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FINANCE AND BUDGET COMMITTEE
OCTOBER 17, 2002
Revised

METRO

Metropolitan
Transportation
Authority

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SUBJECT: BOND REFUNDING

ACTION: APPROVE STRATEGIES FOR LOCKING-IN REFUNDING SAVINGS

RECOMMENDATION

Approve strategies for locking in the potential savings from refunding up to $537 million of outstanding Prop A 1993-A bonds by authorizing the Chief Executive Officer to:

A. Appoint UBS PaineWebber ~~to serve as senior~~as the book-running co-senior managing underwriter and Salomon Smith Barney as co-senior managing underwriter, along with underwriting syndicate member firms, to price and deliver the ~~Prop A~~Prop A 2003-A refunding bonds using a forward delivery agreement in a negotiated bond sale and establish a minority participation goal of 20%~~.~~

B. Direct the MTA's financial advisor to prepare bid specifications and documentation, and competitively select a firm to provide a hedge against changes in interest rates.

Approval of these recommendations does not commit the MTA to executing either of the transactions.

RATIONALE

As a result of currently low interest rates, MTA has an opportunity to refund up to $537 million of the outstanding Prop A 1993-A series bonds to achieve debt service interest savings. If current interest rates continue to the time that refunding bonds can be sold, the MTA would realize net present value savings in excess of $50 million. Savings from the refunding exceed 80% of the bonds' call option value of bond maturities though 2018 as required by the MTA's debt policy. The maturities for 2018 through 2021, approximately $258 million, are currently between 70% and 80% of the call option value and may be included at the discretion of the Treasurer.

Under U.S. Treasury regulations, bonds to refund the Prop A 1993-A bonds cannot be issued until April 2003. Therefore, there is a risk that interest rates may rise during the intervening months. Under a forward delivery agreement the presumably closer to current rates, while the bonds will not actually be issued and delivered until April 2003. An interest rate hedge also seeks to mitigate the interest rate risk until the refunding bonds can be issued and delivered.

The recommended strategies will permit the MTA to be in a position to lock-in interest rates, i.e., the savings, for the refunding bonds by using a forward delivery agreement or entering into a hedge agreement in mid-December 2002, thereby eliminating or minimizing interest rate exposure until the bonds can be delivered in April 2003.

PaineWebber has kept MTA aware of the forward strategy by submitting unsolicited proposals over the past several months. PaineWebber is being recommended to serve as the book-running co-senior managing underwriter because of their preparedness, prior experience in providing a forward delivery bond for MTA in 1999 and willingness to use the existing documentation from that prior transaction. Following an appointment at the October 2002 meeting, the underwriter, MTA and bond counsel will develop an authorizing resolution and other documentation for the bond sale and submit it for adoption in the November 2002 Board cycle. Depending on the ultimate size of the refunding, the MTA may require that it be syndicated. PaineWebber has also indicated that there will be no cost to the MTA should MTA elect not to proceed with this strategy.

Criteria

The primary factor to be considered in determining whether or not to implement any "locking" strategy, essentially buying a form of insurance, is the MTA's interest rate risk assessment at the point of actually doing the transaction. Indicators to be considered include the pricing of interest rate futures contracts, comments by the Federal Reserve's Open Market Committee, and other expert sources. Some weight must also be given to the status of potentially significant world events and related impacts on worldwide economies and capital markets.

Cost effectiveness is the primary factor influencing the choice of strategy, either a forward bond sale or interest rate hedge. For the forward sale, costs include the forward premium, underwriting fees and expenses. These costs will be compared against the alternative costs and risks of using a hedge. The MTA and its financial advisor will evaluate these factors to determine the better strategy considering costs and amount of risk that is mitigated.

FINANCIAL IMPACT

The costs of issuance for this refunding were not budgeted for FY03 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 610310, account 51124, in FY03 to offset the unfavorable variance to costs of issuance.

ALTERNATIVES CONSIDERED

MTA could elect to not to employ either of these "insurance" strategies and wait to execute a traditional current refunding next Spring. However, some or all of the potential savings could be lost with unfavorable changes in interest rates. Implementation of one of these strategies can provide over 3 months of interest rate protection when executed in mid-December, the earliest possible time based on MTA approval processes.

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