



## BECAUSE THAT'S WHERE THE MONEY IS

BY DAN WILES, PRINCIPAL & GENERAL COUNSEL

The current markets call to mind the old explanation for robbing banks attributed to Willie Sutton. The financial markets have had their-apocalypse. For many of you, your portion of the business of government is counting the money, budgeting the money, you get the picture. So, where is the money and where is it going? Since *“The crisis raises the big questions of life, ...and investing.”* “the times, they are a’changin’” the most relevant question is whether the places money goes are changin’ as well. Right now, we’ve got plenty of questions, answers are in shorter supply.

The financial crisis raises the big questions of life, . . .and investing. First, how are those financial investments working out for you now? It seems that for most treasurers, financials were the extent of their investment in corporate America. Debt of Lehman and Washington Mutual are virtually worthless, while other surviving commercial banks have sustained stunning losses. Investments that were previously considered prudent and strong have resulted in some tangible losses. Moreover, those losses have occurred at very difficult times in the government world—times of decreased revenues and increased demands. The funds on which public employees depend for their retirement (as well as the investments the private sector relies on) have racked up an impressive losing streak. We are now waiting for years to pass before recovery seems

feasible.

The three bulwarks of investing are safety, liquidity and yield. In the current environment, does the maximizing of yield—return—actually have a significant place at the table? A fundamental quality of the financial crisis is the recognition of risk in financial instruments. While credit spreads have increased to reflect a more realistic approximation of the actual investment risk, it is not clear that the risk premium paid on investments is sufficient to overcome the inherent risk averse nature of governments. If safety is the “prime directive,” with a renewed realization of the risk in financial instruments, we wonder whether there can be room for any real focus on yield as a goal.

The related question arises: does that “prime directive” under current conditions morph into an imperative to invest so as to cover your tuckus regardless of value? Traditional investment of government funds operates in a world with a high penalty for negative performance (loss of principal) and a low reward for positive investment gains. Of course this risk averse approach can lead one to miss real and substantive opportunities afforded in the market. However, on the upside, it often has the benefit of job security for the finance or investment officer.

Our perspective is to apply a realistic appraisal of investment risk in light of the risk premium available in the market—value investing. Market inefficiencies

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## HAWAII FORMS ITS FIRST COMMUNITY FACILITIES DISTRICT

BY LARRY ROLAPP, PRINCIPAL



The Hawai'i Revised Statutes allow each of the four counties in Hawai'i to create community facilities district (CFD) enabling ordinances, that form CFDs, impose special taxes and issue special tax bonds. Three counties have CFD ordinances in place and have adopted resolutions of intentions to form CFDs. Hawai'i County has adopted Administrative Guidelines for the CFD process and created a committee to review CFDs prior to actions considered by the Hawai'i County Council. The City and County of Honolulu has also created Administrative Guidelines for use in the CFD process. Kaua'i County has, in conjunction with the formation of the Kukui'ula CFD, approved an Acquisition and Funding Agreement which contains, among other things, policy direction with respect to use and sharing of bond proceeds, debt issuance criteria, disclosure obligations, and other matters.

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# MARKET UPHEAVAL FAILS TO UPEND VARIABLE RATE BORROWERS IN 2008

BY PAUL PENDER, ASSISTANT VICE PRESIDENT

Many California water districts with variable-rate bonds experienced volatile, often expensive, borrowing costs in 2008. Through November, however, many such districts assessing their debt costs over the entire year may find they actually paid nearly the same in interest as in recent, more stable

*“...in 2008, most districts...actually paid nearly the same in interest as in recent, more stable years.”*

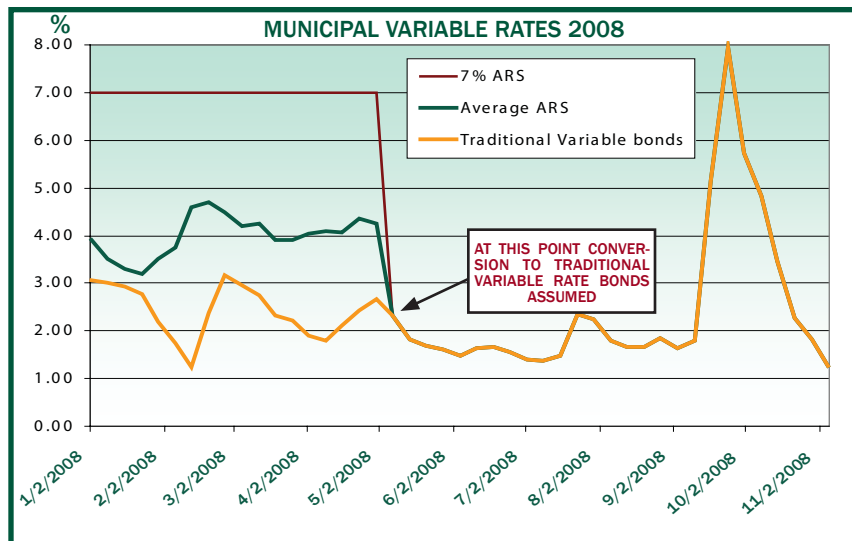
years. This may be surprising, given that many variable-rate borrowers began the year in the now-defunct Auc-

