

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

February 13, 2001 Board Meeting

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9-2

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**Subject**

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Approve restructuring of underwriting team for Metropolitan

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**Description**

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In January 1996, Metropolitan appointed its current investment banking team (see [Attachment 1](#)). At that time, Metropolitan was preparing to finance the Diamond Valley Lake Project, as well as other major capital projects. It was recognized that a significant amount of capital would need to be generated, and that bond sales would be relatively large and complex. As a result, Metropolitan determined that an investment banking team comprised of 14 firms would help ensure that Metropolitan would receive the lowest financing costs available. Further, the Board also anticipated and prepared for negotiated transactions. In this way, Metropolitan was able to take advantage of complex financial structures and market opportunities to access the capital market at opportune times.

Metropolitan has been served well by this approach and has been served well by the members of the current banking team. However, as the needs of Metropolitan have changed, the capital markets have also changed. As a result, Metropolitan again issued a Request for Proposals (RFP) for investment banking services. This RFP was issued for the following reasons:

- While Metropolitan's planned capital expenditures are significantly less than experienced during the construction of Diamond Valley Lake, another \$1 billion of financing will be necessary over the next five years. This level of financing will require a team of underwriters that can ensure Metropolitan's access to capital at favorable interest rates.
- The investment banking community has changed over the past five years. Some firms have moved out of the municipal business, while others have expanded and strengthened their presence. It is appropriate to periodically re-evaluate the investment banking team to ensure that Metropolitan's team continues to represent the best firms in the business and includes the best firms for Metropolitan.
- The municipal market has changed. Retail business is becoming a more important part of the business. The ability to access the retail buyer helps reduce carrying costs of debt.
- Metropolitan is planning to issue more variable rate debt in the future to take advantage of the historical benefits of the lower costs associated with variable rate debt. The Subcommittee on Financial Policies and Reporting recommended and the Board approved increasing variable rate debt exposure to 32 percent of total water revenue bond debt outstanding. Therefore, as Metropolitan increases the issuance of variable rate debt, the investment banking team should include a variety of firms with the ability to remarket this debt.
- The banking community views Metropolitan as a sophisticated issuer. As a result, Metropolitan has access to a variety of debt management tools, including swaps and other financial products to help reduce the cost of debt. As such, it is important to have access to a diverse team of underwriters to help staff take advantage of these financial tools.
- As part of the update to the Long-Range Financial Plan, Metropolitan will be placing greater emphasis on asset/liability management, focusing attention on both sides of the balance sheet. As a result, a broad team of financial experts will be used to develop the appropriate plans and policies for the Board's consideration.

Consistent with the direction of the Budget and Finance Committee, staff recommends that the investment banking team be structured to take advantage of the relative strengths of a number of firms. While “plain vanilla” fixed rate municipal bonds will still be a part of Metropolitan’s financial tools, the emphasis on variable rate debt and synthetic financial products will increase in the future. The underwriting team should include national firms that bring substantial capital, as well as access to institutional and retail buyers (with emphasis on California retail). Just as important, the team should also include regional firms and firms that have strong distribution capabilities. Finally, the team must include firms that can remarket Metropolitan variable rate paper and serve as counterparties for synthetic products.

In October 2000, Metropolitan issued an RFP for banking services. This RFP emphasized the need for senior underwriters that had the capability to underwrite large fixed rate bond issues, as well as the need for other financial products and services. Metropolitan received 26 written responses to the RFP. After careful review of the responses by staff and Metropolitan’s Financial Advisor, staff recommends an investment banking team comprised of 17 firms. The firms were selected on the basis of a number of factors, including:

- Performance in previous Metropolitan financings;
- Financial analyses presented to Metropolitan and overall “coverage” of Metropolitan;
- Capital position;
- Demonstrated understanding of Metropolitan’s issues and role in the water industry;
- The quality of the responses contained in the RFP;
- Ability to underwrite and market Metropolitan’s securities;
- Ability to remarket variable rate debt and demonstrated expertise with synthetic financial products;
- Demonstrated expertise and commitment of the professionals assigned to the Metropolitan team.

