

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

December 14, 2004 Board Meeting

8-3

Subject

Approve selection of Metropolitan's Investment Banking Team

Description

In February 2001, Metropolitan appointed its investment banking team. Metropolitan has worked with this team, taking advantage of the relative strengths of each of the firms to meet the financing requirements of the capital investment program and lower the overall cost of debt. Since February 2001, Metropolitan has issued fixed rate bonds, increased its use of variable rate debt and prudently utilized interest rate swaps to reduce Metropolitan's cost of capital. The existing investment banking team includes national firms that bring substantial capital, as well as access to institutional and retail buyers (with emphasis on California retail), regional firms and small business firms. The existing team was 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 Metropolitan's role in the water industry;
- The quality of responses contained in an RFP or RFQ;
- Ability to underwrite and market Metropolitan's securities;
- Ability to remarket variable rate debt and demonstrated expertise with synthetic financial products such as interest rate swaps;
- Demonstrated expertise and commitment of the professionals assigned to the Metropolitan team.

Attachment 1 details the criteria used to assign specific firms to individual transactions. These criteria were reviewed with the Budget, Finance and Investment Committee, and have proven to be very successful over the past three years. The following firms comprise Metropolitan's existing investment banking team:

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|----------------------------------|--|
| 1. A.G. Edwards & Sons, Inc. | 9. Lehman Brothers |
| 2. Bank of America Securities | 10. Loop Capital Markets LLC |
| 3. Bear, Stearns & Co. Inc. | 11. Merrill Lynch & Co. |
| 4. CIBC World Markets Corp. | 12. Morgan Stanley & Co. Inc. |
| 5. Citigroup Global Markets Inc. | 13. Prager, McCarthy & Sealy, LLC |
| 6. E.J. De La Rosa & Co., Inc. | 14. Ramirez & Co., Inc. |
| 7. Goldman, Sachs & Co. | 15. Siebert Brandford Shank & Co., LLC |
| 8. JP Morgan | 16. UBS Financial Services Inc. |

As with all service providers, it is appropriate and prudent for Metropolitan to periodically solicit requests for qualifications for investment banking services. Such a periodic evaluation enables Metropolitan to ensure that its investment banking team represents the best firms available. In August 2004, Metropolitan issued RFQ No. 688 for investment banking services to augment the investment banking team. Responses were received from 22 firms. These responses were reviewed by a team of staff from the Office of the Chief Financial Officer and one of our financial advisors, Gardner, Underwood & Bacon LLC. After review and analysis of the responses, staff recommends the selection of six investment banking firms to join Metropolitan's existing team to perform various financial services required by Metropolitan.

It is recommended that the following firms be added to Metropolitan's investment banking team:

1. Estrada Hinojosa & Company, Inc. (SBE)
Small Business Enterprise
Headquartered in Dallas, Texas; office in San Diego, California
Established in 1990
Total Capital as of June 30, 2004: \$1.5 million
2. First Albany Capital
Full service national investment banking firm
Headquartered in Albany, New York; office in Los Angeles, California
Established in 1953
Total Capital as of June 30, 2004: \$65.8 million
3. Henderson Capital Partners (SBE)
Regional women-owned investment banking firm
Headquartered in Oakland, California
Established in 1991
Total Capital as of May 31, 2004: \$1.1 million
4. Jackson Securities (SBE)
Minority-owned firm
Headquartered in Atlanta, Georgia; office in San Francisco, California
Established in 1987
Total Capital as of March 31, 2004: \$3.3 million
5. Stone & Youngberg
California's largest regional investment banking firm
Headquartered in San Francisco, California; office in Los Angeles, California
Established in 1931
Total Capital as of June 30, 2004: \$24.5 million
6. Wells Fargo
Fifth largest United States Bank
Headquartered in San Francisco, California; office in Los Angeles, California
Public Finance established in 1983; banking services for over 150 years
Total Capital as of June 30, 2004: \$48.7 million

The six additional firms were selected based on a combination of California banking presence, national presence, capital position, institutional and retail capabilities (with emphasis on California retail), financial analyses presented to Metropolitan, demonstrated understanding of Metropolitan's issues and role in the water industry, the quality of the responses contained in the RFQ, and demonstrated expertise and commitment of the professionals that will be assigned to the Metropolitan team. In addition, three of the six firms qualify under Metropolitan's small business enterprise program consistent with Metropolitan's efforts to create financial opportunities for regional and small firms to participate in future financings. As such, it is recommended that these six firms be added to the existing team, and that the following firms be approved as Metropolitan's investment banking team:

1. Bank of America Securities
2. Bear, Stearns & Co. Inc.
3. Citigroup Global Markets Inc.
4. E.J. De La Rosa & Co., Inc.
5. Estrada Hinojosa & Company, Inc.
6. First Albany Capital

7. Goldman, Sachs & Co.
8. Henderson Capital Partners
9. JP Morgan
10. Jackson Securities
11. Lehman Brothers
12. Loop Capital Markets LLC
13. Merrill Lynch & Co.
14. Morgan Stanley & Co. Inc.
15. Ramirez & Co., Inc.
16. Siebert Brandford Shank & Co., LLC
17. Stone & Youngberg
18. UBS Financial Services Inc.
19. Wells Fargo

In addition, Prager, McCarthy & Sealy, LLC will continue to serve as remarketing agent for Metropolitan's Water Revenue Bonds, 1997 Series C and Water Revenue Bonds, 1999 Series C variable rate bond issues.

Metropolitan will continue to utilize the criteria outlined in [Attachment 1](#) when selecting firms for individual transactions.

Policy

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

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA because it involves 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). In addition, where it can be seen with certainty that there is no possibility that the proposed action in question may have a significant effect on the environment, the proposed action is not subject to CEQA (Section 15061(b)(3) 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)(4) and 15061(b)(3).

CEQA determination for Option #2:

None required

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and approve selection of Metropolitan's investment banking team to provide services associated with the future issuance of Metropolitan debt.

Fiscal Impact: None


Option #2

Do not augment Metropolitan's investment banking team for services associated with the future issuance of Metropolitan debt, and direct staff to continue to utilize firms currently on Metropolitan's investment banking team to provide the necessary financial services.

Fiscal Impact: None


Staff Recommendation

Option #1



Brian G. Thomas
Chief Financial Officer

11/19/2004
Date



Ronald R. Gastelum
Chief Executive Officer

11/19/2004
Date

Attachment 1 – Criteria for Selection of Investment Banking Team

BLA #3194

Criteria for Selection of Investment Banking Team

1. Periodically, Metropolitan will solicit request for proposals (RFP) for investment banking services. The most recent investment banking team was selected in January 2001. At that time, an investment banking team was selected that included 17 firms, divided into the following teams:
 - Senior book-running manager; Co-manager group
 - Co-senior managers: small business firms
 - Re-marketing agent group
 - Swaps and synthetic product team
2. One of Metropolitan's objectives is to create financing structures that will provide opportunities for regional and small firms to senior manage bonds. In this way, Metropolitan encourages the development of a diverse and competitive marketplace for financing activities, encourages all firms to provide coverage and ideas, and to properly compensate firms for work provided to Metropolitan. This policy will help to reduce long-term financing costs by creating more competition in the marketplace. Small firms in Metropolitan's investment banking team will be selected for such opportunities in a manner consistent with the criteria outlined below.
3. Firms are selected for individual transactions based on the following criteria:
 - Overall coverage and service
 - Quality and timeliness of financial products and ideas
 - Performance in previous financings
 - Capital position to allow for underwriting of bonds
 - Demonstrated understanding of Metropolitan's issues and role in the water industry
 - Ability to market municipal debt to California investors
 - Ability to re-market variable rate debt at or below market rates
 - Demonstrated expertise with synthetic financial products with acceptable creditworthiness (firm must meet minimum selection criteria established in Metropolitan's master swap policy)
 - Demonstrated commitment of professionals assigned to Metropolitan team
4. All things being equal, investment banking business will be allocated among all team members to help ensure consistent coverage by a large number of firms, effective and efficient financings and that new ideas are generated. Capital and underwriting support will be a consideration when allocating specific transactions to different firms.

To help ensure that transactions are conducted as efficiently as possible, staff will select specific firms to manage selected transactions pursuant to the above criteria. The Ad Hoc Committee (consisting of the Chairman of the Board, Chairman of the Budget, Finance and Investment Committee and the Chief Executive Officer) will approve the structure of each transaction, and will evaluate the performance and success of the investment banking team to ensure that these and all other board objectives and policies are met.