	Total Adj Refunding DS	Gross Savings	FV'd Cumulative Savings	PV of Future Savings
08/01/85									
08/01/85	22,872,792	1985A	25,107,888		(2,235,096)	22,872,792	-	-	
06/01/87	23,054,581	1985A	24,706,363		(1,651,781)	23,054,581	-	-	
08/01/88	22,352,044	1985A	24,286,988		(1,934,944)	22,352,044	-	-	
08/01/89	21,609,813	1988A	10,288,575		-	10,268,575	11,321,238	11,321,238	
08/01/90	21,321,206	1988A	15,432,863		-	15,432,863	5,888,344	18,136,508	
08/01/91	20,883,700	1988A	15,432,863		-	15,432,863	5,450,838	25,038,266	
08/01/92	20,741,919	1988A	15,432,863		-	15,432,863	5,309,056	31,990,458	
08/01/93	20,900,394	1988A	21,947,863		-	21,947,863	(1,047,469)	32,162,626	
08/01/94	20,374,705	1988A	21,409,388		-	21,409,388	(1,034,683)	32,334,042	
08/01/95	19,313,706	1988A	20,831,988		-	20,831,988	(1,518,281)	32,654,759	
08/01/96	21,119,413	1988A	22,683,573		-	22,683,573	(1,564,160)	33,009,066	
08/01/97	20,427,956	1988A	22,074,553		-	22,074,553	(1,646,596)	33,404,906	
08/01/98	19,870,397	–	6,502,044		-	6,502,044	13,368,353	48,746,236	
08/01/99	19,239,994	1998A	5,454,654	4,250,734	(1,031,463)	8,673,925	10,566,069	62,151,393	
08/01/00	18,566,172	1998A	13,299,558	3,157,390	(1,043,334)	15,413,614	3,152,558	68,965,445	
08/01/01	17,587,362	1998A	15,789,682	3,386,799	(1,255,410)	17,921,071	(333,709)	73,520,524	
08/01/02	17,724,561	1998A	12,460,421	6,392,293	(672,645)	18,180,069	(455,509)	75,857,420	
08/01/03	17,460,407	1998A	12,179,050	622,157	(349,549)	12,451,659	5,028,749	82,383,404	
08/01/04	16,905,767	1998A	11,267,897	6,788,102	(254,801)	17,801,197	(895,431)	82,673,265	
08/01/05	15,937,938	–	3,126,267	5,190,760	(431,014)	7,886,013	8,051,925	92,737,250	
08/01/06	14,765,576	2005A	12,624,648	3,217,506	-	15,842,154	(1,076,578)	95,574,185	
08/01/07	13,722,219	2005A	13,423,056	2,445,721	-	15,868,777	(2,146,558)	98,718,260	
08/01/08	13,092,875	–	14,474,969	3,210,909	(115,924)	17,569,955	(4,477,080)	99,361,578	
08/01/09	12,886,197	2008A1	13,621,400	4,524,972	(174,366)	17,972,006	(5,085,809)	97,477,696	
08/01/10	12,629,354	2008A1	14,365,400	4,673,584	(160,736)	18,878,249	(6,248,894)	92,688,530	
08/01/11	12,068,940	2008A1	14,479,650	4,227,675	(111,274)	18,696,051	(6,527,111)	87,122,312	
08/01/12	11,481,024	2008A1	14,571,300	3,775,076	(81,515)	18,264,860	(6,783,836)		(6,769,789)
08/01/13	10,790,088	2008A1	14,697,750	3,322,854	(107,630)	17,912,974	(7,122,887)		(7,033,164)
08/01/14	10,174,700	2008A1	14,820,750	2,847,274	(107,336)	17,560,688	(7,385,988)		(7,220,743)
08/01/15	9,592,925	2008A1	14,935,550	2,334,541	(107,336)	17,162,755	(7,569,830)		(7,327,200)
08/01/16	2,076,525	2008A1	15,073,350	1,830,011	(107,336)	16,796,025	(14,719,500)		(14,106,257)
08/01/17		2008A1	15,095,950	1,403,435	(10,870,630)	5,628,755	(5,626,755)		(5,340,841)
08/01/18			-	1,023,958	-	1,023,958	(1,023,958)		(961,963)
08/01/19			-	725,509	-	725,509	(725,509)		(674,835)
08/01/20			-	466,037	-	466,037	(466,037)		(429,182)
08/01/21			-	227,785	-	227,785	(227,785)		(207,695)
	621,565,247		491,899,108	70,045,081	(22,804,119)	539,140,070	(17,574,823)		(50,071,669)

Current FV'd Cumulative Savings As of 04/23/12 87,603,840

Current FV'd Cumulative Savings + PV of Future Savings 37,832,171

Approved as to Form and Legality

Oakland City Attorney's Office

OAKLAND CITY COUNCIL

RESOLUTION NO.______________C.M.S.

Introduced by Councilmember ____________________

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING THE CITY ADMINISTRATOR TO NEGOTIATE AND TERMINATE THE CITY'S INTEREST RATE SWAP AGREEMENT WITH GOLDMAN SACHS & CO. TO THE EXTENT THAT THE CITY IS ABLE TO DO SO AT A BELOW MARKET VALUE COST AND NOT LATER THAN THE END OF THE NEXT FISCAL YEAR, JUNE 30, 2013

WHEREAS, in 1997, the City entered into a forward-starting synthetic fixed rate swap agreement (the "Swap Agreement") with Goldman Sachs Mitsui Marine Derivatives Products, U.S., L.P. in the connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2; and

WHEREAS, the Swap Agreement no longer serves its original purpose to mitigate interest rate risks because the interest rates on the original series of bonds tied to the Swap were restructured to fixed rates in 2008, the City Council finds that termination of the Swap Agreement in the best interest of the City; now therefore be it

RESOLVED, that the City Council authorizes the City Administrator to negotiate and terminate of the swap agreement entered in the connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2, without returning to Council, to the extent that the City is able to do so at below market value cost no later than the end of the next Fiscal Year on June 30, 2013; and be it

FURTHER RESOLVED, that this Resolution shall take effect immediately upon its passage.

IN COUNCIL, OAKLAND, CALIFORNIA, ________________________, 20______

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, DE LA FUENTE, KAPLAN, KERNIHGAN, NADEL, QUAN, and PRESIDENT REID

NOES -

ABSENT -

ABSTENTION -

ATTEST: ____________________________

LaTonda Simmons
City Clerk and Clerk of the Council
of the City of Oakland, California