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FINANCE AND BUDGET COMMITTEE
MAY 20, 2004

SUBJECT: REFUNDING OF GENERAL REVENUE BONDS

ACTION: APPOINT UNDERWRITERS FOR A NEGOTIATED REFUNDING OF THE GENERAL REVENUE BONDS, SERIES 1996-A

## RECOMMENDATION

A. Appoint Goldman Sachs & Co. and Morgan Stanley as co-senior managing underwriters and remarketing agents for one or more series of auction rate securities;

B. Appoint Goldman Sachs & Co. and Morgan Stanley as co-senior managing underwriters, with Goldman Sachs & Co. to serve as the bookrunning underwriter, and the following firms to serve as co-managing underwriters in the event one or more fixed rate bond series are issued. Appoint as co-managers, E. J. De La Rosa & Co., Jackson Securities, Inc., Loop Capital Markets, and LLC, Backstrom McCarley Berry & Co., LLC to transact a refunding of the General Revenue Bonds, Series 1996-A in a negotiated sale.

## RATIONALE

Due to generally low interest rates, MTA could have the opportunity to refund up to $186 million of the General Revenue 1996-A bonds, also referred to as the Gateway Headquarters bonds. Approval of the recommendations will position the MTA to be able to expeditiously sell refunding bonds if interest rates reach appropriately low levels. Procedurally, a negotiated bond sale is the longer lead-time item so the appointment of the team is being recommended now.

The two refunding techniques under consideration are an interest rate swap or a traditional fixed rate bond. Because of certain credit and structuring factors for this financing, either technique would be best facilitated utilizing the negotiated bond sale method. The factors influencing the recommendation to use a negotiated bond sale include recent market volatility, use of a non-traditional pledged revenue stream, the need for long-term remarketing contracts and the possible restructuring of the principal repayment schedule and extension of the final maturity date.

Discussion:

During a three-week window in March 2004, interest rates dropped dramatically. During that period, an interest rate swap refunding would have achieved savings in excess of $30 million and met the Debt Policy refunding guidelines. At the same time, the fixed rate refunding alternative would have achieved around $20 million in savings. Due to procedural lead time issues and an equally dramatic rise in rates, the MTA missed these opportunities.

Under the current schedule, through FY 2005 annual debt service payments have been approximately $10.7 million and have been interest only. Annual debt service payments increase markedly each year thereafter and will more than double by FY 2025 to $23.5 million. In order to level the annual requirements it will be necessary to extend the final maturity by as much as 10 years.

In the event that a fixed rate bond will yield substantially similar savings as a swap transaction, the same co-senior managers will share the issuance as in the proportions specified by staff, which shall be between 40% and 60% of the issuance, less amounts for co-managers. Co-managers are recommended based upon their proposal responses, market segments served, geographic regions served and diversity objectives.

## FINANCIAL IMPACT

The appointment of underwriters has no financial impact. The costs of issuance for a refunding are not budgeted in either FY04 or FY05 because of the uncertainty related to completing a refunding. If executed, the refunding will generate a favorable variance in debt service interest, project 610311, account 51124, in FY05 to offset any unfavorable variance to costs of issuance.

## ALTERNATIVES CONSIDERED

Appointment of the remarketing agents could be delayed resulting in the delay of the refunding. Approval of the recommendation allows the MTA to be positioned to take advantage of this refunding opportunity in the face of potentially adverse market fluctuations.

## NEXT STEPS

- Develop bond documents and interest rate swap documents
- Request Board authorization to sell bonds and enter into interest rate swaps whenever market conditions meet Debt Policy guidelines.
- Monitor interest rates and bond refunding savings to determine when there is sufficient savings to comply with MTA's Debt Policy guidelines for bond refundings.
- When policy guidelines are met, distribute the official statement to potential investors, initiate pre-marketing effort, price the bonds, price the interest rate swaps, and deliver the bonds.