In consideration of the above factors, it is recommended that the following 17 firms be approved as part of Metropolitan’s investment banking team:

- |                               |                                   |
|-------------------------------|-----------------------------------|
| 1. A.G. Edwards & Sons, Inc.  | 10. Loop Capital Markets          |
| 2. Banc of America Securities | 11. Merrill Lynch & Co.           |
| 3. Bear, Stearns & Co. Inc.   | 12. Morgan Stanley Dean Witter    |
| 4. CIBC World Markets Corp.   | 13. PaineWebber Incorporated      |
| 5. eBondTrade                 | 14. Prager, McCarthy & Sealy, LLC |
| 6. E.J. De La Rosa & Company  | 15. Salomon Smith Barney          |
| 7. Goldman, Sachs & Co.       | 16. Samuel A. Ramirez & Co., Inc. |
| 8. JP Morgan                  | 17. Siebert Brandford Shank & Co. |
| 9. Lehman Brothers            |                                   |

As shown in [Attachment 2](#), the firms will be expected to provide different roles for Metropolitan. The three “senior managers” will continue to serve as the book running managers for future issuance of fixed rate debt. All banking firms will be expected to continue to contribute ideas and expertise, and, as shown in [Attachment 2](#), banks not in the senior management group could also manage transactions that are best suited for their firm. In this way, Metropolitan has access to a broader pool of firms, and the ability to use the best of what each of the firms has to offer Metropolitan. Staff believes that this flexibility will serve Metropolitan well, while providing additional opportunities for a wider variety of banking firms.

## Policy

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The Board shall establish from time to time a pool of investment banking firms to provide investment banking services to Metropolitan.

## Board Options/Fiscal Impacts

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### Option #1

Determine that the selection of an underwriting team as recommended in this letter is not subject to the California Environmental Quality Act (CEQA) since it constitutes the creation of government funding mechanisms or other government fiscal activities which do not involve the commitment to any specific project which may result in a potentially significant impact on the environment (State CEQA Guidelines Section 15378 (b)(4)).

Approve selection of the underwriting team for services associated with the future issuance of Metropolitan debt.

**Fiscal Impact:** Will vary depending on timing, type, and amount of debt issued.

### Option #2

Determine that the selection of an underwriting team as recommended in this letter is not subject to the California Environmental Quality Act (CEQA) since it constitutes the creation of government funding mechanisms or other government fiscal activities which do not involve the commitment to any specific project which may result in a potentially significant impact on the environment (State CEQA Guidelines Section 15378 (b)(4)).

Do not establish an underwriting team for services associated with the future issuance of Metropolitan debt, and direct staff to select firms to provide the necessary financial services on a case by case basis.

**Fiscal Impact:** Will vary depending on timing, type, and amount of debt issued.

## Staff Recommendation

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### Option #1

	1/18/2001
Brian G. Thomas Chief Financial Officer	Date
	1/29/2001
Ronald R. Jester General Manager	Date

[Attachment 1](#)

[Attachment 2](#)

BLA #477

**Attachment 1**  
**Investment Banking Team**  
**Selected by Board in January 1996**

- Artemis Capital Group
- Bear, Stearns & Co. Inc.
- E.J. De La Rosa & Company
- Grigsby & Associates
- JP Morgan
- Lehman Brothers
- MR Beal & Company
- Merrill Lynch & Co.
- Morgan Stanley Dean Witter
- PaineWebber Incorporated
- Prager, McCarthy & Sealy
- Prudential Securities
- Salomon Smith Barney
- Samuel A. Ramirez & Co., Inc.

## Attachment 2

### Proposed Investment Banking Team Roles and Responsibilities

Function	Investment Bank
Senior Manager for Fixed Rate Transaction	Bear, Stearns & Co. Inc. PaineWebber Incorporated Salomon Smith Barney
Co-Senior Manager for Fixed Rate Transaction	E.J. De La Rosa & Company Loop Capital Markets Samuel A. Ramirez & Co., Inc. Siebert Brandford Shank & Co.
Co-Managers for Fixed Rate Transaction	J.P. Morgan Lehman Brothers Merrill Lynch & Co. Morgan Stanley Dean Witter
Selling Group	A.G. Edwards & Sons Banc of America Securities CIBC World Markets Corp eBondTrade
Remarketing Agents	Banc of America Securities Bear, Stearns & Co. Inc. E.J. De La Rosa & Company JP Morgan Lehman Brothers Merrill Lynch & Co. Morgan Stanley Dean Witter PaineWebber Incorporated Prager, McCarthy & Sealy, LLC Salomon Smith Barney
Swaps and Synthetic Products	Bear, Stearns & Co. Goldman, Sachs & Co. JP Morgan Lehman Brothers Merrill Lynch & Co. Morgan Stanley Dean Witter PaineWebber Incorporated Salomon Smith Barney