Los Angeles County
Metropolitan Transportation
Authority
One Gateway Plaza
3rd Floor Board Room
Los Angeles, CA

File #: 2015-1227, **File Type:** Resolution **Agenda Number:** 9.

REGULAR BOARD MEETING
OCTOBER 22, 2015

SUBJECT: GENERAL REVENUE BONDS AND UNDERWRITER POOL

ACTION: AUTHORIZE REFUNDING OF BONDS AND APPOINT BOND UNDERWRITERS

RECOMMENDATION

A. ADOPTING a resolution:

1. authorizing **the issuance of refunding bonds by negotiated sale to refund the 2004 General Revenue Refunding Bonds** (the “2004 GRRBs”) in one or more transactions through June 30, 2016, consistent with the Debt Policy;

2. approving the forms of the supplemental trust agreement, preliminary official statement and such other documents as required and all as subject to modification as set forth in the Resolution;

3. authorizing 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 2015 General Revenue Refunding Bonds (the “2015 GRRBs”), and approves related documents on file with the Board Secretary; and

4. prohibiting the subsequent issuance of General Revenue Bonds or Parity Debt under the General Revenue Trust Agreement except for refunding bonds.

B. **APPOINTING the underwriter team** selected for the 2015 GRRBs transaction(s) as shown in Attachment B.

C. **ESTABLISHING an underwriter pool**, as shown in Attachment B, that will be used to select underwriters for all future negotiated debt issues through June 30, 2019.

(REQUIRES SEPARATE SIMPLE MAJORITY VOTE OF THE BOARD)

(CARRIED OVER FROM SEPTEMBER BOARD CYCLE)

ISSUE

Currently low interest rates provide an opportunity to lock in fixed interest rates to refund our $86,175,000 outstanding 2004 GRRBs, which were originally issued as weekly auction rate securities (“ARS”) in 2004, in combination with an interest rate swap to produce a synthetic fixed rate of 3.501%. During the financial crisis in 2008, the ARS market failed and it continues to fail, causing investors to be unable to sell their bonds. We were able to refund approximately half of the bonds to fixed rate in 2010 through a tender program, buying the bonds back from owners at a discount. We would like to refund the remaining failed ARS while interest rates continue to be low.

DISCUSSION

ARS bear an interest rate that changes weekly based on the results of an auction process to investors. Following the financial collapse in 2008, and demise of the bond insurers, there has not been an active market for these bonds. When the auction fails, as it has since then, the weekly interest rate is set by formula at 225% of the one-month London Interbank Offered Rate (“LIBOR”). The one-month LIBOR rate is now only about 0.20%, meaning we pay approximately 0.45% on the bonds. Because these bonds are now illiquid, this rate is especially unattractive to investors. Replacing this failed security would be a positive for LACMTA’s relationship with bond investors.

Although current short-term interest rates are extremely low, and thus what was designed as a penalty rate is not burdensome, the cost to LACMTA is expected to increase as interest rates rise. For example, the 10 year average for one-month LIBOR is 1.75%, which would result in an interest rate of approximately 4%.

To avoid these cost increases as the market returns to more normal interest rate levels, we need to refund the ARS into another type of bond. These variable rate bonds were originally matched with an interest rate swap to create a “synthetically” fixed-rate obligation. With falling interest rates since 2009, the fixed rate was higher than the current market, and the swap was terminated at no cost last year. Replacing the failed ARS with a traditional fixed-rate bond financing is recommended. This will allow us to lock in a fixed rate at current low levels for the remaining life of the bonds, through fiscal 2027.

The General Revenue Bonds are rated A1/A+ as of September 1, 2015, by Moody’s and S&P respectively, because the first source of payment for the bonds is farebox revenues, with a subordinate pledge of Prop A, Prop C and certain other funds in the event farebox revenues are not sufficient to pay debt service. Because of the unusual type of revenue pledge and the lower ratings, the negotiated bond sale method is recommended. A negotiated bond sale is justified under the Debt Policy criteria for Method of Bond Sale due to the need to have the underwriters available well in advance of the bond sale because this particular structure is unfamiliar to many of our investors. The underwriters will pre-market the issue, assist with the rating process and advise on market timing for pricing the bonds.

In addition to appointing underwriters for the 2015 GRRBs transaction, we are recommending the establishment of a pool of underwriters to be used in all future negotiated sales. The pool will enable us to move more quickly in forming financing teams when a negotiated sale is the recommended approach for a bond issue. For subsequent negotiated sales, underwriter(s) will be selected from the pool, using a mini-RFP process. Selecting the underwriters early in the process will enable us to benefit from their participation in structuring the debt, bond document development and preparation for credit presentations.

Consistent with our Debt Policy, the underwriting team is recommended based on a competitive Request For Proposal (RFP) process conducted by KNN, our general financial advisor. RFPs were distributed in March 2015 to 29 firms and 24 proposals were received. Members of LACMTA's Treasury staff and our financial advisors reviewed the proposals, evaluating them based on the criteria listed in the RFP. The twelve firms that were ranked the highest by the review team are recommended for inclusion in the pool. The underwriting pool will be retained through June 30, 2019. See Attachment B, Summary of Underwriter Selection.

The underwriters selected for the 2015 GRRBs transaction are the highest ranked member of the pool and the two highest ranked minority owned firms.

Included in the Resolution and in the Supplemental Trust Agreement is language that amends the General Revenue Trust Agreement so that no further General Revenue Bonds can be issued on parity with the current bonds, other than refunding bonds. Our Debt Policy specifically says that we will not issue any additional General Revenue Bonds and we have not issued any General Revenue Bonds, other than refunding bonds, since 1995. By making this legally binding, it should provide an additional level of security to rating agencies and bondholders and does not impose an undue burden on us as we do not have any plans to use General Revenue Bonds as a source of borrowing.

DETERMINATION OF SAFETY IMPACT

Approval of this item will have no impact on safety.

FINANCIAL IMPACT

The costs of issuance for this refunding were not budgeted in FY16 due to the uncertainty related to completing any refunding. The costs of issuance including underwriting fees for this transaction will not affect the FY16 Budget since they will be covered by the proceeds of the bond issue.

General Revenue debt service is accounted for in cost center 0521, project #610309. The 2004 GRRBs refunded bonds that financed the construction cost of the Gateway Headquarters Building and the debt service is allocated as rent cost to departments housed in the Gateway building.

ALTERNATIVES CONSIDERED

Authorization of the refunding and the appointment of the underwriters could be delayed, but would continue to expose us to significantly higher interest costs in the future if interest rates were to rise. This option is not recommended.

The selection of an underwriting pool may either be deferred or not be put into place. This option is not recommended. The Debt Policy identifies that for a negotiated bond sale, the financial advisor will conduct a competitive process to select underwriters, either for a specific bond issue or through the establishment of a pool of underwriters to be used for bond issues over a defined time period.

With a pool, it will be much faster and easier to move forward with negotiated transactions because a new solicitation process will not have to be done each time, which could save us several months in a volatile interest rate environment as we try to get to market.

NEXT STEPS

- Obtain ratings on the bonds, finish legal documentation, distribute the Preliminary Official Statement to potential investors, and initiate the pre-marketing effort.
- Negotiate the sale of the bonds with the underwriter.

ATTACHMENTS

Attachment A - Authorizing Resolution
Attachment B - Summary of Underwriter Selection
Attachment C - Form of the 7th Supplemental Trust Agreement

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