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May 17, 1999

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

From: General Manager

Submitted by: 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, 1999, and will expire on June 30, 2000. 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 was 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 of benefit to Metropolitan. This strategy was included in the 1999 update to the Long Range Finance Plan. This authority would allow Metropolitan to take advantage of certain market conditions whereby outstanding Metropolitan debt would 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 when, due to market uncertainty, the debt of many California issuers including certain Metropolitan debt, sold at a discount.

The original authorization to purchase Metropolitan bonds in the secondary market expired in August 1996 without use of this authority. The May 1997 re-authorization expired on June 30, 1998, and the May 1998 re-authorization will expire on June 30, 1999. Market conditions for Metropolitan bonds in the secondary market that existed throughout these periods did not offer Metropolitan 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 outstanding debt of Metropolitan and increase the equity of Metropolitan. For example, Metropolitan could purchase an outstanding bond in the principal amount of $100 at 95% of par value, reducing cash by $95 and retiring $100 of debt. The $5 differential would be shown on the financial statements as an increase in non-operating income which would increase the equity of Metropolitan.

Re-authorization by the Board of this authority will increase Metropolitan's flexibility in management of its debt obligations. Therefore, it is recommended to re-authorize the General Manager to purchase Metropolitan bonds in the secondary market subject to the conditions noted earlier, except that the authorization would become effective July 1, 1999 and expire on June 30, 2000. It is also recommended that the PAYG Fund be used to make these purchases, because the PAYG Fund is used to reduce the total amount of debt issuance required to finance the capital program of Metropolitan.

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.

KRN:mb