



COMPASS

CASE STUDY

Complex Series of Bond Issues Provides Savings to the California State University System

Since 1999, KNN Public Finance has served as the sole financial advisor for the California State University System, helping to transform its multiple revenue bond programs into one combined program. In March, our team of financial advisors, led by Vice President Dan Cox, assisted CSU with three separate series of bonds designed to consolidate multiple project financings and refundings.

The bonds were structured in the following manner:

- ▶ **Series A, par value: \$254,770,000**
A tax-exempt series of bonds, this offering was used to redeem CSU's interim financing through commercial paper and to fund five new campus projects, including: student housing at Channel Islands; a bookstore at Sacramento; a recreation center at Fullerton; a music center at Sonoma; and parking structures at San Bernardino. The issue also refunded and restructured debt for infrastructure and housing at the new Channel Islands campus.
- ▶ **Series B, par value: \$13,165,000**
This taxable series of bonds encompassed refunding the taxable portions of previous debt incurred to finance commercial facilities at the Channel Islands campus and financing the taxable, private use portion of the new Sacramento campus bookstore.
- ▶ **Series C, par value: \$63,275,000**
This portion of the financing plan was used to refund the CSU's outstanding debt with senior liens on revenue bonds for the student unions on five separate campuses: Chico, Fullerton, Northridge,

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KNN Public Finance welcomes you to *Compass*, our new quarterly newsletter.

In *Compass*, we provide timely discussions of public finance issues, case studies of innovative client transactions, and "Client's Corner," a chance for you to share your thoughts and success stories with colleagues throughout the state. Feel free to contact our team of experienced professionals if you have any questions regarding the topics covered in this online newsletter archive.

To suggest articles, please email us at news@knninc.com

John O'Sullivan

Senior Vice President
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CASE STUDY continued...

San Diego, and San Francisco. A delayed delivery series of bonds, Series C was priced in February 2007 and will be delivered in August 2007 due to restrictions on advance refundings.

"With this series of bonds, Dan Cox's most significant contribution was the research and analysis he conducted for the student union refundings," says Colleen Nickles, the Senior Director of Finance and Treasury for California State University. "He worked very hard to develop a restructuring

plan that met the CSU system's needs centrally and provided a benefit to each of the five campuses involved in the transaction."

By bringing these three series of bond issues to market, KNN Public Finance assisted CSU to reduce the overall cost of borrowing, expand its financing capabilities, and significantly reduce the administrative staff time needed to administer the financing. Dan Cox was assisted by KNN's Nedko Nedev among others on this transaction.

TELL ME MORE

GASB 45 and Other Post-Retirement Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) Statement 45 was issued in 2004. It requires all governmental organizations to calculate and report their funding obligations for other post-retirement benefits (OPEB). Such benefits are primarily in the form of medical insurance, but may also include medical, dental, vision, hearing, life insurance, long-term care, and long-term disability. These extra demands revealed by GASB 45 can appear overwhelming for public agencies, from the sticker shock of the obligation, to finding a way to fund the actuarial requirements, to choosing investment strategies wisely.

First, it is important to know when the GASB 45 requirements will become effective for your organization. Based on your annual revenues in fiscal year 1998-99, the rules come into effect according to the following schedule:

Fiscal Year	Annual Revenue
2007-08	\$100 million or more
2008-09	\$10-100 million
2009-10	less than \$10 million

Prior to the issuance of GASB 45, most public agencies used a pay-as-you-go method to fund OPEB, which did not measure or adequately provide funding for future retiree obligations. Under the new rules, governmental organizations are required to have an actuary calculate their annual OPEB expenses for both current and future liabilities and to report this figure in the notes to the financial statement. It is recommended that these actuarial valuations be performed every two to three years to maintain accuracy.

Once a public agency obtains a solid understanding of its OPEB liabilities, it will be effectively compelled to develop a plan to meet these fiscal obligations. In the short term, an OPEB funding plan will most likely result in a higher annual contribution. While it is possible under the regulations of GASB 45 to legally stay the course of "pay as you go" for OPEB obligations, municipalities must recognize that delaying the development of a long-term funding strategy will only make the challenge greater in the future, and may lead to a weakening of their credit ratings.

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Featuring Eric Sandler, Deputy Director of Finance for the San Diego County Water Authority

The San Diego County Water Authority (SDCWA) recently approved enhanced financial policies relating to reserves and debt service coverage. The enhancements were developed by a workgroup of member agency representatives and received unanimous approval from the Board of Directors. Eric Sandler answers our questions regarding this successful strategic planning effort.

What were the major revisions to SDCWA's financial policies?

