Port of Seattle

COMMISSION
AGENDA MEMORANDUM

ACTION ITEM

Item No. 6h

Date of Meeting November 22, 2016

DATE: November 2, 2016

TO: Ted Fick, Chief Executive Officer

FROM: Elizabeth Morrison, Director, Corporate Finance

SUBJECT: Resolution No. 3729 authorizing the issuance and sale of limited tax general obligation and refunding bonds of the Port in the aggregate principal amount of not to exceed $150,000,000

ACTION REQUESTED

Request First Reading of Resolution No. 3729: A Resolution of the Port Commission of the Port of Seattle, authorizing the sale and issuance of limited tax general obligation bonds of the Port in the aggregate principal amount of not to exceed $150,000,000 for eligible Port purposes, including reimbursement to the Port for a portion of the Port's contribution for the Alaskan Way viaduct replacement program; and authorizing a Designated Port Representative to approve certain matters relating to the bonds.

EXECUTIVE SUMMARY

The 2017 General Obligation (G.O.) bonds will be used to provide long-term funding for the Port's 2016 contribution to the Alaskan Way Viaduct Replacement Program ("Alaskan Way Program") and to pay for the cost of issuance. The funding includes reimbursement to the Port for $65 million paid on May 31, 2016 that was originally intended for permanent cash funding and to reimburse the Port for the $82.7 million paid on October 31, 2016 that was intended to be bond funded.

JUSTIFICATION

The use of bond funding for the entire 2016 payment is an opportunity for the Port to reduce its cost of capital. The bonds used for the Program are considered "governmental purpose" in the tax code and enjoy the most preferential tax-exempt status; therefore interest rates are lower compared to other types of bonds issued by the Port. By replenishing the cash funding with debt, the Port can use cash for potential growth opportunities that would not quality for governmental purpose bonds and would thereby require higher cost debt.

DETAILS

On August 27, 2013, the Port entered into a funding agreement with the State of Washington for the Port's contribution to the Alaskan Way Program. Under the funding agreement, the

Port was obligated to pay the State $120.0 million on May 1, 2015 and $147.7 million on May 1, 2016 for a total of $267.7 million. The agreement was amended on March 31, 2016 to accommodate project delays and provide for a two-part fulfillment of the 2016 payment: $65.0 million was paid on May 31, 2016 and the final $82.7 million was paid on October 31, 2016.

The 2015 payment was funded with the proceeds of G.O. bonds issued in 2015. In anticipation of the 2016 payments, the Commission had set aside tax levy cash into a Transportation and Infrastructure Fund that funded the $65.0 million payment. The remaining $82.7 million was expected to be funded with proceeds from the sale of G.O. bonds that would reimburse the temporary use of Port cash. This original payment plan that relied on a significant portion of cash was made at a time of lower growth at the Port. In view of potential growth opportunities that may require G.O. bond funding, staff recommends that G.O. bonds be issued to repay the entire 2016 contribution of $147.7 million.

Most of the bonds issued by the Port are "private activity" bonds that are exempt from regular income tax, but subject to the Alternative Minimum Tax (AMT), e.g. bonds to modernize Terminal 5. Other growth opportunities might not qualify for any tax exempt bond funding and interest earned by investors would be fully taxable. The bonds that fund the contribution to the Alaskan Way Program are "governmental purpose" bonds and therefore, the interest earned by investors is exempt from all federal income tax. The result is that governmental bonds enjoy a lower interest rate compared to bonds with a less preferential tax status sold in the same market conditions. The Port can lower its cost of capital, by using its least expensive debt for the Alaskan Way Program payments and retain cash to use for future projects that would require higher cost debt. This approach does not make any assumptions about future interest rates; it is based solely on estimated interest rate differentials due to tax status.

The G.O. Bonds are being issued pursuant to Resolution No. 3729. The Bonds will be governmental purpose bonds, the interest on which will be exempt from all federal income tax.

Resolution No. 3729 (the G.O. Bond Resolution) is similar in all material respects to other G.O. Bond Resolutions. G.O. Bonds are backed by the full faith and credit of the Port and require that the Port levy taxes sufficient, along with other funds, to pay scheduled principal of and interest on the Port's outstanding G.O. Bond obligations.

