

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

November 9, 2004 Board Meeting

8-5

Subject

Approve \$115,000 increase in payments for the April 2004 to March 2005 contract year for financial advisory services under Agreement No. 53616 with Public Resources Advisory Group

Description

Since January 2000, Public Resources Advisory Group has served as Metropolitan's primary financial advisor. PRAG's services to Metropolitan include:

- Advice on the timing, method, and structure of debt financings.
- Assistance in negotiating the terms and conditions of interest rate swap agreements.
- Assistance in evaluating opportunities to refinance and restructure debt, including escrow restructuring.
- Preparation of detailed financial analyses and review of financial products, including documents related to the sale of debt and investment of debt proceeds.
- Assisting Metropolitan when negotiating contracts and soliciting bids for various services associated with financial transactions (e.g., verification services, liquidity agreements, etc.).
- Coordinating and developing rating agency presentations and strategies.
- Evaluating financial plans and providing advice on Metropolitan's financial strategies, including asset and liability management.

Attachment 1 lists the detailed scope of work provided by the financial advisors under the current agreement.

PRAG was selected through a request for proposal process. Metropolitan's current agreement with PRAG is for a three-year period (ending March 31, 2006). The contractual maximum amount payable over the term of the agreement is \$240,000 per contract year. This maximum was set based on a typical financing schedule. As of September 30, 2004, Metropolitan has paid \$224,266 to PRAG for services provided since April 2004.

In a typical contract year under the terms of Metropolitan's agreement with its financial advisors, one or two debt financing transactions may occur. Because of the volatile and changing interest rate market seen in 2004, Metropolitan has been able to price and execute two water revenue bond refundings, (one of which included integration of interest rate swaps with the refunding transaction), a basis swap transaction, a cash defeasance of outstanding debt, and complete the restructuring of various escrow accounts linked to prior bond refundings. These transactions will produce over \$30 million of net present value savings.

Due to the difficult and complex technical issues associated with the water revenue refunding bonds, the integration of the interest rate swaps, and the restructuring of the refunding escrow accounts, a considerable amount of time and effort was spent by Metropolitan's staff, financial advisors, bond counsel, tax counsel, and swap team. The focus by PRAG on the technical demands related to the bond transactions, swap agreements, and escrow restructuring enabled Metropolitan to realize additional savings that otherwise would not have been possible. In particular, PRAG identified escrow and reserve fund restructuring opportunities in a timely manner utilizing an innovative financing technique that enabled Metropolitan to realize additional net present value savings of \$5.7 million over and above the \$12.2 million of savings resulting from the bond refunding. PRAG also provided analysis in support of Metropolitan's efforts to realize debt service savings through the annual cash

defeasance program by providing technical analysis related to the August 2004 cash defeasance. The 2004 cash defeasance was done in conjunction with an innovative escrow restructuring devised by PRAG that will produce additional net present value savings of \$1.5 million.

Metropolitan is planning to price a \$300 million new money fixed-rate bond issue in October to help fund the ongoing capital investment program. The financing will have two separate fixed-rate bond pricings, with maturities extending to 28 years.

Metropolitan is also executing a \$136 million water revenue bond refunding transaction that will lower debt service payments over the next 25 years. The refunding transaction will be accomplished by issuing variable-rate water revenue bonds and simultaneously executing a LIBOR-based (London Interbank Offer Rate) interest rate swap with two swap counterparties. Metropolitan will pay a fixed rate of 2.98 percent to each of the swap counterparties and in exchange would receive a payment equal to 61.55 percent of one-month LIBOR. The variable payment received by Metropolitan would approximate, but may not necessarily be equal to the variable rate bond payments made by Metropolitan. The refunding is estimated to produce over \$10.9 million of net present value savings. Metropolitan has negotiated a fee of \$100,000 with PRAG for the new money bond transaction, the issuance of the variable rate water revenue refunding bonds, and the interest rate swap pricings.

