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FINANCE AND BUDGET COMMITTEE
AUGUST 19, 2004

SUBJECT: GENERAL REVENUE REFUNDING BONDS

ACTION: ADOPT RESOLUTION AUTHORIZING ISSUANCE OF AUCTION RATE SECURITIES AND USE OF AN INTEREST RATE SWAP

RECOMMENDATION

Adopt a resolution (Attachment A) authorizing the Chief Executive Officer to price and deliver up to $210 million of auction rate securities as the General Revenue, Series 2004 refunding bonds, in one or more series of auction rate securities to be issued to refund portions of the General Revenue 1996 refunding bonds, and to enter into one or more related interest rate swaps, and to approve documents on file with the Board Secretary for a negotiated bond sale and competitive swap provider selection.
(Requires separate, simple majority Board vote.)

RATIONALE

Current low interest rates are providing MTA the opportunity to refund up to $186 million of the General Revenue 1996 bonds to achieve debt service interest savings. Additionally, the final maturity of the bonds will be extended about 4 additional years to facilitate the restructuring of the debt service payments to significantly reduce the amount of annual increase. Currently, debt service is scheduled to increase annually and will have doubled by 2025. This debt service structure in not in compliance with the current level debt service requirement of the Debt Policy. The extension of the final maturity for the refunding bonds is necessary in order to make the new annual debt service requirements more level. In June 2004, the Board approved the appointment of Goldman Sachs and Morgan Stanley as underwriters and remarketing agents for the auction rate securities.

Staff is recommending use of a London Interbank Offering Rate (LIBOR) indexed interest rate swap strategy, which is projected to generate savings of as much as $20 million. The swap strategy is being recommended over a traditional fixed rate bond sale because it will generate significantly greater savings. Because this refunding is being undertaken to restructure debt service as well as lower the interest cost, the call-option pricing model and refunding criteria guidelines will only be used for reference. However, the savings from this transaction are anticipated to exceed the 3% of par criteria, but will fall short of the 80% of call-option value criteria.

The bonds will be issued and the interest rate swap(s) entered into in accordance with the Adopted Debt Policy and Interest Rate Swap Policy, adopted by the Board in October and June 2003.

FINANCIAL IMPACT

The costs of issuance for this refunding were not budgeted for FY05 because the refunding was not anticipated at the time of the budget's development. However, the refunding will generate a favorable variance in debt service interest, project 610309, account 51121, in FY05 to offset the unfavorable variance to costs of issuance.

ALTERNATIVES CONSIDERED

Alternatives considered include:

Issuing fixed rate bonds to accomplish the refunding. This alternative is not recommended because in the current interest rate environment, issuance of a fixed rate bond will not lower the interest rate sufficiently to provide significant interest cost savings.

Deferring the refunding to a later date. This alternative is not recommended due to the risk that interest rates may continue to rise and potential savings will be lost.

Other financing techniques have also been considered, such as the use of a cost-of-funds swap or a BMA indexed swap. The BMA index is the Bond Market Association floating rate index, an index of municipal floating rate securities. They are not recommended because the recommended LIBOR financing provides a better overall financial benefit.

ATTACHMENTS

A. Authorizing Resolution
B. Transaction Explanation
C. Swap Presentation

Prepared by: Michael J. Smith, Assistant Treasurer

Terry Matsumoto
Executive Officer, Finance and Treasurer

Roger Snoble
Chief Executive Officer

ATTACHMENT A

RESOLUTION OF THE LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY AUTHORIZING THE ISSUANCE OF ITS GENERAL REVENUE REFUNDING BONDS (UNION STATION GATEWAY PROJECT), SERIES 2004 IN AN AGGREGATE PRINCIPAL AMOUNT NOT TO EXCEED $210,000,000, FOR THE PURPOSE OF REFUNDING ITS GENERAL REVENUE REFUNDING BONDS (UNION STATION GATEWAY PROJECT), SERIES 1996-A; PROVIDING FOR THE FORM OF SUCH BONDS AND OTHER TERMS WITH RESPECT TO SUCH BONDS; PROVIDING FOR THE EXECUTION AND DELIVERY OF DOCUMENTS RELATED THERETO; AND AUTHORIZING OFFICERS, AGENTS AND EMPLOYEES TO PERFORM DUTIES AND TAKE ACTIONS IN ACCORDANCE WITH THIS RESOLUTION

