SWEETWATER SPRINGS WATER DISTRICT

TO: Board of Directors **AGENDA NO. V-B**

FROM: Steve Mack, General Manager

MEETING DATE: July 10, 2013

SUBJECT: DISCUSSION/ACTION PROGRESS ON REFINANCING DISTRICT USDA BONDS

RECOMMENDED ACTION: Receive a report on the progress on refinancing the Districts United States Department of Agriculture (USDA) bonds.

FISCAL IMPACT: Refinancing/refunding District bonds may save District up to $50,000 annually.

DISCUSSION:

BACKGROUND

At the June meeting the Board approved Resolution 13-14 which authorized moving forward with refinancing the District's USDA bonds (Prior Bonds). The Prior Bonds consist of two series of loans with the USDA. The initial loan was for $8,000,000 at a fixed rate of 5.0% with a final maturity of 2031. There is $5,651,307 outstanding on this loan. The second loan was for $4,000,000 at a fixed rate of 4.5% with a final maturity of 2042. There is $3,605,000 currently outstanding on this loan. Both USDA loans are callable at any time with no prepayment penalty.

The Underwriters working for the District, Brandis Tallman, and associated bond refinancing legal counsel from Meyers Nave were progressing forward with the refinancing until June 19 when comments by the Federal Reserve Bank Chairman Ben Bernanke sent the financial markets into a period of instability and lower prices on bonds. This made refinancing at that time (we were set to price the bonds on the 20th) infeasible. Since then we have been watching the bond market. Below is a summary of the situation from Brandis Tallman:

Since the financing team presented to the Board at its special meeting on March 21st, interest rates have increased. The 10-year National AAA GO Municipal Market Data ("MMD") yield was 1.95% on March 21st *(Figure 1). The 10-year MMD had dropped to 1.66% on May 1st, however since then rates have increased. The largest jump in rates occurred since May 22nd when the 10-year MMD yield was at 1.86%. On May 22nd, Federal Reserve Chairman Ben Bernanke spoke to Congress and mentioned that the Fed may be considering tapering their asset purchase program of $85 billion a month, sending Treasury interest rates on a steep incline, a run-up of over 20 basis points over 5 trading days. Municipal bonds have taken their lead from Treasury securities. On May 29th, the 10-year MMD yield was 2.07%.

Market Reaction to FOMC Statement and Ben Bernanke's Press Conference, June 19th:

Bernanke spoke again on June 19th just prior to the contemplated pricing of the District's Refunding Bonds. His comments were positive about the economy, and he stated that the Fed's plans to taper bond purchases may begin in the fall and continue through the middle of 2014. Treasuries got hammered, with the benchmark 10-year Treasury yield jumping nearly 15 basis points to end the day at 2.33%, its highest close since March of 2012. The 10-year MMD yield jumped 4 basis points to 2.28%. On June 20th, the muni selloff forced issuers out of the market. The District's Refunding Bond sale was postponed, as were other issues expected to sell that day including the $763 million California Health Facilities Authority bond sale. The MMD yields ended as much as 20 basis points higher. The benchmark 10-year Treasury yield ended 7 basis points higher at 2.40% while the 30-year yield increased 9 basis points to 3.49%.

On June 21st, muni investors continued to pull money from the market in record breaking droves. Muni bond funds suffered outflows of $2.22 billion for the week of June 19th, a record for the year. Muni bond funds reported $1.61 billion in outflows the week before.

Treasury and MMD yields continued to rise through June 25th marking the worst three-day loss in a quarter century. The 10-year MMD yield jumped 17 basis points to 2.80%, the highest since May of 2011. The 30-year MMD yield jumped 17 basis points to 4.13%. Overall, the MMD yields jumped nearly 60 basis points in three days. The benchmark 10-year Treasury yield jumped six basis points to 2.57%.

The market finally saw some relief on Wednesday, June 26th, due to released data showing the U.S. economy had grown less than previously estimated. This eased concern that the Federal Reserve is moving closer to slowing its bond buying. Yields on the MMD ended as much as 22 basis points lower. The 10-year MMD yield dropped 20 basis points to 2.61% and the 30-year yield plunged 22 basis points to 3.91%.

The market continued to steady itself towards the end of the week. A small buying spree continued June 27th following the big rally the day before, led by the primary market. On Friday, June 28th, the yields on the MMD scale ended as much as 8 basis points lower.

Munis had a quiet opening on July 1st, in reaction to a volatile week the week before, as well as thinner staffs around the 4th of July holiday. A weaker open in Treasuries lend to some soft muni secondary trades. Steadier activity was seen in the afternoon. The muni market showed signs of mending itself underscored by increased bond sales. Treasuries steadied in the afternoon.

Trading seemed more consistent on Tuesday, July 2nd. New York's Metropolitan Transportation Authority came to market, pricing for institutions $336 million of revenue bonds that were pulled off the market on June 19th due to volatility. In

California, the City of San Diego issued $49.5 million of revenue bonds. Tuesday's MMD yields ended mostly steady across the curve. The 10-year and 30-year yields were steady for the fourth session at 2.56% and 3.83%, respectively. Treasuries ended with modest gains as the benchmark 10-year Treasury yield settled at 2.47% versus 2.48% on Monday. The 30-year Treasury yield ended the day unchanged at 3.47%.

