WESTMINSTER

Staff Report

REVISED 11/14/2008
4:27:08 PM

TO:	The Mayor and Members of the City Council
DATE:	November 13, 2008
SUBJECT:	Briefing and Post-City Council Briefing Agenda for November 17, 2008
PREPARED BY:	Stephen P. Smithers, Acting City Manager

Please Note: Study Sessions and Post City Council briefings are open to the public, and individuals are welcome to attend and observe. However, these briefings are not intended to be interactive with the audience, as this time is set aside for City Council to receive information, make inquiries, and provide Staff with policy direction.

Looking ahead to Monday night's Briefing and Post-City Council meeting briefing, the following schedule has been prepared:

Dinner ***(<u>Note earlier time</u>)***	**5:30 P.M.**
Council Briefing *(The public is welcome to attend.)*	6:00 P.M.
Charter 50th Anniversary Reception *(Upper Level Atrium)*	6:30 P.M.
CITY COUNCIL MEETING	7:00 P.M.

POST BRIEFING (*The public is welcome to attend.*)

<u>PRESENTATIONS</u>
1. Redemption of 2002 Utility Bonds
2. Discuss RTD's Cost Per Rider Analysis ***(Verbal)***

<u>CITY COUNCIL REPORTS</u>
1. Report from Mayor (5 minutes)
2. Reports from City Councillors (10 minutes)

<u>EXECUTIVE SESSION</u>
None at this time.

<u>INFORMATION ONLY STAFF REPORTS</u> – do not require City Council action
None at this time

Items may come up between now and Monday night. City Council will be apprised of any changes to the post-briefing schedule.

Respectfully submitted,

Stephen P. Smithers
Acting City Manager

WESTMINSTER

Staff Report

City Council Study Session Meeting

November 17, 2008

SUBJECT: Redeem the 2002 Water Wastewater Variable Rate Revenue Bonds

PREPARED BY: Tammy Hitchens, Finance Director
Robert Smith, Treasury Manager
Bob Byerhof, Senior Financial Analyst

Recommended City Council Action:

Direct Staff to prepare an ordinance for Council authorizing the purchase of the outstanding 2002 Water Wastewater Variable Rate Revenue Bonds.

Summary Statement:

- The current world-wide financial crisis has led to significant uncertainty in the financial markets. This uncertainty felt by lenders and investors alike has resulted in significant increases in short-term interest rates paid by borrowers. Since the 2002 Water Wastewater variable rate revenue bonds are considered a short-term debt instrument with interest rates that reset weekly, the cost of borrowing has increased significantly since early September from a rate of 2.15% to a high of 9.50% before decreasing to 6.5% as of November 5th.
- In addition to the overall market uncertainty, rating agencies have either downgraded or put on "credit watch" the letter of credit bank provider, Dexia Credit Local (Dexia). This has led some investors of the Water Wastewater variable rate bonds to "put" or tender back their investment. This action converts the bonds to "Bank Bonds," which means that the bank owns the bonds.
- Given the potential for continued, as well as higher interest rate levels, Staff recommends that the Utility purchase and redeem the outstanding principal balance on the 2002 Water Wastewater variable rate revenue bonds rather than risk the uncertainty of significant interest rate costs, which could escalate to a maximum rate of 15%.
- The Water Wastewater fund has cash available to call the bonds and extinguish the debt.
- The City uses both pay-as-you-go money (cash on hand) and debt proceeds to fund capital projects. The action recommended in this memo would most likely increase the amount recommended to be borrowed in 2010 to fund capital projects approved in the 2010 budget.

Expenditure Required: $5,825,000

Source of Funds: Water Capital Project Reserve

Policy Issue:

Should the City's Utility Enterprise redeem the outstanding principal balance of the 2002 Water Wastewater Variable Rate Revenue Bonds?

Alternative:

Do not direct Staff to prepare an ordinance for Council approval concerning the purchase of the 2002 Water Wastewater Variable Rate Revenue Bonds. This is not recommended given the financial market uncertainty that has led to higher than anticipated interest rate costs for these bonds over the past month and may result in interest costs that exceed budget going into 2009. By redeeming the bonds, the City pursues Council's strategic goal to be a Financially Sustainable City Providing Exceptional Service.

Background Information:

The City's Water and Wastewater Utility Enterprise issued $7,490,000 in variable rate revenue bonds in September 2002 to pay for a portion of the total cost of the Northwest Water Treatment Plant. As of November 1, 2008, principal payments made through 2007 have decreased the amount of bonds outstanding to $6,130,000, of which a $305,000 principal payment is budgeted and scheduled for payment on December 1, 2008. Total debt service budgeted on all variable rate debt includes interest estimated at 4%, principal due and the fees for the liquidity service provider and remarketing agent to service variable rate bonds.