(AUCTION RATE BONDS)

WHEREAS, the Los Angeles County Metropolitan Transportation Authority (the "MTA") is a county transportation commission duly organized and existing pursuant to Section 130000 *et seq.* of the California Public Utilities Code and is authorized to issue bonds under Section 130500 *et seq.* of the California Public Utilities Code (the "Authorizing Act"); and

WHEREAS, the MTA has heretofore issued $185,735,000 in aggregate principal amount of its General Revenue Refunding Bonds (Union Station Gateway Project), Series 1996-A (the "Series 1996-A Bonds"); and

WHEREAS, the MTA desires to refund the Series 1996-A Bonds; and

WHEREAS, pursuant to the Authorizing Act, the MTA is authorized to issue refunding bonds in one or more series for the purpose of refunding any bonds then outstanding if the MTA makes a determination that it is in the public interest to issue refunding bonds pursuant to the terms or conditions of the refunding; and

WHEREAS, the MTA has determined that it is in the public interest of the MTA and the residents of Los Angeles County to issue bonds in one or more series entitled the Los Angeles County Metropolitan Transportation Authority General Revenue Refunding Bonds (Union Station Gateway Project), Series 2004 (the "Bonds"), in an aggregate principal amount not to exceed $210,000,000, for the purpose of refunding the Series 1996-A Bonds; and

WHEREAS, there has been presented to the MTA the form of a Fourth Supplemental Trust Agreement (the "Fourth Supplement Trust Agreement") between the MTA and BNY Western Trust Company, as successor trustee (the "Trustee"), which Fourth Supplemental Trust Agreement authorizes the issuance of the Bonds and amends certain provisions of the Trust Agreement, dated as of January 1, 1995 (the "Trust Agreement"), by and between the MTA and the Harris Trust and Savings Bank, as predecessor trustee; and

WHEREAS, the Fourth Supplemental Trust Agreement provides for the Bonds to bear interest at a variable rate determined by periodic auctions; and

WHEREAS, there has been presented to the MTA the form of a Broker-Dealer Agreement (the "Goldman Broker-Dealer Agreement") among ____________________________, as auction agent (the

"Auction Agent"), Goldman, Sachs & Co., as broker-dealer (the "Goldman Broker-Dealer") and the MTA, providing for certain broker-dealer services in connection with the auction rate provisions of the Bonds; and

WHEREAS, there has been presented to the MTA the form of a Broker-Dealer Agreement (the "Morgan Stanley Broker-Dealer Agreement" and together with the Goldman Broker-Dealer Agreement, the "Broker-Dealer Agreements") among the Auction Agent, Morgan Stanley & Co. Incorporated, as broker-dealer (the "Morgan Stanley Broker-Dealer" and together with the Goldman Broker-Dealer, the "Broker-Dealers") and the MTA, providing for certain broker-dealer services in connection with the auction rate provisions of the Bonds; and

WHEREAS, there has been presented to the MTA the form of an Auction Agreement (the "Auction Agreement") between the Auction Agent and the Trustee, providing for certain auction agent services in connection with the auction rate provisions of the Bonds; and

WHEREAS, the MTA intends to integrate the Bonds with a qualified hedge for tax purposes, thereby producing a fixed yield on the Bonds; and

WHEREAS, such qualified hedge shall be in the form of an interest rate swap agreement for which the MTA intends to receive competitive bids, with the assistance of the MTA's financial advisor, Public Financial Management, Inc., as bidding agent; and

