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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

April 21, 1998

To: Board of Directors (Budget and Finance Committee--Action)

From: *for* General Manager Edward L. Mearns III

Submitted by: Lambertus H. Becker Lambertus H. Becker
Chief Financial Officer

Subject: Re-Authorization for the General Manager to Purchase Metropolitan Bonds in the Secondary Market

RECOMMENDATION

It is recommended that the Board of Directors re-authorize the General Manager to purchase up to \$75 million of Metropolitan bonds in the secondary market subject to the conditions described in the Detailed Report section of this letter. This re-authorization will be effective July 1, 1998, and will expire on June 30, 1999. It is also recommended that if bonds are purchased the Pay-As-You-Go Fund (PAYG) would be used as the funding source.

DETAILED REPORT

In September 1995 your Board approved the 1995 update to the Long Range Finance Plan (LRFP) which included a recommendation authorizing the General Manager to purchase Metropolitan bonds in the secondary market subject to the following conditions:

- Maximum purchase price not to exceed 100 percent of par value;
- no restrictions on maturity dates of the bonds subject to purchase;
- aggregate amount of the authorization not to exceed \$75 million;
- purchased bonds must be canceled and retired, and may not be held for investment or resold;
- the authorization would be valid for twelve calendar months, following the month of adoption; and
- a report would be presented to the Board in the month following each use of the authority.

Staff believes that this strategy continues to be beneficial to Metropolitan's capital financing program. Therefore, this strategy will be included in Chapter 6 - Capital Financing, of the 1998 update to the Long Range Finance Plan.

In May 1997, the Board re-authorized the purchase of Metropolitan bonds in the secondary market for a period to expire on June 30, 1998. The reason for this authority was to allow Metropolitan to take advantage of certain market conditions whereby outstanding Metropolitan debt could potentially sell at a discount to par for reasons generally unrelated to Metropolitan. This was true in the period immediately after the Orange County bankruptcy filing in 1993 when, due to market uncertainty, the debt of many California issuers, including certain Metropolitan debt, sold at a discount.

The original authorization (September 1995) to purchase Metropolitan bonds in the secondary market expired in August 1996 without use of this authority. The May 1997 re-authorization scheduled to expire June 30, 1998, also has not been used. Market conditions for Metropolitan bonds in the secondary market that existed throughout these authorization periods did not offer the District the opportunity to take advantage of such authority.

However, future secondary market conditions may offer purchase opportunities for Metropolitan to take advantage of this authorization. Buyback of these bonds would reduce the District's outstanding debt and increase equity. For example, Metropolitan could purchase an outstanding bond in the principal amount of \$1000 at 95% of par value, reducing cash by \$950 and retiring \$1,000 of debt. The \$50 differential would be shown on the financial statements as an increase in non-operating income which would increase District equity.

Re-authorization by the Board of this authority will increase Metropolitan's flexibility in management of its debt obligations. This re-authorization for the General Manager to purchase Metropolitan bonds in the secondary market would be subject to the same conditions noted earlier, except that the authorization would be become effective July 1, 1998 and expire on June 30, 1999. It is also recommended that the PAYG Fund be used to make these purchases. The PAYG Fund would be used as the funding source because it reduces outstanding District debt by funding capital program expenditures.

The recommendation made in this letter is exempt from the California Environmental Quality Act (CEQA) by Public Resources Code Section 21080 (b) (8) since it constitutes the creation of a governmental funding mechanism which does not involve commitment to any specific project which may result in a potentially significant physical impact on the environment.

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