TO: SCPPA Board of Directors

FROM: Bill D. Carnahan

SUBJECT: Meeting of the SCPPA Finance Committee

DATE: March 4, 2008

A meeting of the Finance Committee was held on March 3, 2008, at the SCPPA office in Pasadena.

Committee members in attendance were: Chairman Bill Carnahan *(SCPPA)*; Ed Zacherl *(Anaheim);* Bob Liu (*Burbank)*; Ned Bassin (*Glendale);* Mario Ignacio (*LADWP);* Shari Thomas *(Pasadena)*; and Jerry Rogers *(Riverside).*

Others present were: Ron Ahlers *(Glendale); S*tephen Cole *(Fulbright & Jaworski)*; Will Frymann and Dan Hartman *(Public Financial Management);* Therese Savery *(LADWP)*; and Craig Koehler and Richard Helgeson *(SCPPA).*

1. Investment Report

   The Committee reviewed the Investment Report for January 2008, and agreed to forward the report to the Board for receipt and filing.

2. Financial Auditor Contract Extension

   The Committee recommended that the Board approve the extension of the agreement with Moss Adams, LLP, for an additional two years.

3. Customer Energy Efficiency Financing Program

   The Committee reviewed a customer energy efficiency financing program and recommended that the Public Benefits Committee prepare an RFP to solicit additional proposals for review.

4. Swap Valuations

   PFM provided the Committee with quarterly swap valuations as of December 31, 2007. Swap valuations have decreased in total since September, 2007. The major drivers of the changes have been the steepening of yield curves and the reduction in short-term rates. SCPPA's eight swaps are spread across five counterparties. The AIG Swap (STS 1991) is the largest, and accounts for 25.8% of the outstanding notional amount and for $55.6 million of the total termination value. The valuation on

SCPPA's eight outstanding swaps was ($96.4 million) as of December 31, 2007, and ($90.0 million) as of February 27, 2008. The valuation decreased by ($20.3 million) from the previous quarter, and improved slightly by $6.4 million since year-end, due to increasing long-term rates.

5. Auction Rate/Variable Rate Market Update

PFM provided the Committee with an update of the ongoing market issues as it relates to SCPPA's Variable Rate and Auction Rate bonds. Citigroup also joined the meeting via conference call to provide an update relative to the VRDO and ARS markets. The markets have experienced an unprecedented amount of volatility over the last several weeks, not only in the change in absolute rate levels for certain indexes, but also in the spreads between certain indexes as well. Since the end of 2007, the municipal bond insurers have been under constant reevaluation by the rating agencies, and a number of negative rating actions continue to be taken.

The approach and considerations for each of SCPPA's ten outstanding variable rate debt series (seven are VRDOs and three are ARS) should depend upon several factors, including the insurer, the liquidity provider/letter of credit provider, and the type of hedge in place for each of the series. Each SCPPA member has a different exposure profile for VRDOs/ARS and to each of the insurers on SCPPA's outstanding VRDO/ARS series because of varying participation in the SCPPA projects. The Southern Transmission 2003 ARS and the 2004 Mead-Phoenix/Mead-Adelanto ARS continue to have failed auctions due to formula max rate provisions and dislocation within the ARS market. The latest problem from the spreading subprime mortgage issues is the insured VRDO market, particularly true for issues insured by FGIC, XL Capital, Ambac, and MBIA.

As noted in the February Board report, SCPPA's exposure (in addition to the ARS) is now primarily with the Magnolia 2007 VRDOs (MBIA insured) and Palo Verde 1996 VRDOs (Ambac insured). The rationale behind the insured VRDO problems is predicated upon a perceived lack of liquidity associated with these bonds, and wherein a liquidity facility has the right to an immediate termination without allowance for a put by investors if the insurer's rating drops below investment grade. Given the circumstances surrounding VRDOs insured by Ambac and MBIA, SCPPA may need to address the Magnolia and Palo Verde VRDO programs that have been affected by the subprime crisis. SCPPA is considering a number of short and long-term options relating to the VRDOs insured by Ambac and MBIA.