tion Rate Securities (ARS) paying high rates. Then in September they were later socked with rates of 5-8% for several weeks as a result of the global financial crisis. What did not grab headlines in 2008, however, were significant periods in which borrowers paid variable-rates below 2%. This has resulted, to date, in average interest rates of some 3-4% for the year. This article’s assessment incorporates certain rates Fieldman, Rolapp & Associates believes to be reflective of many water district borrowers and an analysis of data compiled by Securities Industry and Financial Markets Association (SIFMA).

The year began with unprecedented tumult for ARS borrowers. Such securities bear interest rates that are reset, usually weekly, based on investor demand. ARS carried a credit guarantee from a bond insurance company, such as MBIA or Ambac. But unlike traditional variable-rate bonds, the insurance company was not on the hook to unconditionally purchase any bonds investors wanted to sell back. The auction process typically served this liquidity purchasing function, but of course it could not without investor

demand. In January 2008, investor confidence collapsed in the once-venerable bond insurance companies. Over just a few weeks, all traditional ARS investors sold out (or tried to) of the securities in a stampede, which rapidly drove up ARS borrowing rates from around 3% at the end of 2007 to as much as 12% in some cases. Higher rates also hit more traditional variable-rate bonds using bond insurers for credit support. By late February, most districts with these securities faced significant short-term financial stress. With their debt costs spiraling upward to unaffordable levels, it seemed to many districts they had made an irreparable financial mistake. Many second guessed themselves, wishing they had instead issued traditional fixed-rate bonds. Indeed, these bonds had

ing strategy. Remaining in a variable-rate borrowing mode meant securing new credit commitments from a commercial bank – a structure that remained popular with investors. Indeed, such traditional variable-rate bonds in February were still paying interest rates below 3%. Further complicating the decision was the fact that most bond insurance companies, such as Ambac and MBIA, still were officially branded with “AAA” ratings from Moody’s and Standard and Poor’s. This plausibly suggested to many another prudent strategy was to “stay the course” in ARS rather than incur new costs to restructure. As traditional variable-rate bond rates remained well under 3% throughout March and April, and ARS continued at rates 3-6% higher, many districts pulled the plug on their



ARS and converted to the traditional structures. Although such new issues had restructuring costs, including in some cases new credit costs some 2-3 times higher than prior years, districts immediately saw their variable interest rates slashed below 2% in most cases.

The rates remained at those levels for months, averaging around 1.75% for the next 4 months, never topping 2.4%. But the tranquil period did not endure. On

seen rates at historic lows of some 4.50% for long-term borrowings in 2004 and 2005. In the maelstrom of the usurious January-February ARS crisis, it was easy to forget that ARS and other traditional variable-rate bonds had provided borrowing costs averaging some 3.2% the previous 3 years—just slightly higher than the long-run average of the prior 20 years.

During the financial stress, districts debated whether to convert their ARS to fixed-rate bonds or retain their variable-rate borrow-

Monday, September 15, financial markets opened to a staggering trio of events: Lehman Brothers had filed for bankruptcy, Merrill Lynch was sold, and AIG was shockingly facing bankruptcy. In the ensuing turmoil, investors pulled money from everywhere, including funds invested in municipal variable-rate bonds. As the affected municipal funds scrambled to liquidate investments to meet redemptions, they drove even the highest

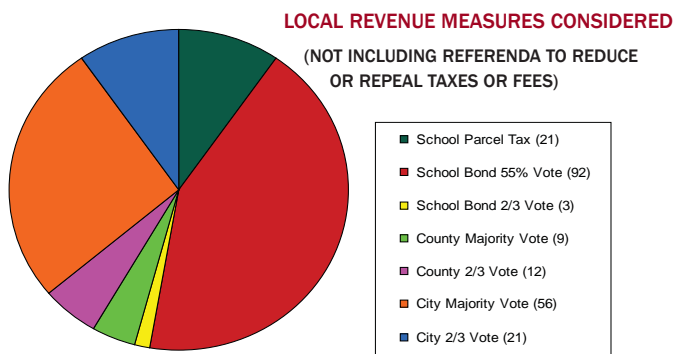
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# RESULTS OF NOVEMBER BOND MEASURES

BY RYAN CHIRIBOGA, ASSOCIATE

November 4th was a very successful day for local ballot measures in California. Voters faced a statewide ballot containing over 380 local measures, 136 of which included taxes or fee increases and 103 included general obligation bond measures totaling over \$24.1 billion.