Financial policies related to reserves were developed based on a comprehensive understanding of the primary financial risks facing the Water Authority—variability in hydrology, interest rates, and building activity (capacity charge revenue). The workgroup analyzed the impact of each of these risks on Water Authority finances and determined to what extent it wished to reserve for them. The key innovation was the quantification of hydrology risk. The enhanced policies protect the Water Authority from between 2.5 and 3.5 years of above average rainfall. Using comprehensive comparative data developed by KNN, we established a debt service coverage target level of 150%, which is above our 120% covenant.

What is hydrological variability and how does that affect your bottom line?

When you set rates based on normal year rainfall, a decrease in actual sales volumes can negatively impact the bottom line. Our Member Agency service area is arid, so rainfall can have a significant impact on Water Authority sales volumes. Two factors are at work. First, there is the retail demand suppression resulting from less outdoor irrigation. Second, some of our Member Agencies have surface water storage to collect the rainfall, which increases their supplies. The result is lower Water Authority sales volumes.

Moreover, the impact of surface water impacts our sales in future years. Our reserve policies protect the financial position of the Water Authority against multiple years of extreme wet weather.

How can you predict rainfall and tie that to your financial planning process?

Working with our Water Resources group, we made use of the same data and models for financial planning that are used for system reliability planning. We used 102 years of hydrological data and ran simulations to determine the impact and likelihood of multiple years of wet weather. We then worked with David Brodsky and KNN to understand its impact on our District's economic picture. The result was a set of proposed revisions to SDCWA's financial policies focused on managing financial risk and creating long-term rate stability.

How did you get that unanimous approval vote?

There were four key factors to our success.

1. We involved our Member Agencies at the very beginning in the form of an ad-hoc workgroup made up of finance officers, general managers, and board members.
2. We provided a large degree of analytical data which the workgroup used to develop its recommendations over a six-month period. We were responsive to all requests and made good use of our financial advisors to provide objective input.
3. Ultimately the recommendations came from the workgroup, rather than staff. We used a structured process with the workgroup to develop recommendations. This included identifying common interests and potential barriers, the development of various alternatives, and a final vote of the workgroup on the ultimate package.

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CLIENT'S CORNER continued...

4. We presented the recommendations to all major stakeholders before going to the Board of Directors for approval. This included all Member Agency finance officers and general managers.

Any advice for public agencies seeking to update and revise their fiscal policies?

As much as possible, try to make it a stakeholder, rather than staff, driven process. Use a structured process to identify common interests and develop recommendations.

TELL ME MORE continued...

We're aware that our clients are being inundated with calls and letters from bond professionals, offering long-term solutions to the fiscal challenges GASB 45 creates. As could be expected, much of the advice from bond professionals involves issuing bonds. A great deal of analysis is required to determine whether or not these financing plans are appropriate for your organization.

For instance, some professionals recommend the issuance of bonds akin to pension obligation bonds (POBs) to cover future OPEB obligations, described as "obligations imposed by law." Unfortunately, it is still unclear whether this bond exemption will apply the same way to the wide variety of OPEB obligations. Additionally, there may still be uncertainty regarding the legality of investing OPEB reserves and bond proceeds in equities and other pension-type assets. Clarification of this point is essential to a bond financing, since the key advantage of issuing bonds would be the potential to generate positive investment return.

Financial advisors can assist public agencies by assessing the benefits and risks of various funding and management strategies, so that their approach is appropriate for their risk tolerance, investment policies and long-term fiscal goals. KNN Public Finance is here for you to conduct the in-depth financial analysis your organization requires. Call us today and we'll help you to evaluate your organization's OPEB financing options.



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MEET OUR PROFESSIONALS

Dan Cox, Vice President

Dan joined KNN in 1985 and has more than 25 years experience advising public agencies on financial matters, structuring debt issues, and managing all phases of the issuance process. As you can see from the article in this newsletter about the California State University system's recent series of bond issues (page 1), no financing plan is too complex for Dan to manage.

Dan leads KNN's efforts in bond pricing and quantitative analysis. He has developed a number of bond pricing models and analytic approaches to evaluating pricing structures. Rather than rely on outdated rules of thumb, Dan has created various methodologies for evaluating advance refunding candidates in order to avoid premature refundings and to assure that savings figures factor in the tax and investment nuances. In addition, he has developed models for debt planning and complex transactions such as multiple refundings, senior/subordinate pledges, true leases, and pooled issues with multiple credits.

Colleen Nickles, the Senior Director of Finance and Treasury for California State University, says, "Dan's institutional knowledge of CSU is extremely beneficial to us. He knows what needs to be done, he understands exactly what our needs are, and he is appreciated for the fact that he offers suggestions for new financing approaches to our challenges."

Prior to joining KNN, Dan worked for a financial advisory firm in New York and a municipal bond counsel. He earned his B.S. from the University of Connecticut.