RIVERSIDE COUNTY TRANSPORTATION COMMISSION

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SPECIAL MEETING AGENDA*
****Actions may be taken on any item listed on the agenda***

11:00 a.m.
Monday, September 22, 2008

BOARD ROOM
County of Riverside Administrative Center
4080 Lemon Street, Third Floor, Riverside

In compliance with the Americans with Disabilities Act and Government Code Section 54954.2, if special assistance is needed to participate in a Commission meeting, please contact the Clerk of the Commission at (951) 787-7141. Notification of at least 48 hours prior to meeting time will assist staff in assuring that reasonable arrangements can be made to provide accessibility at the meeting.

1. **CALL TO ORDER**

2. **ROLL CALL**

3. **PUBLIC COMMENTS (Items not listed on the agenda)**

4. **ADDITIONS/REVISIONS** *(The Commission may add an item to the Agenda after making a finding that there is a need to take immediate action on the item and that the item came to the attention of the Commission subsequent to the posting of the agenda. An action adding an item to the agenda requires 2/3 vote of the Commission. If there are less than 2/3 of the Commission members present, adding an item to the agenda requires a unanimous vote. Added items will be placed for discussion at the end of the agenda.)*

5. EFFECTS OF LEHMAN BROTHERS BANKRUPTCY ON DEBT FINANCING PROGRAM

Overview

This item is for the Commission to:

1) Receive and file a report on the effects of the bankruptcy filing by Lehman Brothers (Lehman) on the Commission's debt financing program;
2) Authorize the Chief Financial Officer to pursue options related to the termination of the forward-starting interest rate swap with Lehman as well as the assignment of commercial paper dealers; and
3) Adopt Resolution No. 08-025, *"Resolution of the Riverside County Transportation to Authorize the Executive Director or designee to Enter into a Replacement Swap Agreement"* and approve other documents related to the replacement swap transaction.

6. ADJOURNMENT

The next Commission meeting is scheduled to be held at 9:00 a.m., **Wednesday, October 8, 2008,** Board Room, County of Riverside Administrative Center, 4080 Lemon Street, First Floor, Riverside.

RIVERSIDE COUNTY TRANSPORTATION COMMISSION	
DATE:	September 22, 2008
TO:	Riverside County Transportation Commission
FROM:	Theresia Trevino, Chief Financial Officer
THROUGH:	John Standiford, Deputy Executive Director
SUBJECT:	Effects of Lehman Brothers Bankruptcy on Debt Financing Program

STAFF RECOMMENDATION:

This item is for the Commission to:

1) Receive and file a report on the effects of the bankruptcy filing by Lehman Brothers (Lehman) on the Commission's debt financing program;
2) Authorize the Chief Financial Officer to pursue options related to the termination of the forward-starting interest rate swap with Lehman as well as the assignment of commercial paper dealers; and
3) Adopt Resolution No. 08-025, *"Resolution of the Riverside County Transportation to Authorize the Executive Director or designee to Enter into a Replacement Swap Agreement"* and approve other documents related to the replacement swap transaction.

BACKGROUND INFORMATION:

In September 2004, the Commission approved the selection of an underwriting team of Banc of America Securities (BAS); Citigroup Global Markets/E.J. De La Rosa & Co.; J.P. Morgan Securities, Inc.; and Lehman. The underwriting team would provide services related to the development of financing programs and the marketing and sale of debt issues to fund projects specified in the 2009 Measure A. The Commission also designated BAS and Lehman to assist the Commission with the development of a commercial paper program.

In February 2005, the Commission approved a $185 million commercial paper program to provide advance funding for projects included in the expenditure plan of the approved 2009 Measure A. A third party liquidity facility in the form of a $190 million direct pay letter of credit was obtained from Bank of America, N.A. to support the commercial paper program in the rare event that the commercial paper could be rolled over by the commercial paper dealers. Under the executed dealer agreements, Lehman and BAS had authorization to serve as dealer of commercial paper up to $110 million and $75 million, respectively.

Due to the uncertainty of future interest rates in connection with anticipated long-term debt issuances, staff and its financial advisor, Fieldman, Rolapp & Associates (Fieldman), recommended an interest rate swap strategy to insulate the Commission's 2009 Measure A financing program against future interest rate volatility. Many of the state's self-help counties engaged in similar transactions, including San Diego Association of Governments and Contra Costa Transportation Authority. In July 2006, following a presentation on the swap strategy that included an overview of the incremental risks assumed, the Commission authorized the execution of swap transaction documents with the successful counterparties. In late August 2006, following a bid process, the interest rate swap agreements were awarded to Bank of America and Lehman Brothers Derivative Products, Inc. for $100 million and $85 million, respectively. These swaps were considered forward-starting interest rate swaps to become effective on October 1, 2009, when the Commission anticipated issued at least $185 million of variable rate long-term debt to refinance the commercial paper program. The swaps provided that the Commission would receive 67% of one month LIBOR (generally equivalent to the rate on floating rate bonds) and would pay 3.679% on the outstanding amount.

RECENT EVENTS:

At the April 2008 Commission meeting, staff requested direction from the Commission regarding efforts to develop a plan to refinance the outstanding commercial paper due to the low remaining capacity in the commercial paper program to commit to funding additional project efforts in FY 2008/09 and beyond. With the Commission's authorization in May 2008, the Commission issued $126,395,000 in fixed rate bonds to refinance $110 million in outstanding commercial paper.

