
Association of California Construction Managers Impact on Local Bond Projects



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Ontario, California



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Financial Market Disarray in 4th Quarter 2008

Unusual Events in 4th Quarter 2008

- **Major liquidity crisis and concerns about mortgage backed securities**
- **Preference for most secure investments even with lower yields**

Led to . . .

- **Changed relationship between municipal bonds and U.S. Treasury securities**
- **Depleted investor base**
- **Industry-wide risk aversion and consolidation**

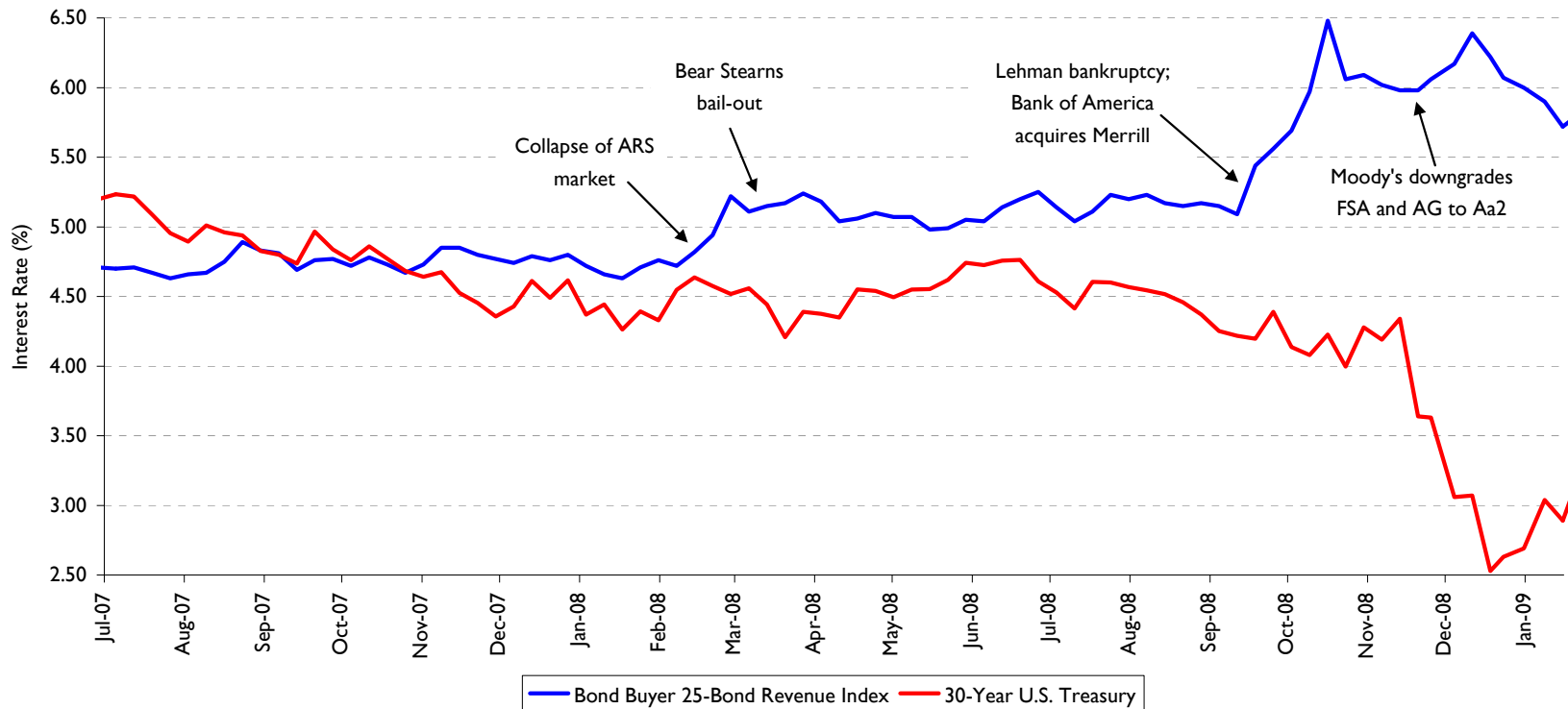
Municipal Bond and U.S. Treasury Markets Change Historical Relationship

- **Flight to Quality**

- Investors flock to U.S. Treasury securities
- Municipal bond preferences shift from insured bonds to AA rated or better