WHEREAS, there has been presented to the MTA the forms of an ISDA Master Agreement and the related Schedule, Credit Support Annex and Confirmation (collectively, the "Swap Agreement") providing a hedge against the MTA's exposure to the variable interest cost of the Bonds; and

WHEREAS, there has been presented to the MTA the form of Request for Interest Rate Swap (the "Request for Interest Rate Swap") prepared by the MTA's financial advisor, Public Financial Management, Inc. (the "Financial Advisor"), in connection with the competitive bid of the Swap Agreement; and

WHEREAS, there has been presented to the MTA a form of a Continuing Disclosure Certificate (the "Continuing Disclosure Certificate") to be executed by the MTA as required by Securities and Exchange Commission Rule 15c2-12, as amended; and

WHEREAS, there has been presented to the MTA the form of an Escrow Agreement (the "Escrow Agreement") between the MTA and BNY Western Trust Company, as escrow agent, providing for the refunding of the Series 1996-A Bonds; and

WHEREAS, there has been presented to the MTA the form of a Preliminary Official Statement to be used in connection with the sale of the Bonds (the "Preliminary Official Statement") which describes the Bonds, the MTA and the MTA's operations and finances; and

WHEREAS, the MTA has been advised by its bond counsel, Fulbright & Jaworski L.L.P. ("Bond Counsel"), that the foregoing documents are in appropriate form, and the MTA hereby acknowledges that said documents will be modified and amended to reflect the various final terms of the Bonds and said documents are subject to completion to reflect the results of the sale of the Bonds; and

WHEREAS, the MTA has determined that it is in its best interest to provide for the private, negotiated sale of the Bonds to Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated (collectively, the "Underwriters"); and

WHEREAS, there has been presented to the MTA the form of a Purchase Contract (the "Purchase Contract"), by and between the MTA and the Underwriters for the initial purchase and sale of the Bonds;

NOW, THEREFORE, BE IT RESOLVED BY THE LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY AS FOLLOWS:

Findings. Each of the above recitals is true and correct and the MTA so finds and determines. The issuance of the Bonds is in the public interest of the MTA and the residents of Los Angeles County. Further, the MTA hereby finds and determines that the Swap Agreement is designed to reduce the amount and duration of rate, spread or similar risk when used in combination with the issuance of the Bonds, pursuant to California Government Code Section 5922.

Issuance of Bonds; Term of Bonds. For the purpose of refunding the Series 1996-A Bonds, the MTA hereby authorizes the issuance of its General Revenue Refunding Bonds (Union Station Gateway Project), Series 2004 in one or more series. The MTA hereby specifies that the aggregate principal amount of the Bonds shall be an amount sufficient to refund $185,735,000 in aggregate principal amount of the Series 1996-A Bonds and to provide for the Underwriters' discount and payment of costs of issuance. The total aggregate principal amount of Bonds in any event shall not exceed $210,000,000. The Bonds shall mature not later than July 1, 2035, shall bear interest at the rates per annum, be subject to redemption, if any, and have such other terms, all as set forth in the Fourth Supplemental Trust Agreement. The Bonds shall be in substantially the form set forth in the Fourth Supplemental Trust Agreement with necessary or appropriate variations, omissions and insertions as permitted or required by the Fourth Supplemental Trust Agreement or as appropriate to adequately reflect the terms of the Bonds and the obligations represented thereby. No Bonds shall bear interest at a rate in excess of 15% per annum. Each of the Chief Executive Officer of the MTA, the Chief Financial Officer of the MTA and the Executive Officer, Finance and Treasurer of the MTA, or any other Designated Officer (as defined below), acting in accordance with this Section 2, is hereby authorized to determine the actual aggregate principal amount of Bonds to be issued and to direct the execution and authentication of said Bonds in such amounts. Such direction shall be conclusive as to the principal amounts hereby authorized.