REFUNDING RESULTS

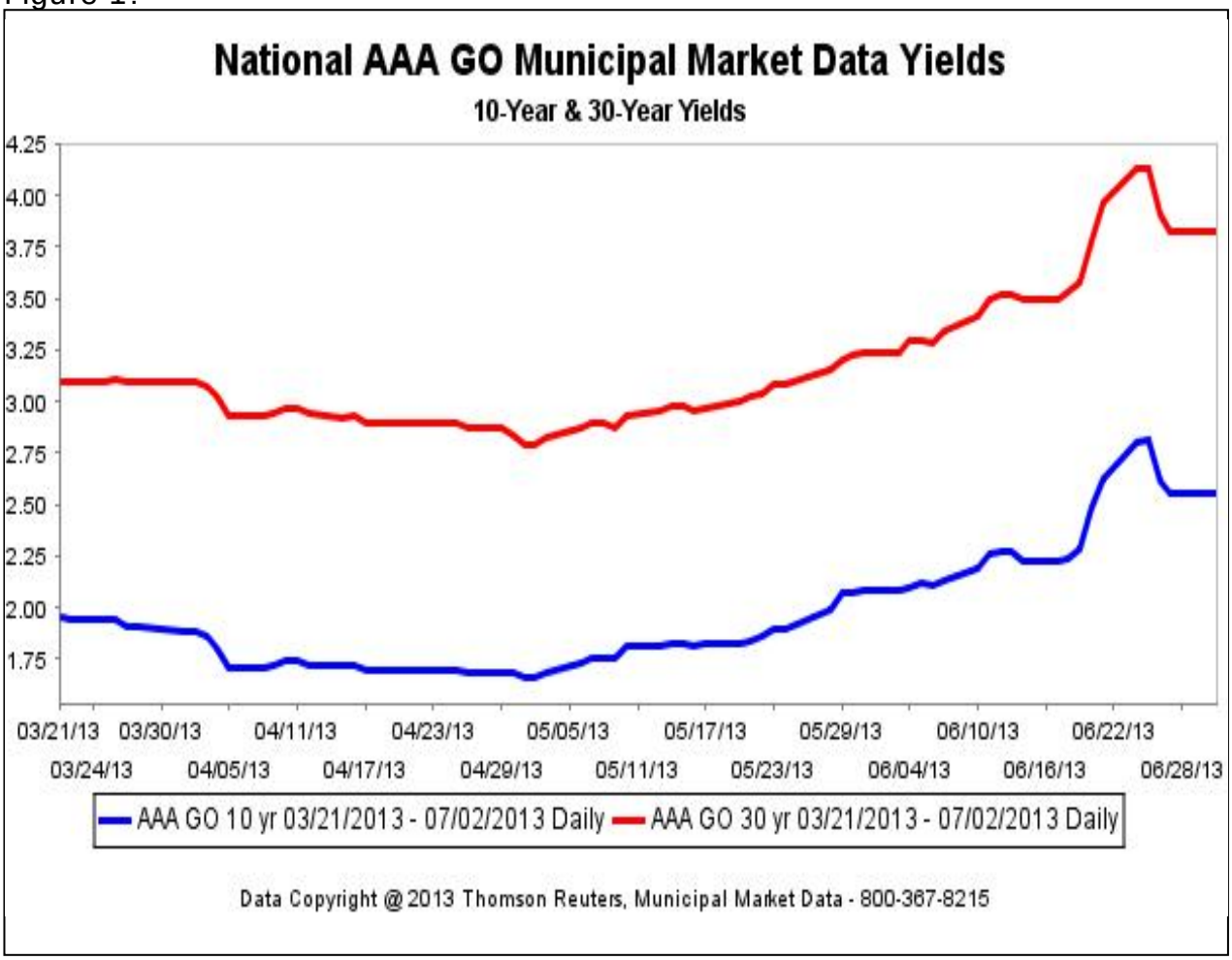
Due to the steep run up of interest rates recently, the savings produced by the refunding have decreased, but are still economically beneficial. With a public offering of the Refunding Bonds, the method of sale anticipated all along, the all-in true interest cost is 4.14%, average fiscal year savings are $32,069, and total savings are $951,573. Net present value savings are $562,457 or 6.70%. The refunding still provides savings comfortably in excess of the industry standard minimum of 3.0%.

Because the bond market has experienced one of its most turbulent periods in the last 25 years, the financing team has also explored a private placement method of sale: A sale to one qualified investor, such as a bank. The limitation of a private placement is that the term cannot extend beyond 20 years. This would allow for the complete refunding of the 1992 Loan and a partial refunding of the 2003 Loan. The 2003 Loan has approximately $1,611,000 outstanding in years 21 through 29 so that portion would remain due and payable to the USDA. The private placement method of sale produces an all-in true interest cost of 3.92%, average fiscal year savings of $43,159, and total savings of $891,360. Net present value savings are $621,147 or 8.12%. The interest rate on the private placement can be locked for up to 30 days while the paperwork on the transaction is in process. Another Board meeting would be required for the Board to approve the revised structure and documentation.

Next Steps

District Staff and the financing team will reconvene on Monday, July 8th, to review market conditions and discuss the best method of sale for the Refunding Bonds. If the market conditions are favorable, we may move forward with the public offering. If not, it may be time to turn to the private offering discussed above. A full report will be presented at the Board meeting on Wednesday.

Figure 1:


National AAA GO Municipal Market Data Yields
10-Year & 30-Year Yields
4.25
4.00
3.75
3.50
3.25
3.00
2.75
2.50
2.25
2.00
1.75
03/21/13
03/24/13
03/30/13
04/05/13
04/11/13
04/17/13
04/23/13
04/29/13
05/05/13
05/11/13
05/17/13
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06/04/13
06/10/13
06/16/13
06/22/13
06/28/13
AAA GO 10 yr 03/21/2013 - 07/02/2013 Daily
AAA GO 30 yr 03/21/2013 - 07/02/2013 Daily
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