

SUBSTITUTION OF LEASED 2007 COP PROPERTIES DISCUSSION

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.

The 2007 COP financing sold participations in the lease revenue stream generated from the Administration Building; the East, West, and North Wings of the Salinas Courthouse; the Monterey Courthouse; the Sheriff's Facility; and, the Monterey County Jail. While these properties are specifically identified in the body of the lease, the legal descriptions pertaining to the Administration Building and the North, East, and West Wings of the Salinas Courthouse covered the entire parcel bordered by Capitol, Gabilan, Church and Alisal Streets. Similarly, the legal description of the Monterey County Jail covered the entire parcel which included the Juvenile Hall and other buildings, as well as 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 certify 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 initially indicated that approval would depend on the County's credit quality, essentiality of the replaced properties to be as great or greater to the County's operations,

improved useful life, adequacy of fair rental value coverage over Base Rental Payments (annual debt service) as reflected in a fair rental value appraisal, and improved security for the credit. The improved security is reflected by insured replacement values.

The County recently obtained a fair rental value appraisal covering the Administration Building, the North Wing of the Salinas Courthouse, the Monterey Courthouse, and the Monterey 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 to time constraints, an appraisal of the fair rental value of the Sheriff's Facility was not completed.

After the original preparation and submittal of the Board Report into Legistar, the County Debt Manager met with the Credit and Portfolio Risk Management representatives at Ambac in New York. Ambac staff stated that they would recommend release of the East and West Wings and lands surrounding the Jail Complex, but only provided that the County would: 1) keep the Sheriff's Facility in the current lease; 2) extend the Sheriff's Facility termination date from August 1, 2017 to August 1, 2037; and 3) add the new Health Department Administration Building to the lease with a termination date of August 1, 2037. Properties covered under the amended lease will now include the new Health Department Administration Building and all of the originally named leased properties, except for the East and West Wings of the Salinas Courthouse. The legal descriptions for the Administration Building, the North Wing of the Salinas Courthouse, and the Monterey County Jail will be amended to specify only those properties, thereby releasing existing unintended encumbrances on land and properties not specifically mentioned in the lease. Should Ambac withhold approval of the substitution, especially as it affects land surrounding the Monterey County Jail, the County would not be able to transfer the property to the State in an unencumbered status, effectively relinquishing the proposed Grant and abandoning the Jail Expansion Project. Therefore, staff is recommending the approval of the amendments to the Lease Agreement, the Ground Lease, and other related documents in accordance with Ambac's security requirements.

Due to time constraints, the finalized amendments to all leases and other documents are not included as revised attachments, but will be in substantially the form already presented, as modified to meet Ambac's request.