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FINANCE & BUDGET COMMITTEE
APRIL 21, 2005

SUBJECT: FULL FUNDING GRANT AGREEMENT BONDS

ACTION: APPOINT BOND UNDERWRITERS

RECOMMENDATION

Appoint Citigroup Global Markets and UBS Financial Services as co-senior managing underwriters with:

- Citigroup Global Markets as senior managing underwriter along with Goldman Sachs & Co. as co-managing underwriter to issue and remarket one or more series of auction rate securities.

- Citigroup Global Markets as senior managing underwriter and bookrunner, with UBS Financial Services as co-senior managing underwriter, with E. J. De La Rosa & Co. and Loop Capital Markets to serve as co-managing underwriters for the sale of one or more fixed rate bond series.

RATIONALE

The project cash flow schedule of the full funding grant agreement (FFGA) for the Gold Line Eastside Extension anticipates a cumulative cash flow deficit of more than $130 million by the end of FY08. Accordingly, the project budget includes a Project Finance Cost line item in the amount of $14.8 million. This interest cost estimate is based on the assumption that our Prop A tax-exempt commercial paper program would be used to provide "bridge funding" until grant monies are received.

Now that the FFGA has been executed, we have access to a new source of credit, the Federal Section 5309 funds promised by the FFGA. This source is accessible via a financing technique similar to a GARVEE, grant anticipation revenue vehicle, which has emerged in the market over the past 5 or more years. Under this technique, the grantee, pledges only the future Federal funds as security for the bonds issued. Bonds proceeds provide the cash to pay for construction costs. The Federal Grant proceeds are used to pay the debt service on the bonds. No other local funds are required to be encumbered by the pledge. Since 2001, successful transit GARVEEs have been issued by Bay Area Rapid Transit (BART), Chicago Transit Authority (CTA) and New Jersey Transit (NJT).

Utilizing a combination of short-term fixed and variable (auction rate securities, ARS) rate bonds secured by the Federal funds, the financing costs of the bridge funding would not be greater than anticipated in the project budget, assuming all other things being equal.

Advantages of utilizing this new credit source include improved accountability of project specific financing costs since the debt proceeds can only be used for the Eastside project. The actual financing costs are tied to the success of obtaining the future Federal appropriations in the amounts and at the times promised in the FFGA. Actual construction outflows impact interest earned on debt proceeds prior to disbursement. These interest earnings can be used to reduce debt service. Our local credit is preserved for future contingencies and other projects' needs.

The use of auction rate securities in this transaction structure requires the use of the negotiated bond selling method. A competitive underwriter selection process was conducted by our financial advisors, Public Financial Management (PFM), to select underwriters and remarketing agents that will sell both the fixed rate and variable rate bonds in negotiated transactions. Inclusion of the fixed rate bonds and variable rate bonds under a single mandate avoids duplication in documents, legal and other ancillary costs. The recommended underwriters include minority and disadvantaged business enterprises.

FINANCIAL IMPACT

The appointment of underwriters has no financial impact.

The actual cost of the financing will depend on the size of the borrowing, the split between fixed and variable rate bonds, rate of construction expenditures and the flow of all project revenue sources, especially Federal and State grants. The size and terms are under review and will be finalized following appointment of the underwriting team. The final transaction will be presented for consideration by the Board at a subsequent meeting, May or June.

ALTERNATIVE CONSIDERED

We could stay with the original plan to utilize Prop A tax-exempt commercial paper for the bridge financing. This alternative would forgo the "no cost" opportunity to access the additional credit provided by the FFGA and the opportunity to preserve our local capacity for future contingencies and other projects' needs.

We could delay the issuance until there is more certainty regarding our bridge financing needs, construction outflows versus grant inflows. However, we are in a rising interest rate market and it would generally be more costly to borrow later if problems had already been incurred.