Designated Officers. The MTA hereby appoints the Chief Executive Officer, the Chief Financial Officer, the Executive Officer, Finance and Treasurer and such other persons as the Chief Executive Officer may designate under the terms of this Resolution and the Fourth Supplemental Trust Agreement as designated officers (each, a "Designated Officer"). The Designated Officers are, and each of them is, hereby authorized and directed to perform those duties set forth in the Documents (as defined below). The Designated Officers are, and each of them is, also authorized to make representations, certificates and warranties concerning the Bonds and to take such other actions and execute such other documents as are necessary to issue the Bonds and to purchase bond insurance, if available, for some or all of the Bonds and to defease the Series 1996-A Bonds.

Special Obligations. The Bonds shall be special obligations of the MTA secured by and payable from Pledged Revenues and Remaining Sales Tax (as such terms are defined in the Trust Agreement) and other amounts pledged therefor.

Execution of Bonds. Each of the Bonds shall be executed on behalf of the MTA by a Designated Officer or any one or more thereof and any such execution may be by manual or facsimile signature, and each Bond shall be authenticated by the endorsement of the Trustee. Any facsimile signature of a Designated Officer or any one or more thereof shall have the same force and effect as if such officer had manually signed each of said Bonds.

Sale of the Bonds. The MTA hereby authorizes the sale of the Bonds through a private, negotiated sale to the Underwriters pursuant to the Purchase Contract. The Bonds, if sold to the

Underwriters, shall be sold subject to an underwriters' discount (excluding original issue discount) not to exceed 0.35% of the aggregate principal amount of the Bonds, subject to the terms and conditions set forth in the Purchase Contract.

Approval of Documents. The forms, terms and provisions of the Fourth Supplemental Trust Agreement, the Broker-Dealer Agreements, the Swap Agreement, the Continuing Disclosure Certificate, the Escrow Agreement and the Purchase Contract (collectively, the "Documents") are in all respects approved, and the Designated Officers are, and each of them is, hereby authorized and directed to execute, acknowledge and deliver each of the Documents including counterparts thereof, in the name and on behalf of the MTA and the MTA's corporate seal is hereby authorized (but not required) to be affixed or imprinted on each of the Documents. The form, terms and provisions of the Auction Agreement are also approved. The Documents, as executed and delivered, shall be in substantially the forms on file with the Board Secretary and hereby approved, with such changes therein as shall be approved by the Designated Officer or Officers executing the same, which execution shall constitute conclusive evidence of the MTA's approval of any and all changes or revisions therein from the forms of the Documents now before this meeting; and from and after the execution and delivery of the Documents the officers, agents and employees of the MTA are, and each of them is, hereby authorized and directed to take all such actions and to execute all such documents as may be necessary to carry out and comply with the provisions of the Documents.

Bid of Swap Agreement. The Designated Officers are each hereby authorized to arrange for the competitive bid of the Swap Agreement among counterparties (or the guarantors thereof) whose long-term, unsecured and unsubordinated obligations are rated AA- or better by Standard & Poor's Rating Services or Fitch, Inc. or Aa3 or better by Moody's Investors Service Inc., on such terms as described in the Request for Interest Rate Swap, with such changes thereto as may be determined by any Designated Officer, upon consultation with the Financial Advisor and Bond Counsel.

Preliminary Official Statement. The distribution of the Preliminary Official Statement in connection with the offering and sale of the Bonds in substantially the form of the draft thereof presented at this meeting, with such changes therein as shall be approved by the Designated Officers, individually or collectively, is hereby authorized and approved. The Preliminary Official Statement shall be circulated for use in selling the Bonds at such time as a Designated Officer (after consultation with the Financial Advisor and Bond Counsel and such other advisors as the Designated Officer believes to be useful) shall deem the Preliminary Official Statement to be final within the meaning of Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended, said determination to be conclusively evidenced by a certificate signed by the Designated Officer to such effect. Each Designated Officer is hereby authorized to make such determination.

