



Agenda Item No. 4

To: Finance-Auditing Committee/Committee of the Whole
Meeting of May 22, 2008

From: Alice Ng, Financial Management & Business Process Manager
Joseph M. Wire, Auditor-Controller
Celia G. Kupersmith, General Manager

Subject: **APPROVE ACTIONS RELATIVE TO THE RENEWAL OF THE
COMMERCIAL PAPER LINE OF CREDIT AGREEMENT WITH JP
MORGAN CHASE BANK**

Recommendation

The Finance-Auditing Committee recommends that the Board of Directors approve the following actions relative to the Line of Credit Agreement (Agreement) with JPMorgan Chase Bank, National Association (JP Morgan), for the Commercial Paper Program:

- 1) Authorize execution of a 364-day extension of the Agreement with JP Morgan, at the cost of thirty two and a half (32.5) basis points, or an approximate annual fee of \$250,000 for the period of July 7, 2008, to July 5, 2009.
- 2) Approve the following conforming amendments to the Agreement with JP Morgan:
 - a. Amend Section 2.06 to reflect an increase in the commitment fee and corresponding escalating point increases in the event of downgrades in the District's credit rating, relative to the 364-day extension period;
 - b. Amend Section 2.10 to reflect a tighter window of notice required by the District to notify JP Morgan of the District's request for extension to not more than 60 days nor less than 30 days prior to the then current stated expiration date of the Agreement; and,
 - c. Amend Section 7.08 and Exhibits B and C to update certain JP Morgan contact information.

Summary

The Commercial Paper Program (CP Program) began on July 12, 2000, with the issuance of \$61 million (of the \$70 million authorized) in commercial paper notes (CP notes) to fund the District's share of the seismic retrofit of the Golden Gate Bridge and the restoration of the main cable. Although the maximum maturity date for the CP notes is 270 days, the CP notes are

remarketed and are essentially “rolled-over” at maturity for another period, up to 270 days. As a result, the \$61 million in CP notes remain currently outstanding.

The terms of the District’s CP Program require that a line of credit (LC) agreement be in place for the projected 30-year duration of the program. This is to assure creditors sufficient funds to repay principal and interest in full upon each maturity date in the event that the remarketing agents cannot find new investors to “roll-over” the CP notes in a timely fashion. From the inception of the CP Program, JP Morgan has been selected as the most cost-effective way to satisfy this liquidity requirement. JP Morgan was originally selected and continues to be selected because it is a world leader in providing financial liquidity agreements for public sector entities like the District.

The District’s last agreement with JP Morgan was renewed in 2005 with a term of three years, through July 6, 2008, for a cost of 20 basis points per year. The proposed 364-day renewal would take effect on July 7, 2008, and run through July 5, 2009, and is at 32.5 basis points. As has been done with each year of the program, the District’s financial advisor, Public Financial Management Inc. (PFM), surveys current market conditions and the results of recent credit RFPs put out by similar public entities to determine the market rate. That information, outlined in the PFM memo attached, is used by the Auditor-Controller to negotiate terms with JP Morgan. This year’s renewal occurs during very challenging market conditions, largely due to the current credit crisis. This has resulted in increased demands toward line of credit facilities, thereby exhausting capacity of banks to provide such facilities. This has driven the cost of these facilities (including the District’s LC) up dramatically.

PFM’s memo points out two options for LC renewal available to the District: (1) renew the existing LC with JP Morgan, or (2) establish a new LC with an alternative LC provider. Given the present turbulent financial market conditions for these types of financial agreements, Staff and PFM believe that the proposed renewal is the most cost-effective alternative without taking on additional transaction costs (estimated between \$75,000 and \$100,000). In addition, by staying within a one-year term, this will allow the District to revisit the LC market in July 2009 when the market may normalize.

The original Agreement has to be amended (Sec. 2.06) to reflect escalating point increases in the event of downgrades in the District’s credit rating. This amendment will not have an impact unless the District is downgraded three times during the Agreement period (see below for details to changes). The Agreement is also amended (Sec. 2.10) to allow for a tighter window of notice for future agreement extensions (see Background for details to changes). Lastly, the Agreement is amended (Sec. 7.08 and Exhibits B and C) to update certain bank contact information.

The following are the changes to the District’s current Line of Credit Agreement.

