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CITY OF OAKLAND
AGENDA REPORT

TO: Office of the City Administrator
ATTN: Deborah A. Edgerly
FROM: Financial and Management Agency
DATE: June 21, 2005

RE: A SUPPLEMENTAL REPORT RELATING TO THE RESOLUTIONS ADOPTING THE CITY OF OAKLAND AND OAKLAND REDEVELOPMENT AGENCY DEBT MANAGEMENT POLICY AND SWAP POLICY FOR FISCAL YEAR 2005-2006

SUMMARY

On June 14, 2005, the Finance and Management Committee was presented with a report on Resolutions prepared for the City Council of the City of Oakland (the "Council") and the Governing Board of the Redevelopment Agency of the City of Oakland (collectively, the "City") to adopt a Debt Management Policy and Swap Policy for Fiscal Year 2005-2006 (the "Debt Policy" and "Swap Policy", respectively).

At that time, members of the Council asked for clarification on the swap associated with the $187,500,000 Oakland Joint Powers Financing Authority, 1998 Series A-1/A-2 Lease Revenue Bonds (the "1998 Bonds"), specifically concerning termination values. This report presents the staff response.

FISCAL IMPACTS

This is a supplemental report and has no fiscal impacts.

BACKGROUND

In December 1, 1988, the City issued $209.835 million in Special Refunding Revenue Bonds, 1988 Series A ("1988 Bonds"). The 1988 Bonds had been issued with very high interest rates (coupons ranging from 6.50% to 7.60%) and were not callable until 1998. As a result, in January 1997, the City entered into a "forward-starting" synthetic fixed rate swap ("Swap") with Goldman Sachs ("Goldman") in order to realize upfront savings on the 1988 Bonds. Under this swap structure, the City received moneys/savings in January 1997, almost 1.5 years *prior* to the call date on the 1988 Bonds[1]. In exchange, the City agreed to defease/refund the 1988 Bonds with new bonds in 1998 (when the 1988 Bonds were callable) and entered into a synthetic fixed rate swap on the new bonds. As a result, in August 1998, the City, under its Joint Powers

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[1] Under a traditional refunding, existing bonds need to be called in order to realize any potential savings.

Financing Authority, issued the 1998 Bonds and swapped $170 million at a synthetic fixed rate of 5.6775%.

KEY ISSUES AND IMPACTS

Results of 1998 Bonds with Synthetic Fixed Rate Swap. The City received an upfront payment of $15 million (approximately 8.5% savings of refunded bonds) from Goldman for entering into this Swap on the 1998 Bonds. In addition, the Swap also succeeded in bringing down the City's overall interest rate from the all-in fixed rate of 7.50% on the 1988 Bonds to the all-in fixed rate of 5.86% on the 1998 Bonds. This decrease in interest rates (7.50% to 5.86%) lowered overall debt service, resulting in an additional $5.8 million of "debt service" savings (approximately 3.3% savings of refunded bonds) over the life of the 1998 Bonds. In April 2000, due to market changes, the City was also able to restructure the Swap on the 1998 Bonds, and received another upfront payment of $5.9 million (approximately 3.4% savings). As of today, the City has realized nearly $27 million of savings on refunding its 1988 Bonds with the 1998 Bonds under a "swap" structure.

Savings Realized by City through Issuance of 1998 Bonds with Synthetic Fixed Rate Swap

Date	Amount
Jan. 97	$15.0 million (*upfront*)
Aug. 98	$ 5.8 million (*debt service savings*)
Apr. 00	$ 5.9 million (*upfront*)
TOTAL	$26.7 million

Market Value of Synthetic Fixed Rate Swap. As with all swap transactions, the Swap on the 1998 Bonds has a market value. As of June 2005, the Swap has a mark-to-market value of negative $24.6 million—meaning that if the City was to terminate the Swap, the City would be obligated to pay Goldman $24.6 million. However, it is important to note that the "termination value" (i.e. mark-to-market value) is based on current market conditions. Should short-term interest rates increase, as they are expected to, the City could potentially terminate the swap at a much lower value, and even "receive" moneys for terminating should interest rates rise.

Even if the City chose today to terminate the Swap, paying Goldman $24.6 million, on a net basis the City would be better off by $2.4 million, having received $20.9 million in up-front savings and $5.8 million in debt service savings. If the City chose *not* to terminate the Swap, and held the Swap to maturity, the City would realize the full benefit of approximately $27 million (over 15% savings on refunded 1988 Bonds).

Synthetic Fixed Rate versus Traditional Fixed Rate. In refunding the 1988 Bonds, the City could have taken the "conservative" route and issued the 1998 Bonds (which refunded the 1988 Bonds) with traditional fixed rate bonds instead of the existing synthetic fixed rate structure; this would have resulted in an estimated $20 million in net present value savings. However, by issuing the 1998 Bonds with the Swap, rather than traditional fixed rate bonds, the City has been able to realize upfront savings of $21 million and debt service savings of $5.8 million.

SUSTAINABLE OPPORTUNITIES

None

DISABILITY AND SENIOR CITIZEN ACCESS

Not applicable.

RECOMMENDATIONS AND RATIONALE

Staff recommends the acceptance of this supplemental report and adoption of the proposed debt and swap policies.

ACTION REQUESTED OF THE CITY COUNCIL

Staff recommends that the City Council and the Board of the Redevelopment Agency approve the accompanying Resolutions adopting the Debt Policy and Swap Policy.

Respectfully submitted,

WILLIAM E. NOLAND
Director, Finance and Management Agency

Prepared by:

Katano Kasaine
Treasury Manager

APPROVED AND FORWARDED TO THE
COUNCIL OF THE CITY OF OAKLAND

OFFICE OF THE CITY ADMINISTRATOR