Official Statement. Prior to the delivery of the Bonds, the MTA shall provide for the preparation, execution, delivery, publication and distribution of a final Official Statement relating to the Bonds in substantially the form of the draft Preliminary Official Statement on file with the Board Secretary. The Designated Officers are, and each of them is, hereby authorized and directed to execute and deliver the final Official Statement in the name and on behalf of the MTA. The execution thereof shall constitute conclusive evidence of the MTA's approval of any and all changes or revisions therein from the form of the Preliminary Official Statement now before this meeting.

Credit Enhancement; Surety. Each of the Designated Officers is hereby authorized to obtain municipal bond insurance or any other guarantee of payment of the principal of and interest on the Bonds as well as the MTA's payment obligations under the Swap Agreement and to obtain a surety bond or other credit facility covering all or a portion of the reserve fund for the Bonds, and to execute and deliver any financial guaranty or reimbursement agreement with the providers thereof, all upon such terms as shall be satisfactory to such Designated Officer.

Additional Authorization. The Designated Officers and all officers, agents and employees of the MTA, for and on behalf of the MTA, are hereby authorized and directed to take any and all actions necessary or desirable to effect the execution and delivery of the Bonds, the Fourth Supplemental Trust Agreement, the Broker-Dealer Agreements, the Auction Agreement, the Swap Agreement, the Continuing Disclosure Certificate, the Escrow Agreement, the Purchase Contract and the final Official Statement and to carry out the transactions contemplated therein. The Designated Officers and all other officers, agents and employees of the MTA are further authorized and directed, for and on behalf of the MTA, to execute all papers, documents, certificates and other instruments that may be necessary or desirable in order to carry out the authority conferred by this Resolution or the provisions of the Documents. All actions heretofore taken by the officers, agents and employees of the MTA in furtherance of the purposes of this Resolution are hereby confirmed, ratified and approved.

Bond Counsel and Disclosure Counsel. The MTA hereby confirms, ratifies and approves the appointment of Fulbright & Jaworski L.L.P. as bond counsel and disclosure counsel to the MTA in connection with the issuance and sale of the Bonds.

Severability. The provisions of this Resolution are hereby declared to be severable and if any section, phrase or provision shall for any reason be declared to be invalid, such sections, phrases and provisions shall not affect any other provision of this Resolution.

Effective Date. **The effective date of this Resolution shall be the date of its adoption.**

ATTACHMENT B

Explanation of Strategy to Refund General Revenue 1996-A Bonds

MTA has an opportunity to refund the General Revenue 1996-A bonds to achieve a lower interest rate and to restructure debt service to reduce the amount of increase in the annual payment through 2025, and to defer some principal to accelerate a portion of the savings into the early years of the financing. The final maturity of the bonds will be extended about 4 to 6 years to facilitate a restructuring of the principal repayment to result in lower debt service payments in each subsequent year through about 2031. Currently, debt service payments escalate from $10.7 million in FY05 to $23.5 million in 2025. The restructuring is anticipated to significantly reduce the debt service payments in the outer years.

Use of a swap based strategy is being recommended, as that strategy will generate significantly greater financial savings compared to use of a strategy of issuing traditional fixed rate bonds. Under the preferred strategy, MTA will issue auction rate securities (variable rate long-term bonds) and enter into a LIBOR indexed interest rate swap. This synthetic fixed rate strategy will produce an interest rate lower than that currently available using a traditional fixed rate bond, by employing a financing structure where variable rate bonds are issued and simultaneously hedged using an interest rate swap to achieve a synthetic fixed rate.

For tax-exempt issuers such as MTA, interest rate swaps are typically able to provide a lower interest rate than tax-exempt fixed rate bonds for terms (maturities) longer than about 12 years. The interest rate advantage increases as the term lengthens. Issuance of the variable rate bonds will provide the funds to retire the prior bonds and generate a variable rate payment obligation. MTA may then enter into a "fixed payer" interest rate swap to lock in a fixed rate payment.

