- **Board of Directors**
  Budget and Finance Committee

July 11, 2000 Board Meeting

9-1

Subject

Re-authorization for the General Manager to Purchase Metropolitan Bonds in the Secondary Market

Description

Metropolitan's Administrative Code requires that the board authorize the General Manager to purchase Metropolitan bonds in the secondary market. 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 12 calendar months, following the month of adoption; and
- A report shall be presented to the board in the month following each use of the authority.

The original authorization to purchase Metropolitan bonds in the secondary market expired August 1996. Since that time re-authorizations have expired at the end of each fiscal year. The current authority expired on June 30, 2000. This strategy was included in the 1999 update to the Long Range Finance Plan, and staff believes that retaining this authority continues to be of benefit to Metropolitan. The ability to purchase Metropolitan bonds in the secondary market provides flexibility to take advantage of market conditions on a short-term basis. While no bonds have been purchased in the past, continued authorization is recommended to ensure that Metropolitan can take advantage of those market anomalies during which Metropolitan bonds are trading at discounts greater than warranted by general interest rate levels. An example of the type of opportunity that occurred in the past was the period immediately after the Orange County bankruptcy filing where, due to market uncertainty, the debt of many California issuers including certain Metropolitan debt, sold at a discount. But, these market conditions are very short-lived, requiring the ability to execute a transaction relatively quickly. This authorization is consistent with your board's direction to restructure Metropolitan's debt, taking advantage of opportunities to reduce Metropolitan's capital costs. Like the recently approved tender program, this authorization would be utilized only in those circumstances where the benefit to Metropolitan was financially advantageous. It is recommended that the repurchase of any bonds in the secondary market be made with Pay-As-You-Go (PAYG) monies. This would not increase PAYG authorization, but only provide a source of funds for any bond purchases under this authority.

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 percent 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.

It is recommended to re-authorize the General Manager to purchase Metropolitan bonds in the secondary market for a five-year period beginning on July 11, 2000. The extension of authority from twelve months to five years reduces administrative burden, assuring that relatively fleeting opportunities are not missed. Staff will continue to provide notification to the board as to the status of this authorization on an annual basis. Should a purchase of Metropolitan bonds in the secondary market occur, staff would inform the board of the results of the transaction at the next regular meeting of the board.

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.

Policy

Board approval required to authorize the General Manager to purchase Metropolitan bonds in the secondary market.

Board Options/Fiscal Impacts

Option #1

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 this letter. This re-authorization will be effective July 11, 2000, and will expire on June 30, 2005. It is also recommended that if bonds are purchased, the Pay-As-You-Go Fund (PAYG) would be used as the funding source.
Fiscal Impact: Up to $75 million.

Option #2

Do not re-authorize the General Manager to purchase up to $75 million of Metropolitan bonds in the secondary market.
Fiscal Impact: Metropolitan may not be able to take advantage of market conditions to reduce debt obligations.

Staff Recommendation

Option #1.

Antoinette Christovale 6/19/2000
for *Brian G. Thomas* *Date*
Chief Financial Officer

Ronald R. Foster 6/27/2000
General Manager *Date*

BLA#88