



**“THE TIMES THEY ARE A-CHANGIN’,”
 WHAT NOW?**

BY DANIEL L. WILES, PRINCIPAL & GENERAL COUNSEL

In September 2008, the financial market rollercoaster kicked up to a real “E” ticket ride with a set of stunning changes to the financial landscape. The September action started with the placement of Fannie Mae and Freddie Mac into conservatorship by FHFA. The weekend of September 13-14, Bank of America switched brides at the altar, exchanging Lehman Brothers for Merrill Lynch. A jilted Lehman Brothers promptly nose dived,

“...the financial market rollercoaster kicked up to a real E ticket ride...”

taking its last gasps in a 158 plus year life as it headed into Chapter 11 bankruptcy liquidation. Bar-

clays plc moved to purchase Lehman’s North American investment banking and trading operations as well as the New York headquarters building. American International Group, the American mega-insurer, requested and eventually received an \$85 billion credit facility from the Fed. The following weekend, both Morgan Stanley and Goldman Sachs, the last of the large investment banks, received permission from the Federal Reserve Board to become bank holding companies, accepting greater oversight in return for the access to more stable bank deposit capital. On September 25, Washington Mutual tanked and

was driven into the arms of JP Morgan Chase. By September 29, the FDIC brokered a deal for Citibank to purchase a wounded Wachovia. As October began, the Administration’s proposed financial intervention, now in Plan B mode, was the subject of contentious debate, with the Dow and NASDAQ suffering historic losses.

So what? So what do all these machinations mean to governments and their citizens? First, they increase debt carry costs. The lack of liquidity has driven up variable rates of interest, for both auction certificates and variable rate demand obligations. These short-term high points currently exceed long term interest rates. Long-term rates for munis have increased while Treasury yields have decreased on the flight to “ultra” quality – while the traditional flight to quality includes both Treasuries and high grade munis, this flight stopped only at Treasuries and did not extend to munis. The increased perception of risk by the general investing public has resulted in increases in long term tax-exempt interest rates in the absence of any increase in long term Treasury security rates. Moreover, the costs of liquidity and credit support have multiplied and show little sign of moderation in the near future. With fewer participating banks, supply

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REDEVELOPMENT FUNDS SHIFTED TO STATE

BY JAMES V. FABIAN, PRINCIPAL

Last week the Governor, at last, signed the 2008/09 State budget. The budget included a one year take away from redevelopment agencies of \$350 million or 7.7% of redevelopment agencies’ 2008/09 revenue. The payment must be made to the State prior to May 10, 2009, with no extensions possible and is subordinate to any existing bonded indebted-

ness. Redevelopment Agencies can use any available funds to make the payment. Agencies can borrow up to 50% of their current year contribution to its Low and Moderate Income Housing Fund (“LMIHF”), as long as the borrowing will not impair any current contracts and a finding is made there are no

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**SCHOOL DISTRICT
 G.O. BONDS ON
 THE RISE**

BY ADAM BAUER, SENIOR VICE PRESIDENT

Since the late 1990s, there has been a significant increase in the number of General Obligation (“GO”) Bond measures approved for California public school districts. A comparison of California Debt Investment Advisory Commission issuance records for two time periods shows that from 1995-1999 school districts issued \$8.0 billion in par amount of GO Bonds while during the period 2000-2005 California school districts issued \$33.4 billion in GO Bonds (see chart of GO Bond issues on back page). This considerable increase is a result of a number of factors detailed in this article.

Prior to explaining why there has been more GO Bond debt issued in recent years, it is important to understand how school construction and land acquisition are funded. Typically, California public school districts are funded through a matching program in which the State attempts to fund 50% of school site acquisition and construction costs, and the local school district funds the remaining 50%. However, many school districts have expressed that the State does not actually fund its full 50% share which leaves a gap. To pay for their share and to fill this gap, school districts use a variety of financing

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CALIFORNIA AT A WATER CROSSROADS

BY THERESA KOEHLER, ASSOCIATE

California has launched a series of water conservation programs. Initially, the public agencies responsible for ensuring water supplies were cautious in their response to the signs of a growing water crisis, perhaps fearing a political backlash from Californians who expect to be able to access free flowing water with the turn of a nozzle, without any sort of limitations. Adding a reservoir, drilling a few more wells or cutting deals with farmers to transfer some of their water to nearby cities has helped soften the effects of the state's growing water shortage. However, the situation is becoming sufficiently dire so that some water agencies are becoming more proactive to give the public a glimpse of the future for water supplies.