Variable rate bonds historically have been a financially prudent means to finance capital projects and over the course of a typical bond term (20-25 years). Since they were issued, the Series 2002 variable rate bonds had saved the Utility Fund approximately $686,000 in interest rate costs through October 31, 2008 (inclusive of additional variable rate fees) in comparison to a 20-year fixed rate cost that the Utility Enterprise would have had paid at the time of issuance.

The current state in the financial markets has resulted in significant uncertainty. This is particularly true within the short-term credit market as banks and investors attempt to assess the magnitude of the credit meltdown impacting the risks and costs of lending and investing. Directly impacting the Utility Fund's variable interest rate is the fact that the Utility's variable rate revenue bond letter of credit bank provider, Dexia Credit Local, has been placed on "negative watch" by Standard and Poor's and downgraded by Moody's from Aa1 to Aa3 and by Fitch from AA to AA-.

Since investors look to the credit worthiness of the letter of credit bank to evaluate the risk of the bonds and not the riskiness of the underlying revenues to pay interest, the interest rate costs have shot upward and some investors have gotten so concerned about Dexia's financial strength that they no longer want to hold the bonds no matter what interest rate is offered. Given the global uncertainty in the credit markets and specifically the credit outlook of Dexia, Staff does not foresee any immediate resolution that would result in the rating agencies placing Dexia's ratings back to level that may lead to lower interest costs for the Utility's variable rate revenue bonds or give confidence back to investors to repurchase them from the bank. In fact, it is more likely that investors in the Utility variable rate bonds may tender more bonds to the bank, thus, increasing the number of bank bonds.

Since the interest rate changes weekly on the Utility's variable rate bonds, the market uncertainty and credit risk associated with the bank has caused short-term rates to increase to historic levels and reached an all time high of 9.5% the week of September 25th. Interest rates have lowered recently to 6.5% as of the reset week of November 5, 2008.

The growing uncertainty in the short-term credit market and credit risk of the bank has not only resulted in short-term interest rates increasing to historic levels, but has led to a deeper issue, which has the buyers of these short-term investments "putting" or tendering back the bonds to the bank holding the letter of credit agreement. In each variable rate issue, the issuer, in this case the Utility, purchases a letter of credit (LOC) agreement, which provides assurance to investors that the provider of the LOC will purchase any bonds that cannot be remarketed to another investor. As of November 3rd, $2,685,000 of the total $6,130,000 outstanding has been tendered back to the LOC bank, Dexia.

All bonds tendered back to the bank are deemed "Bank Bonds" and incur the same interest rate cost as the bonds not redeemed, most currently at a 6.5% rate and could rise to a maximum rate of 15%. Thus, the City is paying Dexia for credit issues it brought upon itself while the Utility's credit remains very good. In addition to paying an adverse interest rate, all bank bonds convert to term bonds after six months if they are not purchased in the open market. The implication of the term bond conversion is that the Utility would need to pay semi-annual principal payments for seven years in addition to interest payments.

The unfortunate reality is that despite solid underlying fundamentals of the Utility's ability to pay its debt obligations, interest rates are being driven up due to concerns specific to Dexia as well as the world-wide financial crisis. <u>The Utility is extremely sound with a debt coverage ratio at the end of 2007 of 2.87 times the maximum annual debt service between now and 2025 when all current outstanding debt is retired</u>. Due to the Utility's sound financial history and fundamentals, rating agencies have assigned very positive ratings on debt offerings: Fitch's rating is AA+, Standard and Poor's rating is AA-, and Moody's rating is A1.

As of October 31, 2008, $27,727,290 of unrestricted cash was available in the Water Fund's Capital Project Reserve. The City has earned an annualized 4.47% year-to-date through October. Staff believes that it is in the best interest to redeem all of the bonds outstanding due to aforementioned risks, predominately centered on the risk of paying an adverse rate above the amount budgeted and potentially well above a reasonable amount up to a maximum of 15%. Assuming the bonds are called by December 1, 2008 and a 4% interest rate, the Utility would save interest and associated variable rate agent fees estimated over the remainder of 2008 and through 2010 as follows:

Year	Interest Costs	Variable Rate Fees	Total
2008	$ 19,789	$ 5,470	$ 25,259
2009	$233,000	$20,308	$253,308
2010	$220,200	$19,185	$239,385
Totals	$472,989	$44,963	$517,952

The savings will be partially offset by the loss of projected income on the cash used to buy the bonds, which is estimated to be $365,000 over the next two years for an estimated net savings of $151,952. As stated earlier in this Staff Report, use of these reserve funds will most likely lend to a recommendation by Staff to increase the size of the 2010 bond issue that was included in the 2009/2010 budget.

Staff and the City's bond underwriter will be on hand at the Post Meeting to address any concerns the Council may have regarding the recommended action to call the 2002 Water Wastewater Variable Rate Revenue Bonds. Since time is of the essence, it is the intent of Staff to bring this item to Council for formal approval on November 24, 2008 as an emergency ordinance.

Respectfully submitted,

Stephen P. Smithers
Acting City Manager