For Magnolia, the short-term option is to approach the line of credit provider to amend the liquidity agreement to avoid an immediate and automatic termination event upon a downgrade by the insurer. In connection with this, the Committee has recommended that the Board approve an amendment to the Standby Bond Purchase Agreement with the liquidity provider (KBC Bank) that would, for a period of time, prevent the automatic termination of the liquidity facility unless there is put option provided to the bond owners prior to the termination. On a longer term basis, the option might be a replacement of the insurance and liquidity with a Letter of Credit through a current refunding. Long-term options for Palo Verde include the same amendment considered for Magnolia for the liquidity facility with JPMorgan or a conversion to fixed rate.

6. Mead-Adelanto/Mead-Phoenix 2004 Series Refinancing

PFM provided the Committee with an update on the VRDO refinancing of the Mead-Adelanto/Mead-Phoenix 2004 Series A bonds. It is PFM's belief that a VRDO structure with a Letter of Credit is the most viable option for the Mead-Adelanto/Mead-Phoenix refinancing. A Letter of Credit bid was originally accepted from Scotia Capital at 32 bps annually for a three-year term, but was subsequently pulled as they notified PFM that the original bid was not sufficient to achieve their necessary internal approvals. PFM is currently negotiating with Scotia Capital to secure a rate that is acceptable by the Committee and has made it clear that backing off from their original fee proposal is problematic. Given the fact that Scotia's annual fee may increase, PFM still believes that the end result will be lower than the bids for comparable transactions in California. The existing swaps will remain outstanding. The swap insurance policy from Ambac will be maintained, since it is non-cancelable.

PFM recommends that the Working Group should attempt to expedite the process of executing the refinancing transaction as quickly as possible, as the cost of 200 bps of basis differential (as is currently the case) is almost $300,000 per month. Basis differential, ongoing costs, and refinancing costs, have had and will continue to have a significant effect on the transaction savings.

The refinancing is expected to preserve more than 70% of the estimated savings from the 2004 refunding transaction. As of March 1, 2008 (assuming 45 bps for LOC and 7 bps for remarketing), the estimated savings with VRDO refinancing backed by a Letter of Credit was $12.0 million gross compared to $16.9 million gross from the original 2004 transaction.

7. Southern Transmission 2003 Series A Current Refunding

PFM provided the Committee with an update of the current refunding of the Southern Transmission 2003 Series A bonds. PFM believes that a fixed rate refinancing makes the best sense given the smaller debt size and large portfolio of other Letter of Credit backed VRDOs. The existing interest rate swap with Citigroup will be terminated, and the current refunding will permanently remove the MBIA insurance.

SCPPA may wish to consider funding the additional amount above the restricted par amount with a termination of the STS Basis Constant Maturity Swap. This will realize a sizable amount of money for SCPPA (currently approximately $3 million net of termination and issuance costs) and effectively provide the benefit that would be close to the overall present value savings. PFM recommends moving as quickly as possible to implement the refunding, while prioritizing with other SCPPA and participant demands. In connection with the refunding, the Committee nevertheless requested that PFM solicit Letter of Credit bids in case the benefit of a fixed rate series declines. A decision to select an underwriter from the bids that were received was deferred, and will be made along with the approval for the refunding at the March Board meeting.

Basis differential, ongoing costs, and refinancing costs, will continue to have a significant effect on the transaction savings, but the refunding is expected to preserve a portion of the estimated savings from the 2003 refunding transaction. The estimated savings with fixed rate financing utilizing swap payments (assuming a May 1, 2008 transaction date) is $2.3 million gross compared to $6.5 million gross from the original 2003 transaction.

8. <u>Gas Prepayment Project No. 2 Update</u>

The Committee received an update on the Gas Prepayment Project No. 2, which continues to progress and is nearing approvals by the LADWP Board and SCPPA Board.

9. <u>Unsolicited Proposals</u>

PFM provided a summary of the unsolicited proposals received. Stone & Youngberg submitted a proposal to address the variable rate bonds. The Committee appreciates the effort that went into the proposal, but is not recommending it for further consideration in context with other options currently being pursued.

THE NEXT REGULARLY SCHEDULED FINANCE COMMITTEE MEETING
WILL BE HELD MONDAY, APRIL 7, 2008, AT 10:30 A.M.
AT THE SCPPA OFFICE