“There is an urgent need for comprehensive water reform...”

GOVERNOR ARNOLD
SCHWARZENEGGER

Earlier this year, the Metropolitan Water District of Southern California (MWD), the largest water agency in the region and the principal supplier to the cities of Los Angeles, San Diego and numerous others in between, officially notified its member agencies of its intention to implement a 30% reduction in deliveries of 2008 agricultural water supplies to agricultural customers. In other words, farmers will have less water for their crops and to ultimately sell to their cities' customers. The action was in response to a record low rainfall in Southern California, continued drought conditions throughout the southwestern United States, and the recent federal court ruling to limit pumping water from the state's San Joaquin-Sacramento River Delta to protect a species of fish.

In addition, the MWD also adopted a contingency plan that could result in similar cutbacks to urban consumers and rate hikes of up to 20%. Local water agencies, including the Los Angeles Department of Water and Power, have followed suit, beginning with voluntary conservation programs but warning of mandatory



conservation to come. Some agencies have passed the need to reduce consumption directly to the agricultural growers. Others pumped from limited local groundwater sources to continue deliveries to customers. Almost all agencies are urging conservation and changes in water use practices, including new restrictions on lawn watering. It is expected that every part of the state will begin to think seriously and creatively about water supply.

Ultimately, water rates and charges will need to increase in order to meet these increasing costs. At its March 2008 meeting, MWD's Board approved a 14 percent increase in overall rates and charges effective January 1, 2009. Under the new 2009 rate schedule, the Interim Agricultural Water Program's rates for treated and untreated water will rise to \$440 (12 percent increase) and \$297 (14 percent increase) per acre respectively, plus the \$25/AF surcharge on all water sales. It will not be long before we may see all municipalities adopt a water rate structure that will be more costly for customers who use more water.

U.S. Senator Dianne Feinstein and Governor Schwarzenegger have both acknowledged our record dry weather conditions throughout the state, which has accentuated the urgent need for long-term water solutions in California. In March, Governor Schwarzenegger proposed a 20 percent reduction in per capita water use by 2020. In response, at least six bills are now before Congress authorizing one or more temporary changes in existing water policy to alleviate drought impacts, as well as long-term drought planning, water transfer provisions, water pricing, and flows for in-stream uses. While most

of the bills emphasize short run provisions, a number of long-term institutional changes are proposed. Assembly Bill 2175, the Water Efficiency and Security Act, increases water use efficiency for new developments and contains global warming reduction measures. AB 2175 would require the state to conserve 3 million acre-feet of water by 2030. The legislation is supported by conservation organizations, including the Sierra Club, Desal Response Group and the Environmental Justice Coalition for Water.

The situation is so dire that Senator Feinstein and Governor Schwarzenegger have proposed a compromise plan to the Legislature to update California's water system by increasing storage, improving conveyance, protecting the Delta's ecosystem and promoting greater water conservation. "There is an urgent need for comprehensive water reform, and this bipartisan plan is offered as a potential compromise that puts us on the path toward restoring the Sacramento-San Joaquin Delta, expanding water supplies and promoting conservation efforts that will ensure a clean, reliable water supply for California," Governor Schwarzenegger said. In June, the Governor issued an executive order declaring a statewide drought, which directed his state agencies and departments to take immediate action to address the serious drought conditions and water delivery reductions that exist in California. He also proclaimed a state of emergency in nine Central Valley counties to address urgent water needs: Sacramento, San Joaquin, Stanislaus, Merced, Madera, Fresno, Kings, Tulare and Kern. Governor Schwarzenegger's recent executive order certifying that California is in a drought and directing state agencies to start thinking about what to do is only the latest sign that a way of life built on inexpensive and readily available water is coming to a close. For much of the state, June was the driest month on record, according to the National Climatic Data Center. The continuing water crisis raises the question of whether we are approaching the limits of growth in California. For

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EMMA — THE FUTURE FOR MUNICIPAL MARKET DISCLOSURE

BY JOSHUA LENTZ, ASSISTANT VICE PRESIDENT



Since 1995, the municipal market place has relied upon the SEC's designated Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) as the source for investors to obtain primary and secondary market disclosure on municipal debt offerings. However, the NRMSIRs have not been a consistent resource for receiving and distributing disclosure information for issuers, obligors or investors. The turn of this

century, has brought forth several innovations in streamlining the dissemination of data of to the NRMSIRs through such venues as DAC and DisclosureUSA. These sources have been somewhat successful, but have not provided a complete answer to the problems associated with dissemination of continuing disclosure information.

