AGENDA ITEM NO. 14
11:00AM

CITY OF SAN ANTONIO
PUBLIC UTILITIES DEPARTMENT
CITY COUNCIL AGENDA MEMORANDUM

TO: Mayor and City Council

FROM: Ben Gorzell Jr., Director of Public Utilities

SUBJECT: An Ordinance Authorizing the Redemption of $3,000,000 and the Remarketing of $157,000,000 CPS Energy Junior Lien Revenue Bonds, Series 2004

DATE: November 3, 2005

SUMMARY AND RECOMMENDATIONS

This Ordinance authorizes (1) the redemption of $3,000,000 of tax-exempt City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2004, initially issued as Variable Rate Demand Obligation Bonds ("Bonds" or "VRDOs") in November 2004, (2) the remarketing of $157,000,000 of the Bonds for a two year Term Rate, and (3) the distribution of a Remarketing Memorandum pertaining thereto.

Approval of this Ordinance is recommended.

BACKGROUND INFORMATION

City Public Service Energy ("CPS Energy") issues bonds periodically to finance new capital construction and capital improvement projects and/or to refinance, defease, or restructure outstanding debt. CPS has a Debt Management Policy providing guidelines under which financing and debt transactions are managed. This policy focuses on providing financial tools to lower debt service cost on outstanding debt, utilizing alternative financing methods to capitalize on market conditions, outlining an optimal capital structure, and maintaining favorable financial ratios.

During 2004, CPS Energy through a Right-of-First Refusal (ROFR) under the STP joint ownership agreement, had an opportunity to purchase an additional ownership interest in STP. STP is part of CPS Energy's electric generation fleet and was the first nuclear plant in Texas with construction beginning in the early 1970's. It is comprised of two 1,250 MW units with Unit 1 becoming operational in 1987 and Unit 2 in 1989. Through the ROFR process, CPS Energy acquired an additional 12% ownership interest in STP which became effective on May 19, 2005, and increased CPS Energy's ownership interest in the plant from 28% to 40%. To fund this acquisition, City Council authorized the issuance of $160,000,000 City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2004 (Bonds) on November 4, 2004.

These Bonds are long-term, variable rate bonds, which offer CPS Energy flexibility that is not present in long-term, fixed rate bonds. The variable rate Bonds are multi-modal meaning that at the reset date they can be converted to different interest rate modes, such as daily, weekly, commercial paper, auction, term (with different rate periods), or fixed. When the Bonds were initially issued, the interest rate was set for a one-year Term Mode at a rate of 2.20%, with an interest reset date of December 1, 2005. The one-year Term Mode requires that at the reset date, the bonds must be re-marketed and will reflect the current market interest rates. For comparison, the same one year Term Mode currently is pricing at 3.10%, an increase of 90 basis points over the course of one year. The conversion to a two-year term rate with an estimated interest rate of approximately 3.40% will assist in insulating CPS from short-term interest rates rising further within the next two years.

The proposed ordinance will also authorize the pay down of $3 million in principal on the Bonds. In conjunction with the acquisition of the additional 12% interest in STP, Ordinance No. 99823 approved on September 30, 2004 authorized an adjustment to electric base rates to recover additional operations and maintenance and debt service related to capital costs resulting from the acquisition. This base rate adjustment was necessary to fund these additional costs but is offset by fuel savings resulting from the additional nuclear generation resulting in overall savings to CPS Energy customers.

For financial planning purposes, it was necessary to incorporate an assumption that fixed rate debt to fund the acquisition would be issued in order to ensure that CPS Energy would have the necessary funding in the event that interest rates rose in the future. However, as part of CPS Energy's overall debt management program, variable rate bonds were issued instead of fixed rate bonds in 2004 to fund the acquisition which allowed CPS Energy to take advantage of a lower cost of borrowing. The initial rate for the term mode was set at 2.20%, which was 2.91% lower than the fixed rate assumption built into the electric base rate adjustment. CPS Energy committed to use the difference between the actual interest incurred and the interest rate assumption built into the electric base rate adjustment to pay down principal of the Bonds on the reset dates. This allows CPS Energy to reduce the amount of outstanding principal sooner and helps reduce the amount of interest cost, which would have otherwise been incurred. The interest rate savings accumulated during the past year will be used to pay down $3.0 million of the principal of the Bonds on December 1, 2005, leaving $157,000,000 of the Bonds to be remarketed.

The Bonds are scheduled to be remarketed with a two-year term rate on November 16, 2005; however, this date may change depending on market conditions. The latest date that the Bonds can be remarketed is November 29, 2005. A mandatory tender of the Bonds in the initial term rate will occur on December 1, 2005. The Bonds will be remarketed for a two-year term, with a tender date of December 1, 2007. Ordinance No. 99938 provides that to remarket to a Term Rate greater than one year requires approval by the City Council. The Ordinance for this transaction authorizes the redemption of $3,000,000 of the Bonds and the remarketing of $157,000,000 of the Bonds and the distribution of a Remarketing Memorandum pertaining thereto.

FISCAL IMPACT

This transaction will have no fiscal impact to the City or on existing rates. The principal and interest on the Bonds will be paid from CPS Energy revenues and will have no effect on the monthly City payment from CPS Energy.

COORDINATION

The CPS Energy Board of Trustees will consider the item on October 31, 2005. This item has been coordinated with staff of CPS Energy, CPS Energy' co-financial advisors and bond counsel and the City Attorney's Office.

SUPPLEMENTARY COMMENTS

A working group comprised of staff of CPS Energy; Remarketing Agent: Morgan Stanley & Co., Incorporated; Paying Agent: Wachovia Bank, National Association; Standby Bond Purchase Agreement (liquidity provider): BNP Paribas; Co-Financial Advisors: First Southwest Company and Estrada Hinojosa & Company; Bond Counsel: Fulbright & Jaworski L.L.P.; Issuer's Outside Counsel: Cox Smith Matthews Incorporated; and Morgan Stanley's Remarketing Agent's Counsel: Andrews Kurth LLP was assembled to work on this bond remarketing.

The disclosure requirements of the City's Ethics Ordinance are not applicable.

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