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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

March 28, 1995

APPROVED
by the Board of Directors of
The Metropolitan Water District
of Southern California
at its meeting held

APR 11 1995

EXECUTIVE SECRETARY

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

From: General Manager

Subject: Appropriation No. 707, in the amount of $30,505,000, for Prepayment of the Allen-McColloch Pipeline Variable Rate Debt

Report

On March 27,1995, Metropolitan completed the purchase of the Allen-McColloch Pipeline from the Municipal Water District of Orange County (MWDOC). As part of that transaction Metropolitan assumed the obligation to pay debt service on outstanding Certificates of Participation (COP's) issued in 1989 and 1992 to finance expansion and to refinance construction of the pipeline facility. The 1989 COP's include Series A and B structured as variable rate COP's. There are currently $30,505,000 of the variable rate 1989 COP's outstanding.

Under the terms of the pipeline sale/purchase agreement, Metropolitan is obligated to pay the debt service, the remarketing fees, the annual cost of the associated letter of credit, and trust and rating fees on the variable rate 1989 COP's. The approximate annual costs are:

Interest Expense	$1,226,301
Remarketing Fees	30,505
Letter of Credit Fee	130,000
Trust and Rating Fees	15,000
Total	$1,402,042

The COP's have a final maturity date of 2016, but may be prepaid and retired by the issuer on any monthly interest payment date. Should Metropolitan desire to have the COP's prepaid and retired, this can be accomplished through a deposit with the trustee for the holders of the COP's.

Since the Orange County bankruptcy declaration on December 6, 1994, the COP's have been remarketed at a premium of approximately 1 percent over comparable "non-

Orange County" short-term notes. This results in an additional conduit debt service cost to Metropolitan of approximately $20,000 per month. Since this adverse condition is expected to continue for some time, staff and Metropolitan's financial advisor, O'Brien Partners, Inc., have analyzed 3 options relative to Metropolitan's payment obligations versus the base case:

Base Case: Permit the COP's to remain outstanding and pay all costs, or

1. Prepay the COP's with cash ,
2. Prepay the COP's with proceeds of tax-exempt commercial paper,
3. Purchase the COP's as a District investment.

Table 1 shows the comparative analysis of the financial effect of each option.

Base Case - Metropolitan would continue to pay all costs associated with the outstanding COP's, as required pursuant to the agreement for purchase of the pipeline. ***Annual cost of $1.40 million.***

Option 1 - Prepayment of the COP's with cash results in loss of income currently being earned on the invested funds. ***Annual cost of $1.68 million, (loss of $280,000 per year compared to base case).***

Option 2 - Prepayment of the COP's with proceeds of commercial paper issued by Metropolitan takes advantage of Metropolitan's strong credit rating. Metropolitan's commercial paper would trade at a significant discount to the Orange County COP's. ***Annual cost of $1.07 million, (savings of $330,000 per year compared to base case).***

Option 3 - Purchasing the COP's in the market as a Metropolitan investment removes interest rate risk since the District would receive the interest it pays. However, this option results in lost investment income as in Option 2, with the added costs associated with leaving the COP's outstanding. ***Annual cost of $1.84 million, (loss of $440,000 per year compared to base case).***

Option 2 is the most economical alternative for the District. However, several steps must be taken before the District will be in position to issue additional commercial paper. A line or letter of credit liquidity facility will be required to support commercial paper in excess of the currently outstanding $60 million program. Staff will recommend that Metropolitan name a second dealer/broker to remarket all or a portion of an expanded commercial paper program. In addition, the offering memorandum must be updated and reissued. Staff estimates that these measures can be completed in time for consideration by your Board at the June 1995 meeting.

In addition to the financial considerations, it should be noted that under the terms of the sale/purchase agreement, Metropolitan does not pay the bondholders directly and does not have direct control over the possibility of actual or technical default by the issuer.

. Due to the uncertain financial conditions in Orange County, staff is recommending that the General Manager be given authority to prepay the 1989 Series A and B COP's with cash on-hand at the soonest available monthly payment date, and that the cash be reimbursed from proceeds of commercial paper as soon as feasible thereafter. This would be a combination of ***Options 1*** and ***2*** above. The reimbursement can be accomplished because your Board adopted Resolution 8457 in October 1994, declaring its intention to use the proceeds of tax-exempt debt obligations to reimburse cash outlays made for certain capital projects, including the purchase of the Allen-McColloch Pipeline.

The recommended action is exempt from provisions of the California Environmental Quality Act because there is no possibility that it will have a significant effect on the environment.

Recommendation

It is recommended that the Board approve Appropriation No. 707, in the amount of $30,505,000 from the General Fund, and authorize the General Manager to deposit with the trustee the funds needed to prepay Series A and B of the Allen-McColloch Pipeline 1989 Certificates of Participation.

John R. Wodraska
General Manager

Submitted by:

Lambertus H. Becker
Chief Financial Officer

Approved:

John R. Wodraska
General Manager

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Attachment

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