- **Treasury interest rates plummet and municipal rates rise, widening credit spreads and affecting historical relationship between municipal bonds and Treasuries**

Bond Buyer 25-Bond Revenue Index v. 30-Year US Treasury (July 2007 - Present)



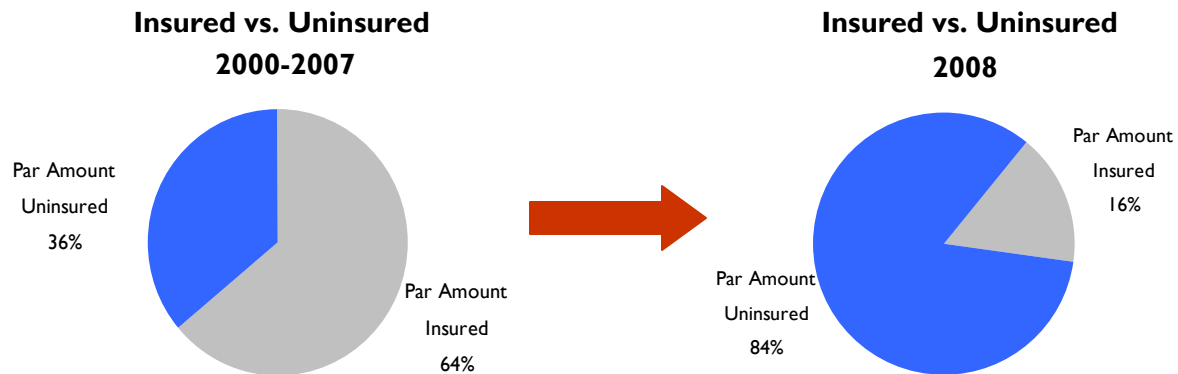
Collapse of Municipal Bond Insurance

Bond Insurer Ratings Snapshot

	Moody's	Standard & Poor's	Fitch
Berkshire Hathaway	Aaa	AAA	***
Assured Guaranty	Aa2	AAA	AAA
FSA	Aa3	AAA	AAA
Ambac	Baa1	A	Rating Withdrawn
MBIA	Baa1	AA	Rating Withdrawn
Radian	A3	BBB+	Rating Withdrawn
CIFG	Ba3	B	CCC
FGIC	Caa1	BB	Rating Withdrawn
Syncora Guarantee Inc. (formerly XLCA)	Caa1	B	Rating Withdrawn
ACA	NR	CCC	NR