The G.O. Bond Resolution delegates to the Designated Port Representative (the Port's Chief Executive Officer or the Port's Chief Financial Officer) the authority to approve the manner and date of the sale of the G.O. Bonds within parameters established by the Commission in the G.O. Bond Resolution. Commission parameters that limit the delegation are a maximum principal amount, maximum interest rate, and expiration date for the delegated authority. If the G.O. Bonds cannot be sold within these parameters, further Commission action would be required.

The recommended delegation parameters are:

Maximum size:	$150,000,000
Maximum interest rate:	5.00%
Expiration of Delegation of Authority:	May 31, 2017

Upon adoption, Resolution No. 3729 (the G. O. Bond Resolution) will authorize the Designated Port Representative to select the manner and date of the sale, approve the final sale terms, pay the cost of issuance, execute all documents, prepare and disseminate a preliminary official statement and final official statement, provide for continuing disclosure and take other action appropriate for the prompt execution and delivery of the G.O. Bonds.

Unlike most Port revenue bonds that are sold through a negotiated process with the Port's underwriting team, the G.O. Bonds are expected to be sold through a competitive sale in which, any banking firm can bid on the Bonds. The Port's debt management procedures allow for competitive sales for appropriate transactions where, in consultation with the Port's Financial Advisor, a competitive sale is likely to provide better financial results than a negotiated sale. Competitive sales are well suited to transactions that have a relatively simple, high quality credit like the Port's G.O. Bonds and sold in relatively stable market environments. Should market conditions change, in consultation with the Port's Financial Advisor, the Designated Port Representative may determine that a negotiated sale is a more effective approach. A negotiated sale would also need to be within the Commission established parameters.

Piper Jaffray, Inc. is serving as Financial Advisor, K&L Gates LLP is serving as bond counsel and Pacifica Law Group, LLP is serving as disclosure counsel on the transaction.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Do not issue any bonds

Cost Implications: Assuming that the Port plans to fund future projects within the next three years that do not qualify for governmental bonds, the additional interest cost due solely to a less preferential tax status for the life of the bonds is estimated to be $0.4 million to $9.8 million present value.

Pros:

(1) Reduces interest costs in the near-term by postponing new bonds

Cons:

(1) Increases costs in the long-term due to the need to fund other projects with potentially higher cost debt

This is not the recommended alternative.

Alternative 2 – Issue bonds only to pay for the $82.7 million payment as originally intended

Cost Implications: Assuming that the Port plans to fund future projects within the next three years that do not qualify for governmental bonds, the additional interest cost due solely to a less preferential tax status for the life of the bonds is estimated to be $0.2 million to $4.3 million present value.

Pros:
(1) Reduces costs in the short-term by postponing new bonds
(2) Uses levy cash originally designated for this purpose

Cons:
(1) Increases costs in the long-term due to the need to fund other projects with potentially higher cost debt

This is not the recommended alternative.

Alternative 3 – Issue up to $150 million to fund the entire 2016 contribution

Cost Implications:

Pros:
(1) Retains an additional $65 million of levy cash that can fund projects and reduce the need to issue higher cost debt for those projects
(2) Likely results in a lower overall cost of capital to the Port

Cons:
(1) Short-term higher costs associated with debt vs. cash

This is the recommended alternative.

Annual Budget Status and Source of Funds

Debt service payments associated with the 2017 bonds were incorporated into the forecasted uses of the tax levy and have been incorporated into the 2017 Budget.

ADDITIONAL BACKGROUND

Municipal bond issuers, like the Port, can issue bonds that are taxable or tax-exempt depending on the use of the bond proceeds. The interest paid to investors in "governmental purpose" bonds is exempt from all federal income tax because the bonds are used to fund capital projects that benefit the general public, e.g. public roads and parking garages operated by the Port. Most of the Port's facilities are leased to private companies and are therefore deemed "private activity" bonds. The interest on these bonds is exempt from regular income tax, but subject to the Alternative Minimum Tax. Facilities that do not qualify as Airport, Docks and Wharves as defined by the tax code, do not qualify for any tax-exempt bond funding. Examples include non-governmental office building and most retail, industrial or warehouse facilities.

ATTACHMENTS TO THIS REQUEST

(1) Draft Resolution No. 3729

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

November 8, 2016 – The Commission was briefed on the preliminary tax levy and draft plan of finance including the 2017 G.O. bonds

March 10, 2015 – The Commission passed Resolution No. 3703, authorizing the sale and issuance of G.O. bonds to fund the $120 million 2015 payment