The fee in Section 2.06 shall increase to 0.325% per annum; provided, however, that such commitment fee shall increase to:

- a) 0.375% per annum if the District's issuer credit rating is reduced to "A+" (or its equivalent) by any two Rating Agencies;
- b) 0.475% per annum if the District's issuer credit rating is reduced below "A+" (or its equivalent); or,
- c) 1.00% if the District's issuer credit rating is withdrawn by any two Rating Agencies.

Section 2.10 of the Line of Credit Agreement will be amended to reflect the period of time of notice required by the District to notify JP Morgan of its request for extension to not more than 60 days nor less than 30 days prior to the then current stated expiration date of Agreement.

Sections 7.08 and Exhibits B and C will be amended to reflect updated JP Morgan contact information.

Fiscal Impact

Renewal of the agreement as recommended would cost approximately \$250,000 for the 364-day term of agreement. Funds have been included in the proposed FY 08/09 operating budget.

Attachment: Memorandum from Public Financial Management, Inc., regarding Line of Credit Renewal Options for the District's Commercial Paper Notes



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May 9, 2008

Memorandum

To: Joe Wire, *Auditor-Controller*, Golden Gate Bridge, Highway and Transportation District
Alice Ng, *Financial Management and Business Manager*, Golden Gate Bridge, Highway and Transportation District

From: Peter Shellenberger, *Senior Managing Consultant*, Public Financial Management, Inc.

Re: Line of Credit Renewal for the District's Commercial Paper Notes

Public Financial Management Inc., ("PFM") has worked with staff from the Golden Gate Bridge, Highway and Transportation District (the "District") over the past two months to renew the Line of Credit ("LC") associated with the District's Commercial Paper Notes (the "CP" or "CP Notes" or "Notes"). This memorandum describes the background for the LC renewal, the current challenging market conditions, the options that the District staff explored and our recommendation.

In brief PFM recommends that the District negotiate a new 364-day term LC with JP Morgan. This will minimize transaction costs and, staying within a one-year term, will allow the District to meet their immediate needs and revisit the LC market in July 2009 when the market normalizes.

Background

On June 28, 2000 the District established a commercial paper program in the authorized amount of \$70 million for the purpose of meeting capital funding needs on an as-needed basis. The District currently has \$61 million of CP principal outstanding. The maximum maturity date on the outstanding CP is up to 270 days, though the Notes may be remarketed with a shorter maturity to meet market demand and lower the District's borrowing cost. Upon maturity, the remarketing agents (i.e. Morgan Stanley and Goldman Sachs) identify investors and remarket the outstanding CP for another period, up to 270 days. In this manner, the CP Notes with a short term maturity may be "rolled-over" to nominally create a medium-term obligation.

The need for liquidity or a Line of Credit stems from the need to periodically roll-over the CP Notes. Upon each maturity date, investors have the right to "put" the CP Notes back to the District to be paid their principal and interest in full. In the event that the remarketing agent cannot find new investors in a timely fashion, the legal structure requires that the District have sufficient liquidity to repay up to \$70 million in CP Notes in the event of an investor put. In order to satisfy this liquidity requirement, the District originally purchased a Line of Credit ("LC") from JP Morgan for a term of one-year. Upon expiration, the District renewed the terms of the existing agreement with JP



Morgan, thereby extending the term of the LC agreement. In 2005, the District extended the term of the agreement for three years, through July 6, 2008 for a cost of 20 basis points per year.

As July 6, 2008 approaches, the District has engaged PFM to discuss alternatives and current market conditions in an effort to determine the best course of action for the LC renewal at this time. A brief discussion of current market conditions is presented below, followed by a discussion of options and our recommendation.

Current Market Environment

The past several months have been a turbulent time for the financial markets, and the municipal bond market has been affected along with many other sectors. At the core of the problem is the significant financial exposure that Wall Street banks and major insurance providers have with respect to residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDOs) and the resulting losses they have suffered as the credit quality of these securities have deteriorated. As these securities decline in value, investment banks must record these reductions as losses, a process known as “writing-down” the value. To date, losses to financial institutions that were holding or trading these securities have reached over \$230 billion world-wide.

