Metropolitan
Transportation
Authority

One Gateway Plaza
Los Angeles, CA
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FINANCE AND BUDGET COMMITTEE
AUGUST 21, 2003

SUBJECT: REFUNDING OF PROP C BONDS

ACTION: APPOINT UNDERWRITERS AS REMARKETING AGENTS FOR AUCTION RATE SECURITIES

RECOMMENDATION

Authorize the Chief Executive Officer to appoint Bear Stearns & Co. and Lehman Brothers, Inc. as co-senior managing underwriters and remarketing agents for one or more series of auction rate securities to be issued to refund portions of the Prop C 1993-B and 1995-A bonds in a negotiated sale.

RATIONALE

Current low interest rates are providing MTA the opportunity to refund up to $335 million of bonds consisting of portions of the outstanding Prop C 1993-B series bonds and Prop C 1995-A series bonds to achieve debt service interest savings. In July 2003, the Board approved the sale of fixed rate refunding bonds via competitive sale. However, due to the recent rise in interest rates, this method is not expected to achieve the Debt Policy refunding minimums.

In this same higher interest rate environment, utilizing an interest rate swap strategy in accordance with the Interest Rate Swap Policy adopted by the Board in June 2003 could generate as much as $30 million in savings and achieve the Debt Policy refunding minimums.

When issuing variable rate debt, in this case auction rate securities, the remarketing function is more important than the initial underwriting since the securities mature and are re-sold every 7 to 35 days. Use of a competitive selection process allows the MTA to appoint the underwriter/remarketing agent team that provides the best value in terms of interest rates on the debt and more importantly, remarketing fees.

Interest rate swap strategies require the issuance of variable rate debt. Procedurally, the negotiated bond sale is the longer lead-time item so the appointment of the team is being recommended now. In subsequent meetings, the Board will be asked to consider approving the documents actually authorizing the bond sale and an interest rate swap provider. Members of the recommended underwriter/remarketing agent team may be considered when selecting the interest rate swap provider.

FINANCIAL IMPACT

The costs of issuance for this refunding were not budgeted for FY04 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 610311, account 51124, in FY04 to offset the 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.

ATTACHMENT

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

Prepared by: Michael J. Smith, Assistant Treasurer

for Terry Matsumoto
Executive Officer, Finance and Treasury

Roger Snoble
Chief Executive Officer

Attachment A

Summary of Underwriter Selection
Refunding of Certain Proposition C 1993-B and 1995-A Sales Tax Revenue Bonds

Recommended Firms:	Bear Stearns & Co. (Co-Senior Manager) Lehman Brothers, Inc. (Co-Senior Manager)
Proposed Price	
-Takedown:	\$2.50 / \$1,000 of bonds, plus expenses
-Annual Fee:	\$0.0025 of amount of bonds outstanding
RFP Issued:	June 30, 2003
RFPs Mailed:	20
Proposals Received:	9
Proposals Due:	July 11, 2003
Evaluation Method:	Best Value
Proposing Firms:	Bear Stearns & Co. Citigroup Global Markets E. J. De La Rosa & Co. Goldman Sachs & Co. Lehman Brothers, Inc. Merrill Lynch & Co. Morgan Stanley RBC Dain Rausher UBS PaineWebber

Attachment B

History of Underwriter Selection
Refunding of Certain Proposition C 1993-B and 1995-A Sales Tax Revenue Bonds

A. Background on Selected Firms

Bear Stearns & Co. Inc (Bear Stearns) is a wholly-owned subsidiary of The Bear Stearns Companies Inc., and is a publicly traded company on the New York Stock Exchange under the symbol "BSC." Active employees own approximately 44% of its stock. As a result, the capital structure of Bear Stearns combines the virtues of being a publicly traded enterprise with employee control over the Firm's future. Its investment banking businesses include underwriting, financing activities, private placements, merger and acquisitions, financial advisory services, real estate finance, securities research and asset management. It operates through five major business units: investment banking, fixed income, institutional equities, individual investor services, and corresponding clearing and custody. The Firm currently employs over 10,500 persons and is headquartered in New York, with 9 branch offices in the United States and an additional 11 international offices.

Lehman Brothers is a global investment bank with leadership positions in public finance, advisory services, securities sales and trading, research, and distribution to institutions and high-net-worth individuals. Lehman Brothers serves the financial needs of governmental, institutional, corporate and individual clients from its headquarters in New York and from 16 additional locations in the United States and 23 locations abroad. The firm is a market-maker in all major fixed income and equity products in both the domestic and foreign markets. Lehman Brothers is an independent, publicly owned corporation, with common stock trading on the New York Stock Exchange. The firm employs over 13,000 people worldwide who own 30% of the firm.

B. Selection Background

This was a negotiated selection process to identify two firms to perform as remarketing agents for the refunding of certain Proposition C 1993-B and 1995-A sales tax revenue 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, the relevant traders and sales force, and the relevant investment bankers in setting up and operating Auction Rate Securities programs. Experience with the programs of California issuers was given additional weight. As a result, due to the higher scores for experience, Bear Stearns & Co and Lehman Brothers, Inc. are recommended to serve as the co-senior managing underwriters and remarketing agents.

