



TO: SCPPA Board of Directors

FROM: Bill D. Carnahan

SUBJECT: Meeting of the SCPPA Finance Committee – January 7, 2008

DATE: January 8, 2008

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A meeting of the Finance Committee was held on January 7, 2008, at the SCPPA office in Pasadena.

**Committee members in attendance were:** Acting Chairman Craig Koehler (*SCPPA*); Ed Zacherl (*Anaheim*); Bob Liu (*Burbank*); Jeannette Olko (via teleconference for item 5)(*Colton*); Larry Silva (*Glendale*); Mario Ignacio (*LADWP*); and Shari Thomas (*Pasadena*).

**Others present were:** Stephen Cole (*Fulbright & Jaworski*); Will Frymann and Dan Hartman (*Public Financial Management*); Therese Savery (*LADWP/SCPPA*); and Richard Helgeson (*SCPPA*).

1. **Investment Report**

The Committee reviewed the Investment Report for November 2007, and agreed to forward the report to the Board for receipt and filing.

2. **SCPPA Updated Project Debt Book**

Public Financial Management (PFM) presented an updated Project Debt Book for the period ended June 30, 2007.

3. **Auction Rate Market Update**

PFM provided the Committee with an update on the auction rate market, guarantors, and insurers, in connection with recent changes and activity in the subprime market. SCPPA currently has ten outstanding variable rate or auction rate bond issues which are spread across several projects. Seven of the ten issues are VRDOs and three of the ten are ARS. SCPPA's ARS series include the Southern Transmission 2003, Mead-Phoenix 2004, and Mead-Adelanto 2004, which are all hedged by 65% of LIBOR swaps.

As of PFM's 2007 study of SCPPA's variable rates, ARS were performing better and resulting in lower borrowing costs for SCPPA. Investors continue to focus concerns on liquidity and credit issues on ARS bonds and failed auctions in other non-muni ARS programs. No other California issuers have switched to VRDOs from ARS yet, with many new programs moving toward VRDOs. If ARS conditions persist or worsen, considerations for alternatives may be necessary. These include extending the auction period, conversion to VRDBs, or refunding with VRDBs or fixed rate bonds.

In addition to the auction rate market, most insurers continue to suffer due to the subprime market crisis as well. Rating agencies have placed numerous insurers on negative watch and have downgraded some insurers. Rating agencies have also reevaluated the credit ratings of a number of major investment banks as a result of those banks' exposure to the subprime crisis. PFM continues to monitor and will report at the next meeting.

#### **4. Gas Prepayment Project No. 2 Update**

The Committee received an update on the Gas Prepayment Project No. 2. The Project 2 prepay continues to progress and is nearing approvals by the LADWP Board and SCPPA Board. However, economic conditions for all prepay deals remain challenging given the market conditions.

#### **5. Gas Reserves Takeout Financing**

The Committee received an update regarding the Gas Reserves Takeout Financing. The SCPPA Gas Reserves have two projects (Pinedale and Barnett) which are currently being financed by the Merrill Lynch bridge loan. The loan has been extended to March 1, 2008. The current balance on the loan is \$75.1 million. As part of the long-term financing, SCPPA anticipates taking out the existing loan and providing funding for the drilling of additional wells for five years. The financing is currently assumed to be done as taxable fixed rate debt with a final maturity in 2032, despite anticipated reserves output exceeding 30 years. SCPPA's borrowing cost is expected to be just below 6.0%, with significantly different spreads for each participant as a result of the increased credit spreads on taxable uninsured bonds.

The difference between borrowing rates and reinvestment rates will currently result in negative arbitrage of approximately \$3.76 million on project funds for the continued drilling, and would be approximately equivalent to 18.8 bps of annual borrowing cost on the transaction. The total transaction would be approximately \$141 million. SCPPA received competitive insurance bids, however the market distaste for most insurers has made the economics of insurance difficult to estimate. Based upon current market estimates there is very little benefit to insurance for any of the Gas Reserves bonds (except for insurance by FSA, who has not yet provided a bid).

The Gas Reserves financing is proceeding on schedule and is expected to price on January 24, with closing on February 6. The SCPPA Board approved the financing at the December Board meeting. Documentation is being finalized, and Rating Agency and bond insurer process is nearing completion.

#### **6. Unsolicited Proposals**

PFM provided a summary of the unsolicited proposals received. SCPPA has continued to receive updates from Bear Stearns (Cancelable Swaps and CMS Modification) and UBS (Fix-Out of Variable Rate Debt) to unsolicited proposals originally presented at the November and December Finance Committee meetings. PFM feels that these are both good products, but recommends no action at this time. The Committee requested PFM to continue to monitor and follow-up with the underwriters regarding swap documentation turnover time.

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**THE NEXT REGULARLY SCHEDULED FINANCE COMMITTEE MEETING  
WILL BE HELD MONDAY, FEBRUARY 4, 2008, AT 10:30 A.M.  
AT THE SCPPA OFFICE**