



**WEST BASIN MUNICIPAL WATER DISTRICT**  
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Carson, CA 90746

**OCTOBER 15, 2008 – Finance Committee**  
Kwan (Chair), Gray  
**OCTOBER 27, 2008 – Board Meeting**  
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Approved by: Rich Nagel

CONSENT CALENDAR

FINANCIAL MARKET IMPACT

SUMMARY:

Once again the financial market has seen unprecedented times. In the past month, well known financial institutions have collapsed, the federal government has stepped into aid failing institutions and investors are nervous about the stock market causing significant drops to the Dow Jones Industrial Average. Most noteworthy are:

- Bankruptcy of Lehman Brothers Holdings,
- Conservatorship of Fannie Mae and Freddie Mac,
- Merrill Lynch’s proposed acquisition by Bank of America,
- Government loan of \$85 billion to American International Group (AIG),
- Government seizure of Washington Mutual and subsequent sale to JPMorgan Chase & Co.,
- Citigroup acquires Wachovia Corporation banking operations, and
- Congress votes on government bailout program.

As an investor and as an organization that participates in the market (selling of municipal bonds), West Basin needs to identify its current exposure to the above, but also look to its overall financial health. West Basin does not hold any direct investments with Lehman, Merrill Lynch, AIG, Washington Mutual or Wachovia.

Investment Exposure

As of October 3, 2008, West Basin has cash or investments in the following institutions:

<b>Operating Fund</b>	
Federal Home Loan Bank (FHLB)	14%
Federal Farm Credit Bank (FFCB)	3%
Federal National Mortgage Association (Fannie)	17%
Federal Home Loan Mortgage Corp. (Freddie)	16%
LAIF	25%
General Electric	5%
United Bancorp Securities	5%
East West Bank (collateralized)	3%
Broadway Federal – FDIC	6%
Broadway Federal (collateralized)	1%
One United – FDIC	3%
Union Bank of California (operations)	2%

## **Other**

Union Bank of California (PARS program)  
Union Bank of California (Rice Swap)  
FSA (bond reserve funds)

News of a conservatorship of Fannie and Freddie are seen as a positive. West Basin holds the debt (bonds) of these institutions that now have the explicit backing of the federal government. What this means is that the federal government will provide 100% support (similar to United States Treasuries) should these entities fail. However, unlike the treasuries, these government-sponsored entities are currently trading higher than the 2-year treasury with a spread of 130 basis points (as of October 1, 2008). In addition, the federal government states that the Federal Deposit Insurance Corporation (FDIC) will continue to serve its role as it has done for 75 years.

For those entities participating in the small banking program, staff has outreached to its client representative to assess their market position. In particular, staff focused on East West Bank and Broadway Federal because of our exposure to their collateral. In addition, staff has also reviewed the ratings, where available, of the above entities with its investment advisor and noted no decline in rating.

## Debt Exposure

Currently, West Basin has approximately \$295 million in debt outstanding. While most of the debt is fixed rate, we do have exposure to approximately \$38 million in variable rate debt. This variable debt is remarketed weekly and swapped monthly to a fixed rate with its counterparty, Citigroup. Although West Basin has seen an increase in its weekly rate increase from 1.5% to 7.48%, the most recent reset was at 5.48%. The impact of these rate increases has resulted in approximately \$70,000 of additional interest payments through September 2008. From a budgeting perspective, this single line item, at present, does not significantly impact coverage; however, a continuation of higher interest rates may result in bottom line impact and therefore lower bond coverage.

Investors who are nervous about the market tend to move out of the stock market and municipals and into treasuries. As a result, West Basin does have exposure on its variable rate debt bonds. If the investors choose to "put back" these bonds and they cannot be remarketed to new investors, the trustee will be required to draw on the standby purchase agreement with Dexia Credit Local. This will cause the rate to jump to the maximum rate of 12% for 45 days and then to 1% plus base rate (the higher of prime rate or the Fed Funds rate plus one-half of one percent). As of Monday, October 6, 2008, West Basin has been informed approximately \$16 million of bonds was "put back" to the bank.

As West Basin moves forward with its capital plan to provide local water reliability through the expansion of recycled water system and through ocean-water desalination, West Basin will need to enter into the municipal market to seek the necessary bond proceeds to fund these projects, which would take place perhaps within a year. When West Basin needs to enter into the market, hopefully the fallout of the above financial crisis has been resolved. In any case, West Basin will be focused on conducting due diligence in selecting its investment banker

partners and other bond-related partners (insurance, trustee) in addition to being mindful of an appropriate debt structure that will limit West Basin's exposure to this market volatility.

Overall

One can feel nervous about the volatility in the global market and concerned about the dramatic swings in the American stock market or the dire news of well-known financial institutions suffering significant losses. However, West Basin will remain focused on its investment objectives of safety, liquidity and then yield. In addition, West Basin will continue to be mindful of its investment partners. Staff will continue to monitor its financial decisions and the potential impact on its operations.

STRATEGIC BUSINESS PLAN IMPLEMENTATION:

Goal 8, Finance – Manage finances to optimize the public's investment return and minimize risk.

COMMITMENT STATEMENT:

Sound Financial and Resources Management – West Basin is committed to efficient business operations, financial planning, and asset management.

FISCAL IMPACTS:

At this time, staff has noted only West Basin's variable rate bonds have been impacted by the financial market situation. For the past three weeks, West Basin has experienced higher weekly resets on its variable rate debt. The impact is that a 1% rate increase in the weekly resets is approximately \$7,000. To date, staff estimates an impact of approximately \$70,000. Staff will continue to monitor the impact of the remarketing on its variable rate debt and the higher interest rate resets.

ENVIRONMENTAL COMPLIANCE:

Not applicable.

COMMITTEE STATUS:

This item was reviewed by the Finance Committee on October 15, 2008 and agendized to the October 27, 2008 Board meeting as information for discussion.

RECOMMENDED MOTION:

This item is for information only.

LIST OF EXHIBITS:

None.