ATTACHMENT

A. Summary of Underwriter Selection Process

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Executive Officer, Finance and Treasurer

Roger Snoble
Chief Executive Officer

Attachment A

Summary of Underwriter Selection Process

Recommended Firms:

Co-Senior Managers -	Citigroup Global Markets UBS Financial Services
Co-Managers -	Goldman Sachs & Co. E. J. De La Rosa & Co. (minority firm) Loop Capital (minority firm)

Proposed Price

Citigroup Global Markets.
Auction Rate Bond Issue
-Takedown: $3.00 / $1,000 of bonds, plus expenses
-Annual Fee: $2.50 / $1,000 of bonds outstanding

Fixed Rate Bond Issue
-Takedown: Average of $2.21 / $1,000 of bonds, plus expenses

Note:
- The actual takedown will vary slightly due to changes in principal amortization
- The senior manager's pricing scale will be applied to all fixed rate bonds sold

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

RFP Issued: February 07, 2005

RFPs Distributed: 20

Proposals Received: 17

Proposals Due: February 18, 2005

Evaluation Method: Best Value

Proposing Firms:

List of Proposers
Backstrom McCarley Berry & Co.
Banc of America Securities, LLC
Bear Stearns & Co. Inc.
Citigroup Global Markets, Inc.
E.J. De La Rosa & Co., Inc.
First Albany Capital, Inc.
Goldman Sachs & Co.,
J. P. Morgan Securities, Inc.
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
Stone and Youngberg
UBS Financial Services, Inc.

History of Underwriter Selection

A. <u>Background on Selected Firms</u>

Citigroup Global Markets - is a full service national and international investment bank headquartered in New York. Citigroup's diverse platform allows it to meet the needs of both government entities and corporations (through underwriting and advisory/specialty financing services) as well as individual and institutional investor (through banking and trading services). With over 275,000 employees, Citigroup is one of the largest brokerage forms supporting the largest distribution network in the industry. Citigroup's Municipal Securities Division is the leading underwriter of municipal bonds over the last 10 years.

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 56 offices in 25 countries and employs more than 20,000 people worldwide. In the United States, Goldman Sachs has 26 regional offices, including offices in San Francisco and Los Angeles.

UBS Financial Services, Inc. - is one of four business groups of UBS AG, the largest private bank in the world, with total client assets in excess of $1 trillion. UBS has one of the largest retail distribution networks on in the nation, consisting of 7,505 registered representatives in 392 offices, nationwide. UBS has 45 retail offices in California, with over 1,100 investment executives managing over 700,000 accounts valued at more than $85 billion. The bank's strong credit ratings and substantial capital base translate into enhanced

B. <u>Selection Background</u>

PFM conducted a competitive selection process to identify one or more senior or co-senior managing underwriters and a team of co-managing underwriters to sell and then remarket the auction rate securities and to sell the fixed rate bonds for the Series 2005 Full Funding Grant Agreement Bonds.

Selection of the co-senior managers and co-managers (other than minority co-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:

- Amount and quality of recent and direct experience and capability of the firm and relevant investment bankers with FFGA backed financings and other Federal grant backed financings, such as GARVEE bonds and Grant Anticipation Notes

- Ability of the firm to lead the effort in structuring this new credit
- Ability of the firm to successfully negotiate terms and covenants with the bond insurers and credit rating agencies

Other relevant experience considered included setting up and operating auction rate securities programs, structuring and selling fixed rate transportation bonds for similar California issuer bonds and demonstrated experience in providing the lowest interest rates for existing ARS clients in California. All services were evaluated in light of proposed fees.

Based on higher scores for experience with FFGA financings and perceived ability to effectively lead the financing effort, Citigroup and UBS are recommended to serve as the co-senior managing underwriters for the overall transaction, with Citigroup serving as the bookrunner for the fixed rate bonds. The co-managers may individually be assigned portions of the fixed-rate bonds. For the ARS, Citigroup and Goldman Sachs will serve as broker/dealer and remarketing agents. The recommended co-managers for the fixed rate bond sale are Goldman Sachs & Co., E. J. De La Rosa & Co., Inc., and Loop Capital Markets. The co-managers are recommended based upon a combination of their proposal responses, market segments served, geographic regions served and minority status.

C. <u>Evaluation of Proposals</u>

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

D. <u>Cost/Price Analysis Explanation</u>

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