

SUBSTITUTION OF LEASED 2007 COP PROPERTIES DISCUSSION

The 2007 COP financing sold participations in the lease revenue stream generated from the Government Center; the East, West, and North Wings of the Salinas Courthouse Complex; the Monterey Courthouse Complex; the Sheriff's Administration Building; and, the County Jail. While these properties are specifically identified in the body of the lease, the legal descriptions pertaining to the County Government Center and the North, East, and West Wings of the Salinas Courthouse Complex covered the entire parcel bordered by Capitol, Gabilan, Church and Alisal Streets. Similarly, the legal description of the County Jail covered the entire parcel which included the Juvenile Hall and other buildings and vacant land. The failure to subdivide those parcels prior to executing the lease effectively encumbered numerous properties which were clearly not intended to be part of the "leased" properties.

The 2007 Lease Agreement, at Article IX, Section 9.03, states that the County shall have the right, but only upon the express consent of the Insurer, Ambac Assurance Corporation, to substitute leased properties, provided the County obtains an independent certified real estate appraisal showing that the Property, as constituted after such substitution, has an annual fair rental value greater than or equal to 105% of the maximum amount of Base Rental Payments payable by the County in any Rental Period and has a useful life equal to or greater than the useful life of the Property, as constituted prior to the release. In addition, the County must obtain a CLTA title insurance policy or policies with respect to any substituted property and an Opinion of Counsel indicating that the substitution will not cause the interest evidenced by the Certificates to be included in gross income for federal tax purposes. Further the County must provide continuing disclosure pertaining to the substitution event, must record those instruments pertaining to the lease amendments, and certified to the Corporation that the substituted property is of approximately the same degree of essentiality to the County as the portion of Property for which it is be substituted.

Unlike Assured Guaranty, the bond insurer covering the Natividad Medical Center Certificates of Participation refunded in 2009 and 2010, Ambac is in bankruptcy. Operations are now limited to reviewing consent requests such as this, and recouping creditor funds. Ambac Consent Operations personnel has indicated that approval will depend on the County's credit quality, essentiality of the replaced properties be as great or greater to the County's operations, improved useful life, adequacy of coverage over Base Rental Payments (annual debt service) as reflected in the fair rental value appraisal, and improved security for the credit.

The County obtained a recent fair rental value appraisal covering the County Administration Building, the North Wing Courthouse, the Monterey Courthouse Complex, and the County Jail, all of which were subject to the original lease. In addition, the newly constructed Health Department Administration Building and other properties were appraised. Due time constraints,

an appraisal of the fair rental value of the Sheriff Administrative Building could not be completed in time to allow for its inclusion in the lease amendment. Therefore, staff is recommending the encumbrance of the Health Department Building for the following additional reasons. Replacement of the Sheriff Administration Building with the newly constructed Health Department Building extends useful life, as does the removal of East and West Wings. The lease termination date reflected at Article II, Section 2.02 (a) for the Sheriff's Facility is August 1, 2017. In order to assure Ambac of adequate security coverage, it is recommended that the termination date of the Health Department lease coincide with the final maturity of the 07 COPs. Adoption of this action will not preclude the County from performing an additional substitution in the future to encumber the Sheriff Administrative Building or other comparable buildings in order to un-encumber the Health Building.

The fair rental values were determined to be \$10,851,012 annually. The County's maximum remaining base rental obligation is \$10,216,925 in Fiscal Year 2015. The minimum substitution amount of \$10,727,771.25 ($\$10,216,925 \times 105\%$) is exceeded by those five properties by \$123,240.75.

On July 26, 2012, the Board of State and Community Corrections (BSCC) accepted the County's Amended Application and revised scope pertaining to the conditional award of \$36,295,000 toward a \$40,327,778 expansion of the County's Adult Jail to add 288 medium security beds. This approval triggered a series of specific milestone activities that the County need to comply with to maintain its conditional award. Under AB900 Public Safety and Offender Rehabilitation Services Act of 2007, the State requires the site for the Jail Housing Addition be free and clear of all encumbrances. Approval of these recommended actions will allow for the County to comply with the milestone set by the State for Project Establishment.