In total, \$23.9 billion in local general obligation bond measures were passed, including a 100% pass rate for eight City, County and Special District measures, which required a 2/3 vote. The largest City approval was the City of San Francisco, where \$887 million in proceeds will now be available for its hospital system.



There was a record 95 school bond measures considered, seven more than the previous high in November 2002. The largest School District measure to pass was in the amount of \$7 billion for the Los Angeles Unified School District. Other notable authorizations include the Los Angeles Community College District with \$3 billion, San Diego Unified School District with \$2.1 billion and Long Beach Unified School District with \$1.2 billion.

With the economy in a recession, questions arose as to how much voter support there would be for increases in taxes. A depressed housing market, rising unemployment and other factors generally lead to fiscal tightening. However, only eight school district bond measures failed to pass, proving that even in a down economy the voters of California realize the need for infrastructure and new schools. ♦

## WHERE THE MONEY IS CONTINUED FROM FRONT PAGE

can provide opportunity to realize gains in return through the careful selection of investment vehicles of similar actual risk. For example, a high grade corporate bond (relatively rare now) or general fund debt of a neighboring government may offer returns at a real spread to comparable Treasuries with virtually no increase in risk. Even tax-exempt debt may provide value in this market.

In the final analysis, where the money is depends on the balance between risk and return. This is going back to basics. ♦

## IFAQs

INFREQUENTLY ASKED QUESTIONS

BY TOM JOHNSEN, PRINCIPAL



Like those in many careers, professionals involved in public finance sometimes slip into jargon and speak in a type of code that may be hard to follow. The use of acronyms, references to arcane technical terms or reliance on little known indexes or formulas may frustrate infrequent market participants and cause them to wonder what was just said and how does it impact their transaction. To assist in making public finance conversations more transparent and easier to understand, we will be providing a series of articles for this newsletter where we offer brief definitions or explanations of infrequently used public finance terms. The intent is to help public finance participants by explaining terms they may not be familiar with or have time to seek clarification of. This edition's infrequently asked questions and the answers include the following:

### Q: *Who or What is SIFMA?*

A: SIFMA is the acronym for the Securities Industry and Financial Market Association. To aid in the liquidity and marketing of variable rate debt SIFMA publishes, every Wednesday, a benchmark floating interest rate for reference during the following week. This is known as the SIFMA Municipal SWAP Index and is commonly referred to simply as SIFMA. The index serves as a benchmark interest rate for floating rate securities and is accepted throughout the industry as the standard 7-day rate. The index is comprised of approximately 650 high-grade, 7-day, tax-exempt variable rate demand obligations that meet specified conditions and limitations. For the week of November 19, 2008 the SIFMA rate was 1.12%.

### Q: *What is MMD?*

A: Thomson Municipal Market Data ("MMD") provides, for a fee, data and analytical services to the municipal bond market. One aspect of their service is to provide information on current municipal bond interest rates for various maturity dates (called yield curves). Information is provided to subscribers for as many as 250 different yield curves for various types of transactions (Revenue Bonds, General Obligation Bonds etc) with a range of rating levels for all fifty states. Therefore, one can determine what are current interest rates, throughout the country, based on a combination of criteria including rating, state location and transaction type. In conversations, traders, bankers and financial advisors often times refer to the MMD and in doing so are likely referring to the latest compilation of interest rates for transactions similar to the one being discussed with the goal of determining current and valid interest rates to assume. ♦

## FIRST CFD IN HAWAII

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In September 2008, Kauai County officially formed the Kukui'ula CFD, the first in the State of Hawaii. A Bond Ordinance authorizing the issuance of up to \$120 million of special tax bonds was subsequently enacted in November 2008.

Hawaii County has commenced proceedings for two CFDs and has received applications and deposits from several other landowner groups interested in exploring the use of this financing tool.

The City and County of Honolulu initiated proceedings for a CFD but has not progressed to the next step of formation.