Under the swap contract, MTA will agree to pay a fixed rate payment to the swap provider and the swap provider will pay a variable rate payment to MTA. It is anticipated that the variable rate payments received by MTA from the swap provider will, over the long run, closely approximate, and thus offset, the payments MTA will pay out to the bondholders on the variable rate bonds. The end result is that the net payment for MTA will be the synthetic fixed rate of the interest rate swap.

The interest rate for the variable rate payment is set each payment period by referencing an index, in this instance either a 1-month or 3-month LIBOR rate will be used. The actual dollar amount of the payments is calculated by multiplying each rate by the "notional" amount of the swap. The notional amount will be equivalent numerically to the par amount of the underlying bond issue and is used to calculate the payments to be exchanged. There is no exchange of principal amounts when transacting a swap.

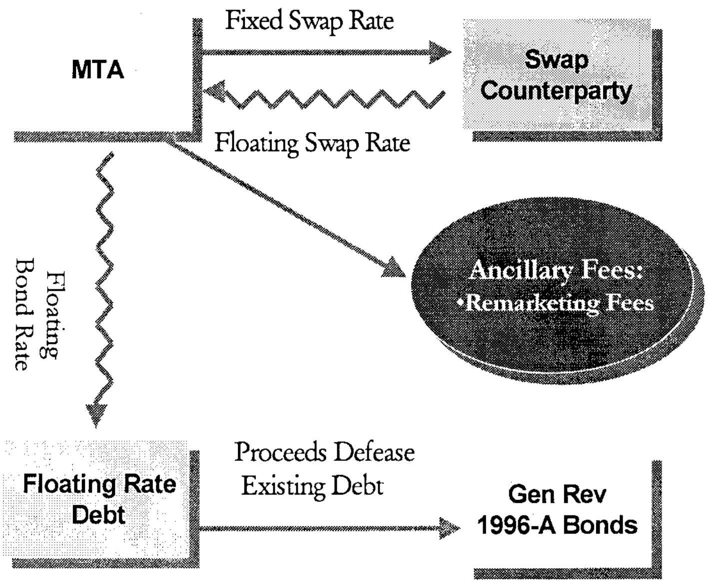
When entering into a LIBOR based swap there is an assumption that MTA's variable rate bond payments will, over time, maintain their historic proportional price relationship of about 62% of the LIBOR index. The index will be used to calculate the variable rate amounts that MTA will receive under the swap. If that historic relationship changes, MTA's variable rate payments won't match and won't offset each other as well, possibly resulting in an increased cost to MTA that would reduce the amount of the savings. If this change in relationship was significant and adverse, and the change occurred early in the life of the transaction it is possible that all savings could be negated, and it is possible that a moderate loss could occur. The greatest threat of a large change in the relationship is that there would be tax reform that would eliminate the tax-exemption for interest on municipal bonds. The likelihood of a significant change early in the transaction is assessed as being remote. This shift in the relationship is know as Basis Risk, and in this example is the result of Tax Risk. It should be pointed out that in the current low interest rate environment MTA expects that the payments received from the swap provider may not be sufficient to offset the actual variable rate payments of MTA's bonds. This is believed to be a temporary situation that will correct as rates return to historically more typical higher levels over the next several years. Finally, various risks need to be considered when entering into an interest rate swap, some of the key risks are listed in Attachment C.