***No rating but corporate wrap rated AAA

S&Y's Insured vs. Uninsured Transactions

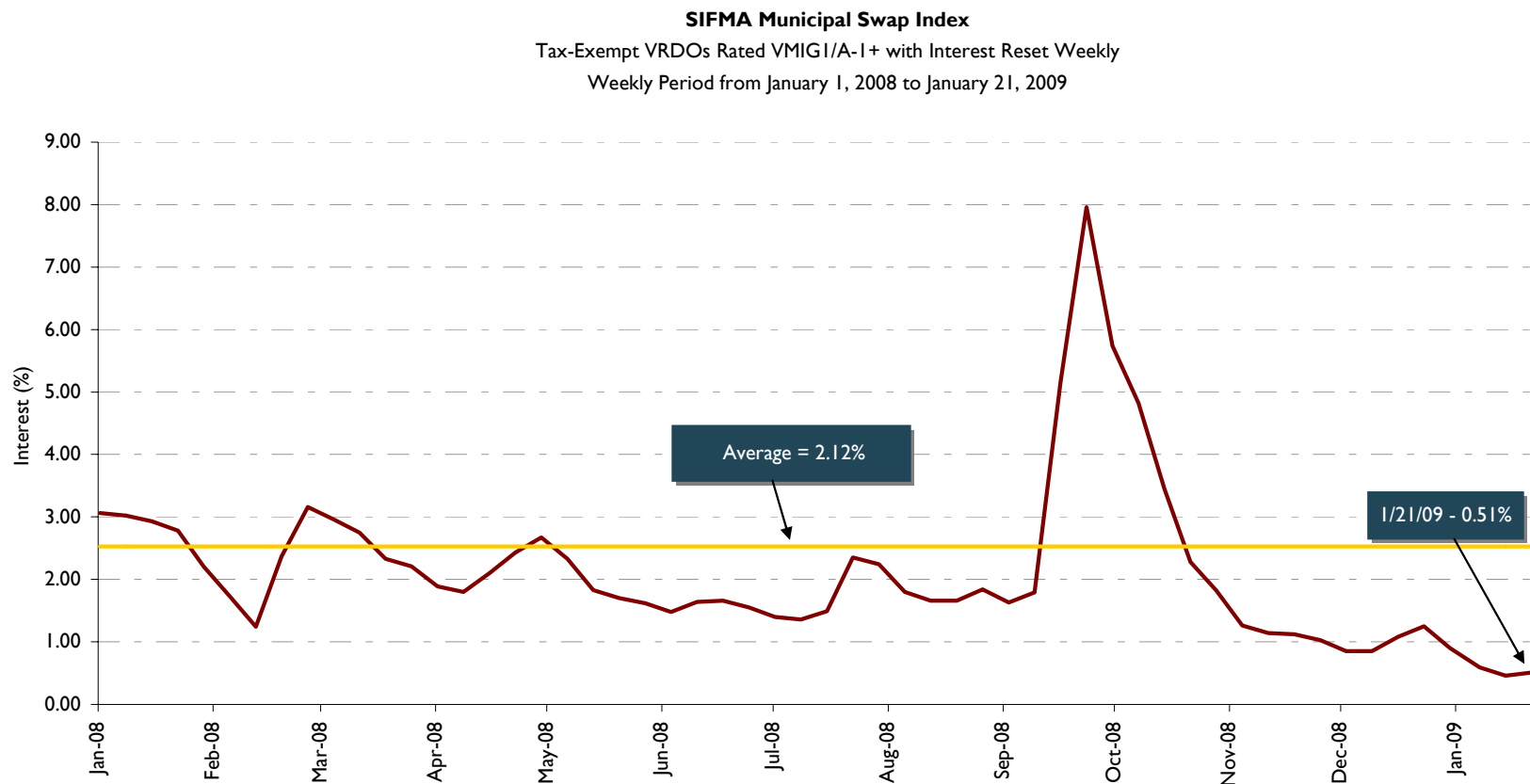


Depleted Base of Customers for Municipal Bonds

- **Hedge Funds**
 - Severely reduced ability to leverage assets to trade securities or respond to investor withdrawals
 - Sidelined
- **Tender Option Bond Programs**
 - Catastrophic losses in investment holdings
 - Severely reduced ability to leverage assets to trade securities or respond to investor withdrawals
- **Municipal Bond Mutual Funds**
 - Outflow of assets as investors withdraw their holdings
 - Net outflow in last 15 weeks of 2008: \$10 billion ⁽¹⁾
- **Individual (“Retail”) Investors**
 - Take advantage of investment opportunity for high quality bonds with significantly higher interest rates

Liquidity Crisis

- **Strains on liquidity**
 - Failure of some underwriting firms and consolidation of others
 - Market for auction rate securities and variable rate bonds collapses
- **Limited availability and higher costs for letters of credit**



Now: Renewed Focus on Credit Fundamentals

- **Both legitimate and exaggerated fears**
 - Impact of recession on municipal credit worthiness
- **Investor focus on credit fundamentals**
 - Bias towards GO bonds and essential service revenue bonds
 - Uninsured ratings of AA or better greatly preferred to A rating or insured bonds
- **Result is significantly wider interest rate spreads to national municipal bond index**
 - AA: +10 bps → +50 bps
 - A: +25 bps → +100 bps
 - BBB: +50 bps → +300 bps
 - NR: +75 bps → +350 to 500 bps



Now: Functioning But Fragile Municipal Market

- **Early January market rally**
 - Market very sensitive to supply
- **Extremely specific credit inquiries**
 - Credit quality focus varies by investor
- **Widened credit spreads to national index**
 - Sharply weakened demand for lower rated credits



Future: What This All Means for Public Agencies

- **Need to focus on timely market information, telling story to investors**
- **Bond structuring decisions shaped by investor preferences: debt service coverage, call features, etc.**
- **Creative alternatives: Bond Anticipation Notes (“BANs”), Lease Revenue Bonds (“LRBs”), new credit enhancers, etc.**
- **Potential impacts of legislative changes and stimulus**



