PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA | **Item No.** 6a

COPY CORRECTED 1/6/2012 | **Date of Meeting** November 1, 2011

DATE: October 3, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: Elizabeth Morrison, Sr. Manager Corporate Finance

SUBJECT: Resolution No. 3653 Authorizing the Issuance and Sale of Revenue Refunding Bonds.

ACTION REQUESTED:

Second Reading and Final Passage of Resolution No. 3653 authorizing the issuance and sale of Revenue Refunding Bonds (the Bonds), in an amount estimated at $140,000,000 for the purpose of refunding certain outstanding Port bonds.

SYNOPSIS:

Commission authorization is requested to issue First Lien Revenue Bonds in multiple series in an amount estimated at $140 million (including a reserve fund and cost of issuance) to refund $123,995,000 of outstanding Special Facility Revenue Bonds (Terminal 18 Project) and $11,124,000 of outstanding Subordinate Lien Revenue Bonds, Series 1998. The Bonds are being issued solely for the purpose of achieving debt service savings; there is no new project funding associated with this transaction. Based on current market conditions, the estimated present value savings is $19 million. Actual savings will be based on market conditions at the time of the bond sale. This refunding also provides an opportunity to create a smoother, flatter, debt service payment structure.

BACKGROUND:

Terminal 18 Bonds

In 1999, the Port issued $217,425,000 Special Facility Revenue Bonds (Terminal 18 Project) (T-18 Bonds) to fund a portion of the costs of expanding Terminal 18. The T-18 Bonds are secured solely by the lease payments from the terminal tenant which are paid directly to a bond Trustee. The Trustee pays the debt service on the T-18 bonds and remits the net revenue to the Port. As a result, the Seaport Division revenue reflects only the Terminal 18 revenue after the payment of T-18 Bond debt service. Similarly, the assets and liabilities associated with the T-18 Bonds are excluded from the Port's balance sheet. Since the T-18 Bonds are secured only by the terminal lease payments, in the event of a shortfall in lease revenues the Port would have no obligation to pay bondholders from other revenue sources to prevent a bond payment default. The Port could choose to remedy the revenue shortfall by paying the debt service on the bonds; otherwise, if a bond payment default occurred the Trustee would gain control of Terminal 18 through the provisions of a Base Lease agreement between the Port and the Trustee. In addition to the Terminal 18 bonds, the Port has used cash and several other Revenue and General Obligation bonds to fund projects at Terminal 18; obligations on these bonds are not alleviated by relinquishing control of the facility. The book value of the Port funded assets at Terminal 18 totals $322 million.

In 2006, the Port refunded a portion of the T-18 Bonds with General Obligation Bonds for debt service savings. This reduced the T-18 Bond debt service and therefore increased Seaport Revenues. Port assets and liabilities were also adjusted to reflect the change from conduit debt to Port debt.

The 2011 Bonds would redeem the remaining T-18 Bonds. This would result in overall lower debt service, and it would eliminate the need for bond insurer approval to any changes to the Terminal 18 lease and other documents.

The T-18 Bonds are being refunded as First Lien Revenue Bonds secured by all net revenues of the Port. Staff analyzed the option of refunding the T-18 Bonds under a Special Facility structure similar to the existing T-18 Bonds. The current risk-adverse market conditions made such a refunding more costly and greatly reduced savings potential compared to refunding with Port Revenue Bonds. Given that most of the assets at Terminal 18 have been funded with Port bonds or cash it is consistent to refund the T-18 Bonds with Port bonds. Under the Port’s current lien structure, the First Lien is used for Seaport financings, and staff recommends this approach.

This refunding also presents an opportunity to restructure the debt service. Since the T-18 Bonds were secured solely by Terminal 18 lease payments, the debt structure was back-loaded to mirror the lease payments, which escalate over time. Port revenue bonds, secured by general Port revenues, are generally structured with level debt service. The Bonds are expected to be issued with a debt service structure between the current back-loaded T-18 Bonds and traditional level debt service of Port Revenue bonds; for example, the Bonds may have a modestly increasing debt service. A level debt service structure would create negative savings in the early years and reduce the Seaport’s capital funding capacity. The moderately increasing debt service reduces the long-term risk associated with back-loaded debt without overly burdening near-term funding.

