Legislation Details (With Text)

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Title: Financing Item Related to Future Debt Issuance (NB)

The Utility will need to issue debt in the future to finance a portion of the capital improvement program. Long-term interest rates are currently close to their historic lows. There is an opportunity to enter into an interest rate swap to hedge future bond rates. The Utility staff and our Financial Advisor recommend that any of the interest rate swap transactions be accomplished through a competitive selection process. Capturing the current favorable interest rate environment will allow the Utility to issue future new money debt at low rates, which will help hold down future debt service costs.

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Date	Ver.	Action By	Action	Result
10/9/2006	0	City Commission	Approved as Recommended	Pass

Financing Item Related to Future Debt Issuance (NB)

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To support the Utility's capital improvement program, the Utility will need to issue debt in the future to finance a portion of these planned expenditures. Although long-term interest rates are currently close to their historic lows, it is too far in advance for the Utility to sell bonds for these future capital needs. There are however, financing alternatives that enable the Utility to capture current market conditions for a financing that would not occur until one or two years in the future. With the assistance of PFM, we are monitoring various options to capture the benefit of this favorable interest rate environment, even though we do not need the construction funds at this time. These options will allow us to obtain a high degree of certainty for a portion of our future debt service costs, and potentially generate significant savings, by financing future bond needs at current market rates. The most efficient method of locking in the current market is to enter into an interest rate swap to hedge future bond rates. In most markets it can be quite costly to lock-in future rates. This cost comes in the form of a "forward premium". The forward premium is the difference between current market rates and the available rates for a future (or forward) financing that can be locked-in today. Currently, the forward premiums for interest rate swaps are as low as they have been for decades. The combination of (1) low actual rate levels and (2) the low additional forward premium to capture these rate levels for a future financing make this an opportune time to fix costs on a portion of our future capital needs. This will significantly reduce our exposure to potentially rising interest rates.

The Swap options that we are currently evaluating have the Utility paying a fixed swap rate and receiving either (1) the BMA Municipal Swap Index (a tax-exempt floating rate index); or (2) a percentage of LIBOR (a taxable floating rate).

If approved, the Swap will be structured in a way that will allow the Utility to terminate the Swap and issue fixed-rate bonds in the future. If interest rates increase by the future termination date, the Swap counterparty will owe the Utility a termination payment. The receipt of the termination payment will allow the Utility to reduce the size of its bond issue and still fund the anticipated capital expenditures. The lower amount of future bonds issued at the then higher rates will have debt service requirements approximately equal to the full amount of bonds sold at today's lower rates. The goal is to fix the Utility's future debt service payments regardless of interest rate changes. If interest rates decrease, the reverse of this mechanism will take place. The Utility will owe a termination payment to the Swap counterparty. The payment will be financed with a larger amount of future bonds that will be issued at lower rates. Again, debt service should remain approximately the same as a result. With either scenario, the net future borrowing cost will effectively be established when the Swap is entered into. The Swap could also be structured to remain in place on the forward start date, with the Utility issuing floating-rate bonds on that date.

In the case of each of the financing options described above, the optimal solution will depend on market conditions and debt structure existing both at the time of the execution of the Swap and at the time of the subsequent issuance of debt. Thus, since it can not currently be known which option will be better for us, we recommend that staff and our Financial Advisor continue to monitor the market to select the best alternative when entering into the Swap, and when issuing the debt related to the Swap.

This delegation authorizes the Interim General Manager or her designee: (i) to determine, among other things: (a) the notional amount of the Swap;
(b) the term of the Swap and the amortization schedule; c) the indices upon which both payments to and from GRU will be based; and d) the optimal process for selecting the Swap counterparty or counterparties; provided, however, that: (1) the maximum notional amount of the Swap shall not exceed $150 million; (2) the term of the Swap shall not be later than October 1, 2042 and the notional amount of the Swap shall amortize in such a manner as will result in the greatest amount of annual debt service on the associated bonds to be issued being not in excess of 150 percent of the smallest amount of annual debt service on such bonds, assuming that such bonds bear interest at the fixed rate payable by the Utility pursuant to the Swap; (3) the fixed rate payable by the Utility pursuant to the Swap shall not exceed 4.50% percent; and (4) the floating rate payable to the Utility pursuant to the Swap shall be either the BMA Municipal Swap Index or a percentage of LIBOR not less than 65 percent nor greater than 80 percent; and (ii) to enter into such documents evidencing the Swap (including, without limitation, a Confirmation under the ISDA Master Agreement currently in effect between the Utility and each selected Swap counterparty) as she determines are necessary or appropriate, subject to the approval of the Office of the City Attorney as to form and legality.

GRU staff and our Financial Advisor recommend that any of the interest rate swap transactions referred to above be accomplished through a competitive selection process with Goldman Sachs, Bear Stearns, and JP Morgan constituting the pool of potential counterparties. These three firms have brought significant value to the Utility in the form of solid recommendations for financing opportunities, familiarity with the Utilities Bond Resolution, and work concerning future debt issues. They have also been active participants in both competitively bid and negotiated swap transactions. Given the fact that all three firms have been consistent, strong performers on competitively bid swap transactions, the Utility and its Financial Advisor are confident that selecting from among these firms assures that the Utility will receive aggressive market rates for this transaction.

The Clerk of the Commission, the General Manager or other Authorized Officers of the City (as defined in the Utilities Bond Resolution) may be required to take certain other actions and hire certain other professionals to proceed with this transaction. Therefore, we recommend that these officials be authorized to take such other actions as may be necessary or desirable to proceed with the transaction in accordance with this City Commission authorization and delegation.
The City Commission: 1)Authorize the execution of one or more "floating-to-fixed" interest rate swap transactions, subject to the limitations set forth below (collectively, the "Swap"); 2) Authorize the Utility to work with its

Financial Advisor, Public Financial Management ("PFM"), to utilize a competitive process that will select one or more counterparties to provide the Swap from among a group to include Goldman Sachs, Bear Stearns, and JP Morgan; 3) Approve the designation of the Swap as a "Qualified Hedging Contract" within the meaning of the City's Amended and Restated Utilities System Revenue Bond Resolution ("Utilities Bond Resolution"), and authorize the securing of the Swap under the Utilities Bond Resolution; and 4) Authorize the Clerk of the Commission, the Interim General Manager and other Authorized Officers to enter into such documents evidencing the Swap (including, without limitation, a Confirmation under (and as defined in) the International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreement currently in effect between the Utility and each selected Swap counterparty) as they determine are necessary or appropriate, subject to approval of the Office of the City Attorney as to form and legality, and to take such other actions as may be necessary or advisable to proceed with this transaction in accordance with this City Commission authorization.

Capturing the current favorable interest rate environment will allow the Utility to issue future new money debt at low rates, which will help hold down future debt service costs. Current market rates are below those used by the Utility in developing its forward financial projections. Locking in these rates will enable the Utility to achieve debt service costs that allow it to improve upon expectations.

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Submitted by: Karen Johnson, Interim General Manager