C. Evaluation of Proposals

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

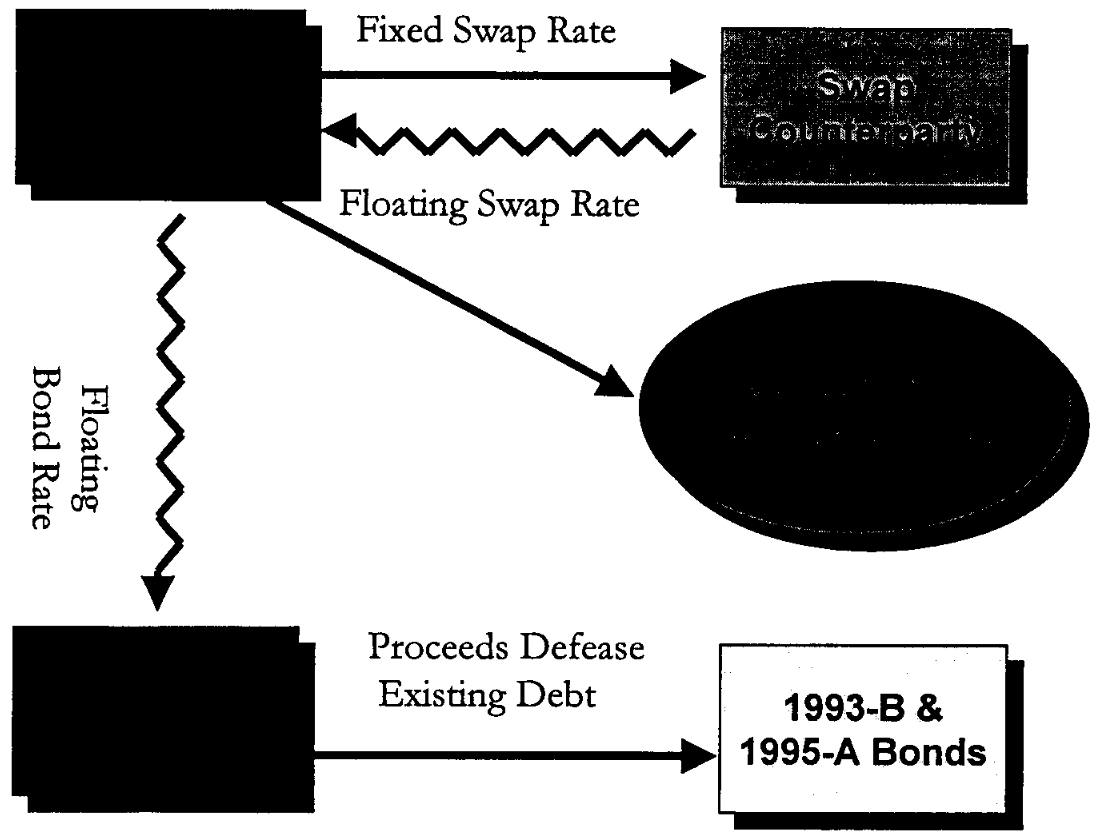
D. Cost/Price Analysis Explanation

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

Prop C 1993-B & 1995-A Bonds
Refunding & Interest Rate Swap Strategy

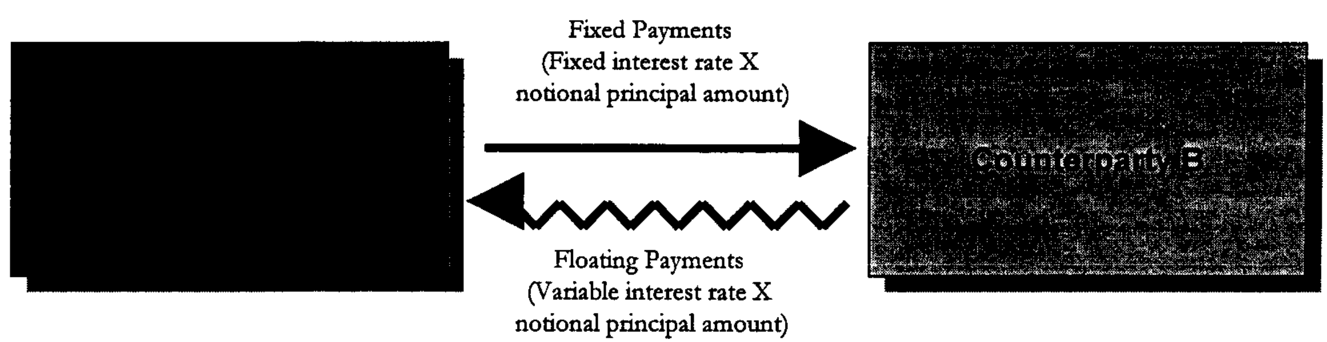
August 21, 2003

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



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.



Credit agency opinions

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

Credit agency opinions

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	

Next Steps

- This action will select the underwriters as remarketing agents to issue floating rate debt to defease existing fixed rate debt.
- If the Board approves of the underwriter selection:
  - The Board will be asked in the next month to consider a resolution 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, the MTA will direct the underwriters to issue floating rate debt, and a will seek competitive interest rate swap bids from counterparties in October 2003.