## ATTACHMENT

A. Summary of Underwriter Selection
B. History of Underwriter Selection

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Executive Officer, Finance and Treasurer

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Chief Executive Officer

Attachment A

Summary of Underwriter Selection
Refunding of the General Revenue 1996-A Bonds

Recommended Firms: Goldman Sachs & Co. (Co-Senior Manager)
Morgan Stanley (Co-Senior Manager)

Proposed Price

Goldman Sachs & Co.
Auction Rate Bond Issue
-Takedown: $2.50 / $1,000 of bonds, plus expenses
-Annual Fee: $2.50 / $1,000 of bonds outstanding

Fixed Rate Bond Issue
-Takedown: Average of $3.61 / $1,000 of bonds, plus expenses (takedown may vary slightly due to market conditions)

Morgan Stanley
Auction Rate Bond Issue
-Takedown: $3.25 / $1,000 of bonds, plus expenses
-Annual Fee: $2.50 / $1,000 of bonds outstanding

Fixed Rate Bond Issue
-Takedown: Average of $3.69 / $1,000 of bonds, plus expenses (takedown may vary slightly due to market conditions)

RFP Issued: April 05, 2003

RFPs Mailed: 19

Proposals Received: 18

Proposals Due: April 16, 2004

Evaluation Method: Best Value

Proposing Firms:

| List of Proposers |
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| Backstrom McCarley Berry & Co. |
| Banc of America Securities, LLC |
| Bear Stearns & Co. Inc. |
| Blaylock & Partners, LP |
| Citigroup Global Markets, Inc. |

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| E.J. De La Rosa & Co., Inc. |
| First Albany Capital, Inc. |
| Goldman Sachs & Co., |
| J. P. Morgan Securities, Inc. |
| Jackson Securities |
| Lehman Brothers, Inc. |
| Loop Capital Markets, LLC |
| M. R. Beal & Co. |
| Merrill Lynch & Co. |
| Morgan Stanley |
| Samuel A. Ramirez & Co., Inc. |
| Siebert Brandford Shank & Co., LLC |
| UBS Financial Services, Inc. |

Attachment B

## History of Underwriter Selection
## Refunding of the General Revenue 1996-A Bonds

### A. Background on Selected Firms

*Goldman Sachs & Co.* is a leading global investment banking and securities firm, that provides a full range of investing, advisory, and financing services worldwide to a client list that includes governments, corporations, financial institutions and individuals. Headquartered in New York, Goldman Sachs has 55 offices in 25 countries and employs more than 19,000 people worldwide. In the United States, Goldman Sachs has 26 regional offices, including offices in San Francisco and Los Angeles.

*Morgan Stanley* is a top-ranked global financial services firm with one of the industry's largest total consolidated capital positions of $82.7 billion. Morgan Stanley also maintains leading market positions in its three primary business areas of securities, asset management, and credit services. The firm holds $595 billion in assets on behalf of its 4.6 million customer accounts, including $46 billion in directly held municipal bonds. Within California, the firm has approximately 2,401 financial advisors managing 955,000 accounts with $106.2 billion in assets.

### B. Selection Background

This was a negotiated selection process to identify two co-senior managing underwriters to perform as both the underwriters and remarketing agents to issue the General Revenue 2004-A bonds as a variable rate issuance of auction rate securities, or alternatively as fixed rate bonds. Additionally, a team of co-managing underwriters was selected to assist in the sale of fixed rate bonds only.

The General Revenue 2004-A bonds will advance refund the currently outstanding General Revenue 1996-A bonds. Depending whether the bonds are issued as variable rate or fixed rate bonds the underwriters will perform differing functions. For issuance of the auction rate securities, the co-senior managers (no co-managers will be used) will initially place the bonds with investors and will then provide ongoing weekly or monthly remarketing services over the life of the bonds. In the event a fixed rate bond is issued, the co-senior managing underwriters and team of co-managing underwriters will provide typical underwriting services of marketing and selling the bonds.

Selection of the co-senior managers was made based on proposal responses and negotiation with firms in the competitive range by ranking each according to the selection criteria. The criteria included consideration of the amount and quality of recent and direct experience of the firm, of the relevant investment bankers, bond traders and sales force in setting up and operating auction rate securities programs and in structuring and selling fixed rate transportation or similar California issuer bonds. Related to the selection of auction rate remarketing agents, weight was given to demonstrated results in providing the lowest interest rates for existing clients.

Based on higher scores for experience and demonstrated results in lowering costs, Goldman Sachs & Co. and Morgan Stanley are recommended to serve as the co-senior managing underwriters and remarketing agents. The firms recommended to serve as co-managers are E. J. De La Rosa & Co., Jackson Securities, Inc., Loop Capital Markets, and LLC, Backstrom McCarley Berry & Co., LLC. The co-managers are recommended based upon a combination of their proposal responses, market segments served, geographic regions served, and minority status.

C. Evaluation of Proposals

18 proposals were received and evaluated in accordance with the guidelines and criteria established in the RFP.

D. Cost/Price Analysis Explanation

The proposed pricing was determined to be fair and reasonable based upon competition and ranking relative to the other proposers.