At that time, staff and Fieldman provided a report on the credit market environment resulting from the credit crisis and the reliance on sub-prime mortgages for the U.S. housing market. The environment had significantly affected municipal bond insurers, the demand for auction rate securities (a form of variable rate debt), and the availability of traditional bank liquidity. The effect on major investment banks soon followed with the collapse of Bear, Stearns & Co. and exit of UBS Securities LLC from the municipal market. In the past week, the municipal market was stunned by the bankruptcy filing of Lehman Brothers Holdings and the sale of Merrill Lynch & Co. to Bank of America, leaving four major investment banks. Subsequently, the British bank, Barclays PLC (Barclays), agreed to purchase the broker-dealer operations of Lehman, which purchase was the subject of a hearing by the bankruptcy court on September 19, 2008. While the bankruptcy filing did not include the broker-dealer operations of Lehman, the Securities Investor Protection Corporation placed the broker-dealer operations in liquidation in anticipation of the sale to Barclays. It was reported on September 20, 2008 that Lehman Brothers Holdings won approval to sells its North American business to Barclays.

The current market environment today is remarkably different today than two years ago, at the execution of the swaps, when the primary concern was that interest rates might increase significantly beyond the levels achievable in the swap market. Today, the financial crisis has resulted in the failure and/or downgrade of bond insurers and investment banks, reductions in and higher cost of credit liquidity, and declines in interest rates in some markets, particularly the swap market.

Under the terms of the swap with Lehman, the bankruptcy of Lehman Brothers Holdings is a "trigger event" under the swap. The Commission has received a notice of the trigger event pursuant to the swap agreements. Accordingly, the early termination date of the swap agreement will be September 23, 2008. Due to the fall in interest rates since August 2006, the calculation of the termination payment would result in the Commission being required to make a payment to Lehman. As of September 19, 2008, the estimated payment was $3.759 million; however, the final amount will be determined as of the close of business on September 23, 2008 and is dependent on the movement of forward swap interest rates. Commercial paper funds may be used to make this payment based on bond counsel and tax counsel interpretations of the underlying agreements and tax-exempt debt regulations; however, a budget adjustment to increase debt service expenditures is required.

Since the $85 million swap with Lehman is set for termination and interest rates are lower than the 3.679% rate obtained in August 2006, the Commission has the following options to consider:

- Make the termination payment on the Lehman swap and leave the remaining swap agreement with Bank of America in place;
- Make the termination payment and obtain Commission approval to enter into a new swap agreement for the $85 million with Bank of America (or another counterparty acceptable to the Commission) at today's rates; or
- Develop an assignment transaction with a counterparty (Merrill Lynch has proposed) under which the new counterparty pays a fee to Lehman and assumes the swap agreement under the same or very similar terms.

Any of these considerations have an effect on the potential amount of variable rate debt that may be issued in October 2009 and the underlying liquidity facility that would be required.

While the resolution of the interest rate swap termination is a significant issue, the Commission must also address the status of Lehman as a commercial paper dealer. Due to BAS's strong performance as a dealer, staff intends to elevate BAS as the senior commercial paper dealer responsible for $110 million of the commercial paper. As to filling the co-dealer position, the Commission may assign the agreement to Barclays as successor to Lehman, enter into a new agreement with one of the remaining underwriters selected by the Commission in September 2004, amend the BAS agreement for the entire $185 million of commercial paper, or conduct a procurement of additional firms to identify a second commercial paper dealer. Since the Commission currently has $90 million of commercial paper outstanding and the Lehman transactions can be rolled over to BAS for the next several months, the sense of urgency regarding the commercial paper dealer issue is not as great as the interest rate swap termination issue.

SUMMARY:

The financial crisis has impacted the Commission by causing the termination of the Commission's $85 million swap with Lehman. The Commission will pay the termination cost and discontinue the swap, pay the termination cost and enter into a new swap for $85 million, or consent to an assignment of the swap with no payment from the Commission. Staff is analyzing the options and implications of each potential action.

Staff intends to rearrange the Commission's commercial paper dealers, designating BAS as the primary commercial paper dealer responsible for $110 million of commercial paper. The secondary commercial paper dealer position is under analysis.

In the interest of full disclosure, it should be noted that on September 15, 2008, following the proposed purchase of Merrill Lynch, Bank of America's credit rating was placed on credit watch and downgraded by Standard & Poor's from "AA" to "AA minus." Moody's Investors Service placed Bank of America's credit rating on credit watch but did not change the Aa2 rating. Fitch Ratings downgraded Bank of America's rating on its long-term, senior unsecured debt from "AA" to "A plus."

<table>
<tr><th colspan="6">Financial Information</th></tr>
<tr><td>In Fiscal Year Budget:</td><td>No</td><td>Year:</td><td>FY 2008/09</td><td>Amount:</td><td>$5,500,000 (est)</td></tr>
<tr><td>Source of Funds:</td><td colspan="3">Commercial Paper</td><td>Budget Adjustment:</td><td>Yes</td></tr>
<tr><td>GLA No.:</td><td colspan="5">303 19 97201</td></tr>
<tr><td>Fiscal Procedures Approved:</td><td colspan="3">Theresia Trevino</td><td>Date:</td><td>09/21/08</td></tr>
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