CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Chuck Reed
MAYOR

June 1, 2012

Board of Supervisors, County of Santa Clara
George Shirakawa, President
70 West Hedding Street
San Jose, CA 95110

Re: Distribution of Tax Revenues to Successor Agency
Breach of Bond Covenants

Dear George:

As we discussed on the phone, I am sending this letter to comply with the protocol set forth in our 2001 Agreement regarding disputes between the City and County. This matter needs immediate attention. I hope we can sit down as soon as possible to discuss this issue in greater detail to figure out a way to avoid litigation and a breach of loan covenants that would have significant negative consequences to the City, the Successor Agency and the County.

City, Successor Agency and County staffs have been working for several months on implementing ABX1 26 which mandates the dissolution of redevelopment agencies statewide. As Chair of the Oversight Board for the Successor Agency to the Redevelopment Agency of the City of San Jose, I have been impressed with how smoothly the meetings have gone, which is indicative of the good working relationship established among our organizations. However, within the past few weeks, in the context of calculating the distribution of tax revenues to be paid to the Successor Agency to make required payments on enforceable obligations over the next six months, two new issues have arisen that will impair our ability to make debt service obligations in August and place us in breach of our bond convenants.

First, County staff has a novel interpretation of ABX1 26 that would make the County pass through payment, which by contract is subordinate to all debt of the former Redevelopment Agency, senior to all existing debt, including bondholders. This interpretation would result in the deduction of approximately $16 million off the top of the tax revenues needed to pay debt service on August 1, 2012.

Additionally, County staff is now changing its calculation of what constitutes former tax increment to deduct preexisting tax levies, including approximately $6.5 million annually for the County's contribution for its employees' retirement system. This deduction would be a breach of bond covenants that require tax increment to be used to pay bond holders first.

Either of these deductions alone will impair the Successor Agency's ability to pay debt service on its Non-Housing Subordinate Tax Allocation Bonds in August. Taken together, the Successor

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Agency will be in default on Senior and Subordinate Tax Allocation Bonds and Subordinate Housing Tax Allocation Bonds.

We have been informed by JPMorgan, the Letter of Credit provider on the Non Housing Subordinate Tax Allocation Bonds, that they have rescinded their current offer to grant a one year extension of the Letters of Credit (LOC) securing $94 million. Instead they are only offering a 30 to 60 day extension. This is in direct response to the threatened actions of the County to withhold tax increment from the June 1st disbursement.

While we all agree that the legislation is poorly drafted and can be subject to various legal interpretations, the intent of ABX1 26 is clear in its mandate to protect bond holders. The existing agreement with the County is absolutely clear that the County pass-through is subordinate to all other obligations. There is no authority in the law that allows a subordinate creditor to leapfrog in priority over bondholders.

The County's stated intention to make unsubstantiated deductions from tax increment and to unilaterally reorder the priority of the County subordinate pass-through not only violates the County-Auditor Controller's fiduciary duties under the legislation but also immediately and irreparably threatens the rights of existing bond holders. It also would be a violation of the City-County Agreement with potential for enormous financial damages.

The Successor Agency has a responsibility to protect the rights of bondholders. As such, we must demand that the County exercise its legal obligation to distribute to the San Jose Redevelopment Property Tax Trust Fund the entire amount of revenues that have been pledged to bondholders, and are due and payable on August 1, 2012.

Making this distribution will maintain the status quo and provide some time to resolve the differing legal interpretations and avoid litigation.

Please also note that we are required to notify bond holders of any material events that come to our attention that will impact the Successor Agency's ability to pay debt service when due. Any deductions by the County will constitute such a material event and, as JPMorgan has demonstrated, we fully expect that others will take action in order to protect their rights.

Sincerely,

Chuck Reed

Chuck Reed
Mayor