ATTACHMENT C

General Revenue 2004 Bonds
Refunding & Interest Rate Swap Strategy

August 19, 2004

MTA Will Issue Floating Rate Debt to Defease Existing Fixed Rate Debt and Enter Into Floating-To-Fixed Rate Swap



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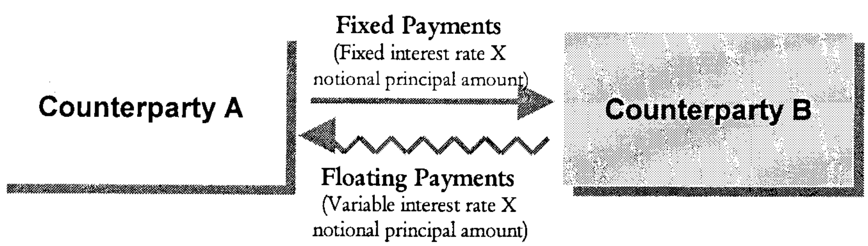
Interest Rate Swaps in General

- An interest rate swap is a contract between two parties (referred to as "counterparties") to exchange interest rate payments at specified dates in the future.
- The interest rate payments for a given counterparty equal the product of an swap rate and a notional principal amount.
- The swap rate for one counterparty is a fixed rate, while the swap rate for the other counterparty is a variable rate.
- The principal amount by which the swap rates are multiplied is notional because principal payments are not swapped, paid or exchanged; the notional principal amount is only a "placeholder" used for calculating swap payments.



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Credit agency opinions

	MOODY'S	S&P	FITCH
Swap Policy	• Foundation of review; articulates management's philosophy regarding risk management and use of derivatives, including exit strategy	• Part of debt management plan outlining risk and reward of swap, risk mitigation or funding strategy, monitoring, quantitative assessment of risk	• Important in evaluating overall credit • Strong policy may mitigate other risks • Professionals associated with Issuer may also mitigate risk
Termination Risk (Risk that a swap will be terminated by a counterparty before maturity)	• Assumes Issuer will not terminate unless economic • Reviews terms governing termination by counterparty and potential cost to Issuer • Counterparty credit is evaluated	• Analyze swap contract legal provisions to insure remoteness of termination triggers (ideally, failure to pay, bankruptcy, merger w/o assumption, illegality). Termination lien is also important • Other termination criteria (i.e. downgrade) must be established as remote or stress test must be run • Means to reduce termination risk are also considered (i.e. term, contingency plan) • Remedies should not infringe upon bondholders' rights	• Conducts analysis of termination costs under various interest rate scenarios • Prefers termination events limited to circumstances considered in ratings (i.e. downgrade, bankruptcy, default) • Non-credit termination events may cause disregard for the swap

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Credit agency opinions

	MOODY'S	S&P	FITCH
Counterparty Risk (risk that the counterparty may be unable to meet its payment obligations)	• Looks to internal rating of counterparty • Accepts posting of collateral to limit counterparty risk • Evaluates Credit Support Annex	• Counterparty rating of at least A/A-1 • No credit given to swap is "terminating" counterparty	• Expects counterparty to be rated at least as highly as Issuer • Prefer provisions providing for collateral in event of downgrade • Prefer termination provisions to relate to counterparty credit
Rollover Risk (swap maturity does not match maturity of hedged debt or asset)	• Timing and impact of rollover is evaluated	• Concrete rollover strategy or bonds presumed unhedged at swap maturity	
Basis Risk (potential mismatch between interest cost of underlying variable rate bonds and variable rate payment received)	• Analysis of possible interest rate scenarios	• Risk tested by BMA/LIBOR scenarios incorporated in tax event risk analysis	• Issuer must demonstrate that they have planned for the possibility of adverse basis movement (i.e. through reserves or budgeting)
Tax Risk (risk of a change in tax law creating basis risk)	• Stress scenario at 25% marginal tax rate in 5 years (BMA = 75% of LIBOR)	• Stress scenario BMA/LIBOR ratio of 69% for first 5 years, 72% for next 5 years and 75.5% thereafter	

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Next Steps

- At the August Board meeting:
  - The Board will be asked to consider adopting a resolution authorizing MTA to issue floating rate debt and enter into an interest rate swap.
  - The Board will also be asked to approve relevant floating rate debt and interest rate swap documents.
- Upon approval of the resolution by the Board, MTA will direct the underwriters to issue floating rate debt (auction rate securities), and a will seek competitive interest rate swap bids from counterparties in September 2004.

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