The T-18 Bonds are the Port’s leading candidate for refunding and this refunding has been contemplated since completion of the 2010 refundings.

1998 Subordinate Lien Bonds

In 1998 the Port issued Subordinate Lien Revenue Bonds to refund bonds issued to fund construction of Pier 69. Debt service on these bonds is paid by the Real Estate division and can now be refunded for savings. Due to their relatively small size, it is most cost effective to add them to this transaction rather than executing a separate Subordinate Lien Bond refunding.

Other Refunding Candidates

In addition to the planned refunding described above, there are other Port Revenue bonds that could be refunding candidates, including First Lien Revenue Bonds, Series 2001, a portion of First Lien Revenue Bonds, Series 2003 and Subordinate Lien Revenue Bonds, Series 1999. These bonds are not currently included in this transaction or in the maximum authorized amount for the Bonds. If market conditions make it advantageous to include some or all of these bonds, Resolution No. 3653 and the maximum par amount authorized, can be amended for Second Reading and Final Passage. No such amendment is requested.

First Reading

On October 11, 2011, the Commission approved First Reading of Resolution No. 3653. At that time, the Commission requested that staff research the possibility of amending the Resolution to direct one half of any refunding savings to support an equal reduction to the Port's tax levy. Staff consulted with K&L Gates, the Port's bond council, and determined that such an amendment would not be enforceable and would compromise the enforceability opinion necessary for underwriting the Bonds. Staff recommends that any action related to the tax levy be addressed in conjunction with the 2012 budget.

ADDITIONAL BACKGROUND:

The Bonds are being issued pursuant to the Amended and Restated Master Resolution No. 3577. The Bonds will be issued in multiple series based on their tax status: governmental purpose bonds exempt from all federal income tax, private activity bonds exempt from regular federal income tax, but subject to the Alternative Minimum Tax (AMT) and taxable bonds subject to federal income tax (this series will only be used if taxable interest rates are lower than the AMT rates).

Resolution No. 3653 provides for a contribution to the Common Reserve Fund. The Common Reserve Fund was added to the Master Resolution in 2007 and the Revenue Bonds, Series 2007 are the only other participants in the Common Reserve; the Reserve is currently funded by a surety policy. The credit quality of the surety provider, Ambac Assurance Corporation, is weak, and the cash contribution to the Reserve from this refunding will strengthen the overall quality of the fund.

The Resolution delegates to the Port's Chief Executive Officer the authority to approve interest rates, maturity dates, redemption rights, interest payment dates, and principal maturities for the Bonds (these are generally set at the time of pricing and dictated by market conditions at that time). Commission parameters that limit the delegation are a maximum bond size, minimum savings rate and expiration date for the delegated authority. If the Bonds cannot be sold within these parameters, further Commission action would be required. The recommended delegation parameters are:

Maximum size: $140,000,000
Minimum debt service savings: 3.75%
Expiration of Delegation of Authority: six months

Upon adoption, Resolution No. 3653 will authorize the Designated Port Representative (the Chief Executive Officer or the Chief Financial Officer) to approve the Bond Purchase Contract, the Official Statement, escrow agreement (if any), pay the cost of issuance and take other action appropriate for the prompt execution and delivery of the Bonds. The Bonds will be sold through negotiated sale to Merrill Lynch, Pierce, Fenner & Smith Inc.; Backstrom McCarley Berry & Co., LLC; Barclays Capital; Drexel Hamilton, LLC; J.P. Morgan Securities, LLC; and Morgan Stanley & Co. Inc. Seattle Northwest Securities Corporation, Inc. is serving as Financial Advisor and K&L Gates LLP is serving as bond counsel on the transaction.

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Resolution No. 3653

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

October 4, 2011, Commission was briefed on the refunding resolution.

October 11, 2011, Commission approved First Reading