

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

October 14, 2008 Board Meeting

8-1

Subject

Approve selection of Metropolitan's Investment Banking Team

Description

In December 2004, Metropolitan appointed its current 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 plan and lower the overall cost of debt. Since December 2004, Metropolitan has issued fixed rate bonds and variable rate debt bonds, and prudently utilized interest rate swaps to reduce Metropolitan's overall cost of capital. The existing investment banking team includes national firms with substantial capital resources, as well as access to institutional and retail buyers (with emphasis on California retail), regional firms and small business firms. The 2004 investment banking 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 a request for qualifications;
- The ability to underwrite and market Metropolitan's securities;
- The ability to remarket variable rate debt and demonstrated expertise with synthetic financial products such as interest rate swaps; and
- 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 Business and Finance Committee at its meeting on August 18, 2008, and have proven to be very successful over the past four years.

Recently, there have been many changes to the municipal bond market including the bankruptcy filing of Lehman Brothers Holdings Inc. in September 2008, the pending purchase of Merrill Lynch & Co. by Bank of America Corp., the financial impact to municipalities of the credit downgrades of the municipal bond insurers, the breakup of the auction rate securities market, the decision by UBS in May 2008 to exit the municipal bond market, and the purchase of Bear Stearns by JP Morgan in March 2008. Metropolitan was impacted by each of these events during the past year. Under direction of the Board of Directors, Metropolitan was able to mitigate the financial risk associated with the credit downgrades of the municipal bond insurers and was able to eliminate its exposure to the auction rate securities market by refunding all of Metropolitan's auction rate securities. In addition, Bear Stearns and UBS were senior members of Metropolitan's investment banking team; however, each of those firms are no longer participating in the municipal bond market, and with the overall turmoil in the municipal market, the composition of many of the investment banking firms on Metropolitan's investment banking team has changed dramatically since selection of the current banking team in December 2004.

Given the changes in the municipal market and the changes to the composition of the firms in Metropolitan's investment banking team, staff determined that it was once again a prudent time to solicit requests for qualifications for investment banking services. A periodic reevaluation of the various firms in the investment banking community enables Metropolitan to ensure that its investment banking team represents the best firms available. In August 2008, Metropolitan issued RFQ No. 877 for investment banking services to select its

investment banking team. Responses were received from 28 firms. These responses were reviewed by staff from the Office of the Chief Financial Officer, and by representatives from each of Metropolitan's team of financial advisory firms, Public Resources Advisory Group (PRAG); Public Financial Management, Inc. (PFM); and Gardner, Underwood & Bacon LLC. After review and analysis of the responses, staff recommends the selection of 16 firms for Metropolitan's investment banking team. As with the composition of prior investment banking teams, the recommended firms will be expected to provide various financial services to Metropolitan. The investment banking team will be comprised of a senior manager pool of firms and a co-manager pool of firms. The senior manager pool of firms will have the opportunity to serve as a book running senior manager for the future issuance of fixed rate debt of Metropolitan and also participate in fixed rate bond financings as a co-manager. All firms will be expected to contribute ideas and expertise to Metropolitan and could manage other transactions best suited to their firm or provide other services of use to Metropolitan. Staff believes this flexibility will serve Metropolitan well, and provide Metropolitan with all the financial resources of national firms with substantial capital resources, as well as access to institutional and retail buyers (with emphasis on California retail), regional firms and provide opportunities for minority-owned business firms.

The following ten firms are recommended to comprise the senior investment banking team pool for Metropolitan:

- Bank of America
- Citi
- De La Rosa & Co.
- Goldman, Sachs & Co.
- JP Morgan
- Loop Capital Markets, LLC
- Morgan Stanley
- Ramirez & Co., Inc.
- Siebert Brandford Shank & Co., L.L.C.
- Stone & Youngberg

The following six firms are recommended to comprise the co-manager pool of Metropolitan's investment banking team:

- DEPFA First Albany Securities LLC
- Fidelity Capital Markets Services
- Jackson Securities
- RBC Capital Markets
- Wedbush Morgan Securities
- Wells Fargo Institutional Securities, LLC

In August 2008, Metropolitan's Board adopted the Eighteenth Supplemental Resolution to the Master Revenue Bond Resolution authorizing the sale of up to \$750 million of water revenue bonds to continue to provide funding for the ongoing requirements of Metropolitan's capital investment plan. As of September 23, 2008, Metropolitan had approximately \$103 million remaining in the bond construction funds. Given the anticipated expenditures for the CIP, staff anticipates that Metropolitan will need to issue debt to fund the CIP by the first quarter of 2009.

As such, staff recommends that Metropolitan be prepared to issue \$200 million of fixed rate water revenue bonds within the next three to six months. The following financing team will be used for the issuance of the fixed rate water revenue bonds:

- Senior Manager: Stone & Youngberg
- Co-Senior Manager: Siebert Brandford Shank & Co., L.L.C.
- Co-Managers:
 - Bank of America
 - Citi
 - De La Rosa & Co.
 - Goldman, Sachs & Co.
 - JP Morgan
 - Loop Capital Markets, LLC
 - Morgan Stanley
 - Ramirez & Co., Inc.

Staff will work with the financing team and Metropolitan's financial advisors, legal counsel, and the Ad Hoc Committee to determine the timing and structure for the upcoming new money financing.

Metropolitan will continue to utilize the criteria outlined in [Attachment 1](#) when selecting firms for individual financing 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 actions are not defined as a project under CEQA because they involve continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not subject to CEQA because they involve 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 actions are not subject to 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

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

9/29/2008
Date



Jeffrey Kightlinger
General Manager

10/1/2008
Date

Attachment 1 – Criteria for Selection of Investment Banking Team

BLA #6258

Criteria for Selection of Investment Banking Team

1. Periodically, Metropolitan will solicit requests for proposals or request for qualifications for investment banking services. Metropolitan's current investment banking team was selected in December 2004.
2. One of Metropolitan's objectives is to create financing structures that will provide opportunities for regional and small firms. 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.
3. Once a firm is selected as part of Metropolitan's investment banking team, 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 remarket variable rate debt at or below market rates
 - Ability to provide broker dealer services for auction rate securities
 - Demonstrated expertise with synthetic financial products with acceptable creditworthiness (firm must meet minimum selection criteria established in Metropolitan's 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 new ideas that are generated. Capital and underwriting support will be a consideration when allocating specific transactions to different firms.
5. 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 Business and Finance Committee and the General Manager) will approve the structure of each transaction, and will evaluate the performance and success of the underwriting team to ensure that these and all other board objectives and policies are met.