Local School District Impacts

- **Budget woes could designate school district 2nd interim reports “qualified” which would temporarily suspend the ability to issue debt instruments**
- **State capital funding freeze has forced some school districts to postpone their capital plans until funds are released**
- **BANs available to provide short term funding solution**
- **Case studies of local school districts:**
 - Poway USD – Delayed sale of GO bonds
 - Murrieta Valley USD – Bond Anticipation Notes
 - San Mateo-Foster City SD – Bond Anticipation Notes

Local City/County Impact

- **State intercept of local funds (i.e. redevelopment) have cities and counties on edge for long term and short term projects**
- **Budget issues (reduction of sales tax and property tax revenue) leads to bond rating criticism from rating agencies and effects both short/long term borrowing cost**
- **Short term capital lease market has diminished and causing stress on small project financings**
- **Case studies of City/County impacts:**
 - Placentia RDA – Un-rated note issuance to get short term interest rate relief
 - Contra Costa, Sacramento Counties - No significant public construction developing; Other Post Employment Benefits (“OPEB”) top issue

Local Water District Impact

- **Water supplies are declining, lowest level in 8 years**
- **Major financing/construction/acquisition issues include:**
 - ❑ Lost sales which result in higher rates
 - ❑ Increased expenditures
 - ❑ Water use efficiency
- **A bond financing market that seems to be quite active along with the school district market**
- **Case Studies of Water Districts:**
 - ❑ Metropolitan Water District of Southern California – January 2009 - \$200 million water system improvements, well received financing
 - ❑ Santa Margarita Water District – January 2009 \$38 million emergency water system bonds, well received financing

The Presenter



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John R. Baracy Vice President

John R. Baracy is a Vice President in our Los Angeles office. He brings over thirteen years of experience to California and Arizona education finance. John has expertise in the structuring of new money and refunding issues, analysis of debt capacity, tax rate analysis, rating agency credit presentations, arbitrage rebate requirements, derivative financings, and investment of bond proceeds for general obligation bonds, certificates of participation, Mello-Roos bonds, and all other education financing vehicles.

John is a member of the 2008 CASH Statewide General Obligation Bond Committee. He comes from an education family: his parents are long-standing administrators for a school district and community college in Arizona. John has a bachelors of science degree from Arizona State University. He also enjoys playing golf and is an active snowboarder.

Stone & Youngberg LLC

Stone & Youngberg was founded in San Francisco in 1931. The firm was established to advise, structure, underwrite and sell California municipal bonds. In addition to its headquarters office in San Francisco, the firm maintains public finance and sales offices in Los Angeles, San Diego, Big Bear, New York, Chicago, Phoenix, Richmond and Annapolis.

Today, Stone & Youngberg is California's largest regional investment bank devoted to municipal bonds. Over the past five years, Stone & Youngberg has led all investment banks and financial advisors by structuring the most long-term government financings in California.

Stone & Youngberg's leading status in local California municipal finance reflects the firm's 75-year dedication to helping local public agencies achieve their financial goals. In 2007, Stone & Youngberg underwrote 222 financings for California public agencies. Since 2001, Stone & Youngberg has participated on over 1,270 transactions representing \$23.9 billion of California financings as sole or senior managing underwriter or financial advisor in all areas of municipal finance. The firm's website is www.syllc.com.

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Bruce W. Kerns is a Managing Director in Stone & Youngberg's Public Finance Group, focusing on school financings for California issuers. He has been involved in over 100 K-12 and community college district financings in recent years, serving as financial advisor or underwriter. Mr. Kerns' school experience includes short-term note financings, certificates of participation, adjustable and variable rate financings, general obligation bonds, and Mello-Roos bonds.

Mr. Kerns also has 12 years of involvement in urban economics, planning and consulting to local governments. He was a principal in an economic consulting firm where he directed the firm's work in public finance and infrastructure financing. This included formulating strategies for funding capital improvements and services, and recommending implementation programs for various cities, counties, and school districts. His work for California school districts as an economic and planning consultant included enrollment studies, facility master plans, and development impact studies.

Mr. Kerns holds a Master's degree in city and regional planning from the University of California, Berkeley, and a Bachelor of Arts degree from the University of California, Santa Cruz.

Mr. Kerns' expertise in school financings has been recognized by his appointments to the State Treasurer's Task Force on School Facilities Funding, the School Facilities Advisory Committee of the Little Hoover Commission, and California Department of Education School Facilities Division Advisory Committee. Mr. Kerns was a member of the Board of Directors of the Coalition of Adequate School Housing (C.A.S.H.) for eight years.

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