Now the Municipal Securities Rulemaking Board (MSRB) has created a system that parallels the centralized disclosure currently available for securities offerings by public companies through the SEC's EDGAR system. The MSRB's venue is called Electronic Municipal Market Access (EMMA), which is an electronic format that provides primary and secondary municipal market data along with real-time municipal bond trade price information. EMMA would eventually eliminate the need for the NRMSIRs. Furthermore, EMMA provides a detail index of disclosure information related to particular issuers and obligors.

Rule 15c2-12 currently requires underwriters to get commitments from issuers and obligors that the issuers and obligors will provide continuing disclosure information to the NRMSIRs. The SEC is now intending to amend Rule 15c2-12 to have underwriters get commitments from issuers and obligors that they will file continuing disclosure information only through EMMA. EMMA would provide investors with streamlined access to more information about municipal securities at no charge in order to make better investment decisions.

In a statement released by the SEC, Chairman Christopher Cox remarked about the turmoil of the municipal market and the proposed amendments to Rule 15c2-12, stating it would "bolster investor confidence in the municipal securities market, encourage improvement in the completeness and timeliness of investment disclosures, and foster increased interest in municipal securities by retail and institutional customers." The SEC expects to make a ruling on its amendments to Rule 15c2-12 and the implementation of the EMMA system later this fall. Until a ruling takes affect, the NRMSIRs will continue to be the designated venues for filing continuing disclosure information to municipal market place and issuers and obligors should continue to use services such as DAC or DisclosureUSA to comply with continuing disclosure obligations. ♦

THE TIMES THEY ARE A-CHANGING

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goes down and prices face upward pressure.

Second, in the long run, federal taxes seem likely to increase—at least over where they would have been absent the credit crisis. With a total national debt of about \$9.7 trillion, a bump of \$700 billion in one program from the proposed federal intervention has a real impact. Perhaps the federal government will recover a proportion of the investment, perhaps not. In the interim, the additional interest alone is in the tens of billions each year. Over time, the cost of the intervention has to be paid from somewhere.

Third, the relationship between governments and their investment banking firms may change in some subtle, but important, ways. With all major investment banks now regulated by the Fed as bank holding companies, they will face tighter constraints on the amount of leverage that they can apply to their businesses, including underwriting of securities. At this early point, we do not know how this might impact the actual distribution of bonds. There will be fewer national firms offering investment banking services. Moreover, we wonder whether the consolidation and changes in national firms will create opportunities available to be exploited by the more "regional" investment banking firms. A paradigm shift is underway. When Bob Dylan sang his protest song in 1963, America was being forever changed; the same is happening today.

What now? First, don't panic - but don't assume all the shoes have dropped. There may be more bad news. Second, remember that credit quality is even more important now (we said that in our last issue). Act accordingly by taking steps to effectively manage your finances and do a better job of communicating your situation to the market. Even in the recent "closed" market some transactions by issuers with good demographics and sound credit have closed. Finally, stay the course – if you are pulling together a financing, continue your plans. The market will continue to fluctuate and evolve for a time, and sticking to good fundamentals will be the best thing to respond to the changing times. ♦

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REDEVELOPMENT FUNDS SHIFTED

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other funds available to make the payment. The borrowed amount must be repaid within 10 years. An agency cannot use any funds in the LMIHF on July 1, 2008.

The estimated amount for each Redevelopment Agency's ERAF shift is posted on the CRA website, www.calredevelop.org, under "Impact of \$350 million Take away." ♦



SCHOOL DISTRICT G.O. BONDS ON THE RISE CONTINUED FROM FRONT PAGE

methods such as GO Bonds, developer fees, and mitigation agreements.

Of the several possible factors influencing the increase in GO Bond measures and issuance, the most prominent include the passage of Proposition 39, rapid escalation of assessed values, the State providing less than its 50% match, and pent up and increasing demand for school facilities.

With the passage of Proposition 39, California school districts were provided an alternative to the traditional election requirement of 2/3 voter approval for GO Bonds. Prop 39 allows for a school district to only require 55% voter approval if the district meets specific conditions. By lowering this threshold, GO Bond passage rates have increased and more school districts have been encouraged to place GO Bond measures on the ballot. As an example, on February 5, 2008 thirty-four school districts had GO measures on their ballots. The results were very positive - 27 of the measures were approved by voters resulting in a 79.4% passage rate.

