

# THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

## MEMORANDUM

TO: REDEVELOPMENT AGENCY BOARD	FROM: HARRY S. MAVROGENES EXECUTIVE DIRECTOR
SUBJECT: SEE BELOW	DATE: JANUARY 30, 2008

### INFORMATION

SUBJECT: BOND INSURANCE – RATINGS REDUCED

The Redevelopment Agency has historically purchased bond insurance to enhance the credit rating of its fixed rate bonds, thereby reducing the interest rate paid for those bonds. Insurers also provide surety bonds to secure debt service reserve requirements. The ratings and creditworthiness of several municipal bond insurers (Insurers) have recently been reduced. Industry observers blame the subprime mortgage market crisis as the cause of the Insurers' recent problems, as these Insurers have guaranteed the repayment of subprime mortgage pools.

#### Agency Insured Debt Service:

The Insurers' guarantees for Agency debt are only provided to the Agency's fixed rate bonds. The downgrades in credit ratings of Insurers cause insured fixed rate bonds to trade at lower values in the secondary market. Since the Agency's debt service obligations with respect to its fixed rate bonds were fixed at the date of issuance and are unaffected by secondary market activity, outstanding Agency fixed rate debt will be unaffected by the Insurers problems.

By contrast, the Insurers' problems have affected issuers' borrowing costs associated with insured variable rate bonds, compared with letter of credit-backed variable rate bonds. As the Agency's variable rate obligations are credit enhanced by a letter of credit from JP Morgan, the Insurers' problems have not affected the cost of the Agency's variable rate bond issues.

Debt Reserve Fund Sureties:

All fixed rate debt issued by the Agency is required to have a debt service reserve that is equal to the lesser of 125% average annual debt service, 10% of the par amount of the bond issue, or one year's annual debt service. The Agency typically purchases a reserve fund surety policy from an Insurer instead of funding the reserve fund with bond proceeds. At the time of sale, Agency reserve funds can be replaced by a surety policy. The Agency's Trust Indenture requires that the surety be rated "AAA" by Standard & Poor's (S&P) and "Aaa" by Moody's Investors Service (Moody's) at the time the surety is provided. The indenture does not require any action by the Agency if the surety provider is later downgraded. At this time, all but one of the Agency's sureties are currently rated "AAA" by S&P and "Aaa" by Moody's. The Agency was able to get consent to utilize a surety bond rated "AA" by S&P and "Aa3" by Moody's for its Series 2006A-T and 2006B Bonds.

XL Capital Surety:

One surety, in the amount of \$12.4 million, is provided by XL Capital Assurance. This surety replaced the cash funded reserve fund for the Agency's 2003 Tax Allocation Bonds (the "2003 Bonds") insured by FGIC. FGIC imposed an additional surety requirement requiring that it be rated "AAA" by S&P and Moody's throughout the term of the 2003 Bonds. Currently, XL Capital is rated "AAA" by these rating agencies. However, on January 24, 2008, Fitch Ratings downgraded XL Capital to "A". S&P and Moody's have indicated that XL Capital's "AAA" rating is being reviewed for possible downgrade.

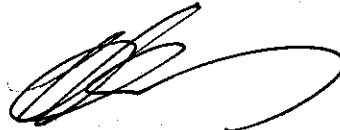
If downgraded by Moody's or S&P, the Agency has several options. First, staff will discuss with FGIC the possibility of waiving the "AAA" maintenance requirement or providing a surety bond on the 2003 Bonds. Alternatively, we could seek a surety from another, more stable insurer. In the worst case, the Agency would need to cash fund the reserve for the 2003 Bonds over a five year period. This would cost the Agency approximately \$2.5 million per year.

Other Surety Providers:

Other Insurers providing sureties on the Agency's outstanding tax allocation bonds are MBIA, AMBAC, FGIC, Radian and FSA. All are currently rated "AAA/Aaa" by S&P and Moody's, except Radian, which is rated "AA/Aa3". All Insurers, except Radian and FSA, are under review for possible downgrade by S&P and Moody's. However, the Agency would not need to replace these sureties since

they met the rating requirements at the time of issuance. As first reported in an information memo to the Board in September, Fitch preemptively reduced its rating on Radian to A+ on September 5, 2007. Fitch also reduced its rating on Ambac to “AA” and FGIC to “AA”, on January 18 and January 30, 2008, respectively.

We will continue to monitor the Insurers and apprise the Board as more information is available.



HARRY S. MAVROGENES  
Executive Director