



Board Report

File #: 2015-1306, File Type: Resolution

Agenda Number: 13.

**FINANCE, BUDGET AND AUDIT COMMITTEE
JANUARY 20, 2016**

SUBJECT: PROPOSITION A REFUNDING BONDS

ACTION: AUTHORIZE SALE OF REFUNDING BONDS

RECOMMENDATION

ADOPT a resolution, Attachment A, that:

- A. AUTHORIZES the issuance of bonds by competitive sale to refund the **Prop A Series 2008-A1, Series 2008-A2, Series 2008-A3 and Series 2008-A4 Bonds** ("the 2008-A Bonds") in one or more transactions through August 31, 2016, consistent with the Debt Policy;
- B. APPROVES the **forms of Notice of Intention to Sell Bonds, Notice Inviting Bids, Supplemental Trust Agreement, Bonds, and Preliminary Official Statement**, all subject to modification as set forth in the resolution; and
- C. AUTHORIZES taking all action necessary to achieve the foregoing, including, without limitation, the further development and execution of bond documentation associated with the issuance of the bonds.

(REQUIRES SEPARATE, SIMPLE MAJORITY BOARD VOTE.)

ISSUE

Lower interest rates offer an opportunity for Metro to lock in low long term rates by refunding the outstanding variable rate 2008-A Bonds and eliminate short term interest rate risk. The 2008-A Bonds refunded the 2005-C bonds, which were issued in combination with interest rate swaps that were intended to produce a synthetic fixed rate of approximately 3.37%. Because the fixed rate based on the interest rate swaps was higher than the current market, we terminated the swaps on July 1, 2015 at no cost to Metro. Metro has entered into agreements with two banks for the 2008-A bonds where we pay a variable interest rate that resets monthly and is tied to one-month London Interbank Offered Rate ("LIBOR") index. A refunding with fixed rate bonds will allow us to lock-in the interest cost over the remaining term of the bonds at currently low interest rates and remove the risk of rising short term rates. We are requesting the authority to sell Proposition A First Tier Senior Sales Tax Revenue Refunding Bonds (the "Refunding Bonds") in one or more transactions through August 31, 2016, to allow flexibility should significant market volatility occur. It is our expectation that the \$238.4 million

outstanding principal of the 2008-A Bonds will be refunded through a competitive sale by spring 2016, depending on market conditions.

DISCUSSION

The 2008-A Bonds bear an interest rate that resets monthly based on one-month LIBOR. The variable interest rate, including a spread that Metro has agreed to pay to the two banks that purchased the bonds, is currently about 0.50% (half of one percent). Although current short-term interest rates are very low, the cost to Metro is expected to increase as interest rates rise due to the fact that the 2008-A bonds bear interest at a variable rate. Issuing fixed rate bonds will mitigate that risk.

The Debt Policy establishes criteria to evaluate refunding opportunities. The Refunding Bonds are recommended to change the debt from variable rate to fixed rate and the Debt Policy provides for refundings that change the type of debt instrument being used. The refunding is not being undertaken solely to achieve cost savings or meet target savings amounts. At the current variable interest rate of 0.50%, including the bank spread, a fixed rate refunding will result in a higher interest cost. However, should the LIBOR index increase to the 10 year average for one-month LIBOR of 1.495% for the remaining 16 year term of the 2008-A Bonds, the refunding will result in about \$4 million in present value total debt service savings to Metro.

As part of this issuance of Refunding Bonds, the Trust Agreement will be amended to conditionally eliminate the Debt Service Reserve Fund ("DSRF") requirement. The Refunding Bonds and any future Prop A bonds will be issued under supplemental trust agreements that allow for the elimination of the DSRF requirement once 60% of all outstanding First Tier Senior Lien bonds are issued under this revised DSRF provision, which is estimated to occur in July 2021. During the period between this Refunding Bond issue and when the amendment actually takes place, Metro may have to contribute funds to satisfy the DSRF requirement. Once the amendment takes effect, Metro will have the option to issue any new or refunding bonds without a debt service reserve fund, can also elect to have the new bonds establish a new debt service reserve requirement or participate in the existing reserve fund.

Currently, Metro is required to set-aside \$140 million in a debt service reserve fund to secure all Prop A First Tier Senior Lien Bonds, which is equal to the maximum amount of future debt service paid in a fiscal year. Metro meets this requirement with approximately \$54 million in cash and investments, and an \$85.5 million surety, or insurance policy. The cash and investments were funded from prior Prop A First Tier Senior Lien bonds, and currently earn a relatively low investment rate. The surety policy was purchased in 2008 and expires in July 2021.

Based on current projections of refundings, we anticipate meeting the 60% consent requirement in 2021, enabling us to reduce the DSRF requirement and initiate the reduction of cash and investments held in the DSRF. The lower DSRF requirement will also eliminate the need to replace the surety policy. Factoring in principal paydowns, we project that the DSRF requirement will only be approximately \$11 million by fiscal 2022, securing the remaining bonds (Prop A 2014A and 2015A bonds) that have not been issued under the amended trust agreement. At that level, we estimate \$43 million of the \$54 million cash in the DSRF will be available to pay Prop A debt service, thereby

freeing up funds for other Prop A projects.

The Reserve Requirement was created in 1986 when the Trust Agreement was originally executed. Purchasers of Metro bonds and the rating agencies no longer place a significant amount of value on a debt service reserve fund for an issuer with the AAA credit strength of our Prop A bonds. We have received confirmation from Standard & Poor's and Moody's Investors Service that removing the debt service reserve fund for future bond issues will not have an impact on the bond ratings for the First Tier Senior Lien Bonds, keeping our ratings at the current levels of AAA and Aa1, respectively.

DETERMINATION OF SAFETY IMPACT

Approval of this report will not impact the safety of Metro's patrons or employees.

FINANCIAL IMPACT

The costs of issuance for the bonds will be paid from proceeds of the financing and will be budget neutral. Bond principal and bond interest expense for the Prop A 2008-A Bonds are included in the FY16 budget in project 610306, account 51101 for principal and account 51121 for interest.

ALTERNATIVES CONSIDERED

The Board could defer the refunding to a later time or indefinitely. This is not recommended because recent market conditions have been favorable for the refunding. Also short-term rates have risen since the Federal Reserve increased the Fed Funds rate on December 16, 2015, and the Federal Reserve is signaling more short-term interest rate increases will occur during 2016. Strength in the domestic economy could also cause short-term interest rates to rise. A refunding at a later time may result in the payment of higher interest costs over the term of the bonds. In addition, the current agreements with the two banks providing the short term liquidity expire in August 2016 and if we do not issue Refunding Bonds we will have to replace the existing bank facilities.

NEXT STEPS


- Further develop bond issuance documentation and publish the sales notices
- Obtain credit ratings
- Distribute the preliminary official statement to prospective underwriters and potential investors
- Initiate pre-marketing effort
- Receive electronic bids from underwriters
- Finalize bond documentation and deliver the bonds

ATTACHMENTS

Attachment A - Authorizing Resolution

Prepared by: Donna R. Mills, Treasurer, (213) 922-4047
LuAnne Edwards Schurtz, Assistant Treasurer, (213) 922-2554

Reviewed by: Nalini Ahuja, Executive Director, Finance and Budget,
(213) 922-3088



Phillip A. Washington
Chief Executive Officer