The increased number of GO Bond issues can also be partially explained by provisions of Proposition 39. Formerly school district GO Bond issue par amounts were limited by either the maximum authorized amount of bonds approved by the voters or Government Code provisions with limits of 2.50% of taxable assessed value for a unified school district or 1.25% for a union school district. Since the passage of Prop 39, when a school district elects to seek voter approval through a Proposition 39 Election, an additional constraint is imposed

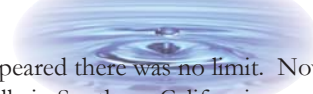
zation and issue sizes thus requiring school district is utilizing Prop 39 having to seek voter approval and sell bonds more frequently.

As an additional factor, rapid increases in assessed valuations have opened the GO window to many more school districts throughout California. In the last few years, it has not been uncommon to find a school district which has experienced 20% or more growth in assessed value – in one instance, a district experienced 45% growth in only one year! This growth increases the maximum amounts that can be issued, both under the traditional election revenue limit and the Prop 39 limit.

Since the passage of Proposition 39, school districts have experienced an overwhelming rise in the number of GO Bond measures presented and passed. School districts may be more inclined to seek voter approval knowing they only need 55% for a successful election. Along similar lines, voters may be more likely to approve a GO Bond knowing that the cost will be contained and their “Yes on 39” vote will help fund the needed improvements in their community schools. ♦

CALIFORNIA AT A WATER CROSSROADS

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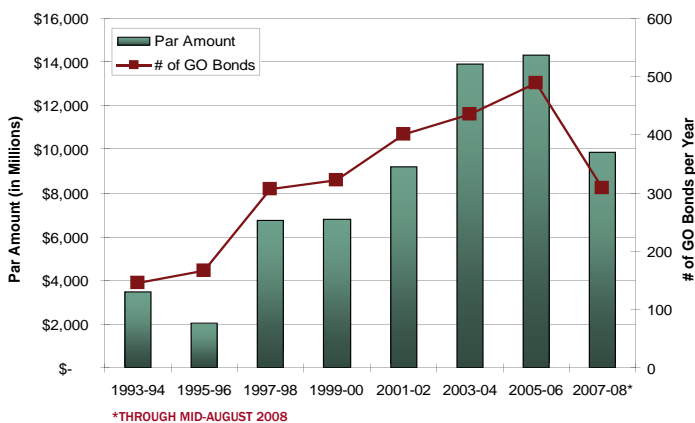


that last century, it appeared there was no limit. Now we may be at a turning point, especially in Southern California.

California is approaching a crossroad in water supplies. Without a plan of action by state and local governments, coupled with across-the-board changes in how we consume, major sectors of the state's economy such as agriculture and real estate development would soon face previously unimagined restrictions. Real estate development is already feeling the pressure of state laws that took effect six years ago requiring water agencies to document sufficient long-term water supplies to support large developments. If the water agencies cannot, then they must block the developments. Additionally, dozens of planned developments throughout Southern California already have been delayed or abandoned because of uncertainty about long-term water supplies. Beginning with the MWD's reduction in water supplies, agencies throughout the state are pressing farmers to cut their water consumption by not growing water-intensive crops, investing in more efficient irrigation systems and even taking land out of agricultural use altogether.

The entire economy ultimately will be affected by the water crisis. Yet it is unrealistic to expect that California's population and economy will stop growing. Accommodating that growth will require major commitments to reducing water consumption and increasing supply. The least expensive and easiest way to increase water supplies is conservation. Even small increases in the efficiency of agriculture's use of water can produce huge savings. Cutting back landscape irrigation, which accounts for more than half of urban and suburban consumption, is another alternative, as is treating and recycling water. We all have a part to play in our quest to prevent drought from devastating California. Making the most of water conservation, preventing pollution and appreciating the long-term benefits of stored supplies are integral actions to achieving water independence during dry times to come. ♦

ISSUANCE HISTORY OF SCHOOL GENERAL OBLIGATION BONDS



as a trade-off for having access to the lower 55% approval threshold. This additional threshold is a revenue limitation requiring a reasonable expectation that a unified school district will not tax more than \$60 per \$100,000 of taxable assessed value, and a union school district not tax more than \$30 per \$100,000 assessed value.

Legally, if needed, a school district may levy whatever amount is needed to pay the principal and interest on the GO Bonds. But, as would be expected, school districts take the reasonable expectation pledge seriously and are very reluctant to exceed the politically pledged limit. The result of the revenue limit is typically smaller GO Bond authori-