The financing team for each of these projects has varied but each team has consisted of experienced professionals familiar with this real estate based public financing tool. The teams include legal counsel from Honolulu, Hawaii, California, and Arizona; special tax consultants and investment bankers from California; and real estate experts from Hawaii and California.

Fieldman, Rolapp & Associates has been part of all the CFD activities in each county, working with county department heads and staff and other members of the county finance teams to create local CFD ordinances, establish protocols, coordinate finance team activities and develop best practices for this new financing tool. ♦

## FIELDMAN, ROLAPP & ASSOCIATES NEWS



Fieldman, Rolapp & Associates is pleased to announce that Thomas M. DeMars has been selected as Managing Partner and Chairman of the Board. Tom has been with the firm since 1988 and is a long time member of the Board and the firm's

## VARIABLE RATE BORROWERS

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rated, well-secured variable-rate bonds to rates approaching 8% for a week. For about a 2-week period, many variable-rate borrowers thought they were facing another ARS-type meltdown.

In October, however, rates fell to 3.5% and ultimately dipped below 2% by November. For the year through November 15, that brought the average interest-cost to around 2.5% for districts that began the year in the traditional form of variable-rate bonds. For borrowers that began the year in ARS with higher penalty rates (7% January to May), the average interest cost to date was approximately 4.25%; for districts that began in ARS with more average penalty rates, the average interest cost to date was approximately 3.05%. (Both ARS scenarios assume a conversion to traditional variable-rate bonds in early May.)

For many water districts that utilize variable-rate bonds, 2008 has therefore turned out to be surprisingly benign given the headline-grabbing periods of high rates and volatility. And while the financial crisis remains intractable, likely well into 2009, future periods of volatility could yet strike the same borrowers again. But as many districts have found in 2008, intermittent periods of unexpectedly high rates are unlikely to undermine the average long-term costs of their variable-rate strategies. ♦

Executive Committee. He replaces Larry Rolapp as Chairman of the Board. In 2009 Larry Rolapp will continue to serve on the Board and plans to focus his efforts on strategic clients (such as Hawaiian CFDs mentioned elsewhere), industry educational activities and municipal trade groups. ♦

The table below indicates current ratings of municipal bond insurance firms. Also listed is the rating agency outlook and the date of the most current rating agency action.

### CURRENT MUNICIPAL BOND INSURANCE RATINGS EFFECTIVE AS OF NOVEMBER 19, 2008 \*

INSURER	MOODY'S	S&P	FITCH
AMBAC ASSURANCE CORPORATION	Baa1, Developing (11-5-2008)	A, Negative Watch Effective (11-19-2008)	Not Rated, Withdrawn (6-26-2008)
ASSURED GUARANTY CORP.	Aaa, Watch Effective (7-21-2008)	AAA, Stable Outlook (6-18-2008)	AAA, Stable Outlook (12-12-2007)
BERKSHIRE HATHAWAY	Aaa, Stable Outlook (2-21-2008)	AAA, Stable Outlook (4-11-2008)	Not Rated
CIFG ASSURANCE NORTH AMERICA, INC.	B3, Watch Effective (10-28-2008)	B, Negative Outlook (8-22-2008)	Not Rated, Withdrawn (10-21-2008)
FINANCIAL GUARANTY INSURANCE COMPANY	B1, Watch Effective (10-24-2008)	BB, Negative Outlook (6-6-2008)	CCC, Negative Outlook (7-31-2008)
FINANCIAL SECURITY ASSURANCE INC. **	Aaa, Watch Effective (7-21-2008)	AAA, Negative Watch Effective (10-8-2008)	AAA, Stable Outlook (1-24-2008)
MBA INSURANCE CORPORATION	Baa1, Developing (11-7-2008)	AA, Negative Outlook (8-14-2008)	Not Rated, Withdrawn (6-26-2008)
RADIAN ASSET ASSURANCE INC.	A3, Watch Effective (10-10-2008)	BBB+, Negative Outlook (8-26-2008)	Not Rated, Withdrawn (5-2-2008)
SYNCORA GUARANTEE INC. (FORMERLY XL CAPITAL)	Caa1, Watch Effective (10-24-2008)	B, Watch Effective (11-18-2008)	Not Rated, Withdrawn (9-5-2008)

\* Material is current as of the indicated date. This material has been prepared for informational purposes only, is subject to change and is not intended to be used and disseminated for purposes of secondary market disclosure filings.  
 \*\* On November 14, 2008, Assured Guaranty announced that it would acquire Financial Security Assurance from Dexia SA. This transaction is subject to confirmation from the rating agencies that the acquisition will not have a negative impact on the financial strength ratings of either insurer.