For the remainder of contract year 2004/05, it is anticipated that PRAG will provide other financial advisory services for Metropolitan in accordance with the terms and conditions of the current agreement. Based on work already performed by PRAG during the 2004/05 contract year, the anticipated fees for the bond and interest rate swap transactions, and other financial advisory services anticipated through March 2005, staff estimates payments to PRAG for contract year 2004/05 could total as much as \$355,000. Therefore, payments to PRAG for contract year 2004/05 are estimated to be \$115,000 greater than the maximum amount payable identified in the agreement.

Policy

Metropolitan Water District Administrative Code § 8115: (a) Negotiated Contracts

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA because it involves continuing administrative activities (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not subject to the provisions of CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and approve additional payments up to \$115,000 to a total of \$355,000 under Agreement No. 53616 for contract year 2004/05.

Fiscal Impact: Up to \$115,000


Option #2

Do not approve the additional payments under Agreement No. 53616 for contract year 2004/05.

Fiscal Impact: Metropolitan would not receive financial advisory services from PRAG for the remainder of the 2004/05 contract year.

Staff Recommendation


Option #1



Brian G. Thomas
Chief Financial Officer

10/11/2004

Date



Ronald R. Gastelum
Chief Executive Officer

10/18/2004

Date

Attachment 1 – Financial Advisory Services – Scope of Work

BLA #3173

Financial Advisory Services
Scope of Work

Public Resources Advisory Group, serving as Metropolitan's financial advisor, will provide Metropolitan financial advisory services to include but not limited to the following services and commitments:

- (a) Provide Metropolitan with information, judgments, and forecasts regarding economic, capital market, and money market conditions.
- (b) Advise Metropolitan on the timing, method, and structure of Metropolitan's bond sales. Assist and advise Metropolitan in negotiating the amount and components of the underwriters' spread, pricing, and other terms of the bond sale, including verification of the true-interest-cost of winning bids for a competitive bond sale by Metropolitan.
- (c) Assist and advise Metropolitan in evaluating opportunities to refinance and restructure outstanding Metropolitan debt.
- (d) Evaluate and advise Metropolitan on the use of new and complex debt structures, including various derivative and swap products that are proposed to Metropolitan. May also be required to prepare a detailed financial analysis and review of such debt structures and financial products.
- (e) Assist Metropolitan in negotiating contracts, such as swaps, investment agreements, purchases and sales of assets.
- (f) Solicit bids related to escrow funds, insurance, swap rates, lines of credit, and any other bids Metropolitan may request.
- (g) Assist Metropolitan in updating and implementing strategies, plans, and policies. This includes analyzing short, intermediate, and long-term financing options, and ongoing surveys of the financial activities of public and private water utilities and, if requested, electric utilities.
- (h) Assist Metropolitan in preparing and reviewing documents necessary for the sale of its securities and investment of the proceeds thereof.
- (i) Assist Metropolitan, in coordination with Metropolitan's General Counsel and Bond Counsel, in ensuring that applicable laws and regulations relating to security offerings are followed.
- (j) Assist Metropolitan in preparing for meetings with rating agencies and investors.
- (k) Assist Metropolitan in reviewing and analyzing legislation that may have a financial impact on Metropolitan.

- (l) Comment on reports, mainly on financial matters, that have been completed or are being prepared by Metropolitan staff.
- (m) Assist Metropolitan staff in reviewing RFPs for investment banking services and the selection of underwriting teams.
- (n) Upon request, prepare special studies of a financial nature and review new financial products or techniques that may be proposed to Metropolitan.
- (o) Attend Metropolitan's monthly Budget, Finance and Investment Committee meetings and, upon request, attend other various meetings of the Board, and Subcommittee meetings. Consultant may be asked to make presentations to the Board of Directors, the Budget, Finance and Investment Committee and any Subcommittee.

The financial advisor shall assist Metropolitan in other matters related to financial advisory services as mutually agreed upon.

Metropolitan reserves the right to amend responsibilities of financial advisor consistent with this general scope of work.