The rating agencies themselves have been placed into question because of their failure to provide any forewarning of the impending danger in many securities they had previously rated as “AAA.” Most pertinent to the District, the monoline bond insurers have been significantly impacted by the deterioration of RMBS and CDOs, leading to downgrades by the rating agencies for those insurers that were insuring significant amounts of these securities. Currently FSA and Assured Guaranty are the only commonly traded bond insurers receiving a clean ‘bill-of-health’ from the three rating agencies.

As the rating agencies have downgraded the bond insurers, the interest rates on variable rate bonds insured by monoline insurers have increased dramatically. In an effort to reduce the interest rates and bond debt service on their variable rate obligations, municipal issuers have sought to replace existing monoline insurance policies with a direct-pay letter of credit (“LOC”) provided by LOC banks, such as JP Morgan and others. This increased demand for “credit enhancement” through LOC banks has driven the cost of these facilities (including the District’s LC facility) up dramatically in the last several months. It has also reduced the availability of these facilities as the LOC banks only allocate a certain amount of annual budget to use towards LOCs and similar products. When this capacity is exhausted, market prices increase further.

Options Available to the District

It is in the challenging market environment described above that the District must renew its existing LC. The good news within this context is that the interest rate that the District is receiving on the outstanding CP is currently 1.20%, reflective of the strong underlying credit of the District and



recent decreases in short-term rates. Furthermore, the District is not competing for “credit enhancement” on the CP – as most other issuers are with respect to their variable rate obligations – but only liquidity with the line of credit, which is less costly.

There are two options for LC renewal available to the District: (i) renew the existing LC with JP Morgan or, (ii) establish a new LC with an alternative LC provider. A new LC with an alternative provider is more time consuming – soliciting bids and negotiating terms – and entails significant transaction costs as new legal documents must be drafted, reviewed and signed. These transaction costs are estimated to be between \$75,000 and \$100,000. Additionally, as demand for LCs and LOCs has spiked in recent months, the capacity and willingness for banks to offer new LCs and LOCs to new clients has declined significantly.

The District relied, in part, on PFM’s information and experiences in this market to determine the appropriate course of action. In terms of market capacity for new banks to offer new LCs and LOCs, PFM issued a competitive Request for Proposals (RFP) process on behalf of a double-A rated California county transportation authority in February 2008. PFM sent the RFP to approximately 15 LOC banks and received zero responses. We spoke to individuals from at least 10 of the banks and were informed that LOC banks were overwhelmed with proposals and quickly exhausting their annual budget allocated to LOC and LC facilities. With the increased demand on LOCs, the banks are prioritizing by first working with existing clients, then working with clients with whom they envision a long-term relationship that could support other lines of business internally. Within this context, the first priority was for the District to ensure that they had the option of renewing the LC with JP Morgan and that JP Morgan would honor the existing relationship by allocating sufficient capacity to meet the District’s needs.

After JP Morgan confirmed that they had sufficient LC capacity, we sought to establish a pricing context. Specifically, PFM reviewed the bids from a successful RFP process for a new variable rate bond program that we established for a second California county transportation authority in 2008. We received three bids for liquidity facilities for this “AAA” rated entity on February 5, 2008. The bids ranged from 18 basis points (0.18%) for a one-year facility to 28 basis points. These bids were solicited just before the credit markets contracted even more in late-February and March, and were for a very highly rated entity (“AAA”). While not a direct comparable from a credit rating perspective, these bids do provide some context for negotiating renewal costs for the District with JP Morgan.

Recommendation

After reviewing the options available to the District and the current market environment, PFM recommends that the District negotiate a new 364-day term LC with JP Morgan. This will entail no new transaction costs and, staying within a one-year term, will allow the District to meet their immediate needs and revisit the LC market in July 2009 when the market normalizes. Following that recommendation, District staff received a bid for a 364-day renewal from JP Morgan at a cost



of 35 basis points. After discussion with PFM, staff successfully negotiated JP Morgan down to a cost of 32.5 basis points for the facility renewal. Based on our understanding of the current market and prevailing pricing received by other California issuers, we believe this is a reasonable price and should be accepted by the District.

It has been PFM's pleasure assisting the District in the LC renewal process during this challenging time in the municipal market place. We hope you have found this memorandum informative and we welcome the opportunity to address any further questions you may have. If you have any questions regarding this memorandum, please contact Peter Shellenberger at (415) 982-5544.