California Debt and Investment Advisory Commission

Interim Financing Options

October 1, 2009

Morgan Stanley

What Are Interim Financing Options?

- Commercial Paper (CP), BANs, GANs, RANs, TANs and TRANs are all forms of interim financing options

- Short Term Debt generally issued for one of two purposes:
  - Provide funds in advance of a long term financing solution, such as long term fixed rate debt or receipt of grant funding
    - ➢ Capital financing forms of interim financings could be a construction loan, commercial Paper (CP), bond anticipation notes (BANS) or grant anticipation notes (GANS)
  - To solve a projected cash flow deficit sometime during a fiscal year (revenue anticipation notes, tax anticipation notes, tax and revenue anticipation notes)

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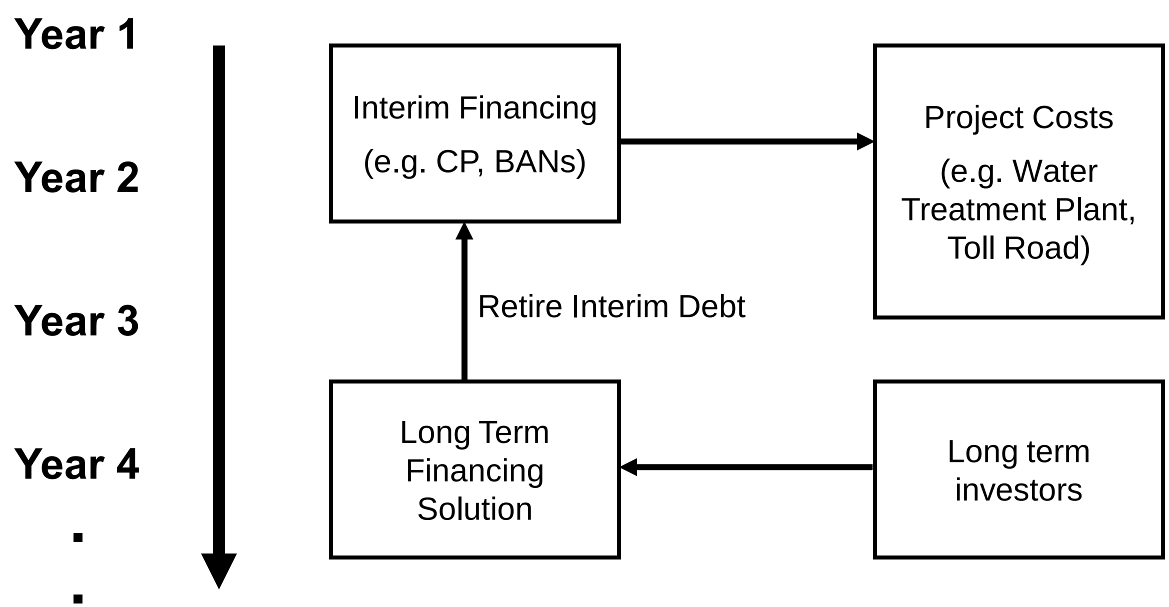
Interim Financing for Long Term Capital

- **Interim Financings for capital projects simply provide funds in advance of the receipt of long term funding sources**



- Interim financing used to access funds until project is built, thereby producing revenues (e.g., toll road) or when grant money can be received (e.g., matching funds from State or Federal Government)
  – Short term cost lower, with flexible repayment
  – More attractive terms for long term debt

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Interim Financings for Capital

- **BANs, GANs and CP are all financing forms that provide funds on a short term basis, with a permanent financing solution projected to retire them**

- Bond anticipation notes (BANs)
  - Accelerates project dollars ahead of long term financing solution
  - Typically one to several years in maturity
- Grant anticipation notes (GANs)
  - Accelerates project dollars ahead of Federal, State or other grants expected to be received
- Commercial Paper (CP)
  - Accelerates project dollars ahead of long term financing solution
  - Typically used for longer term or ongoing construction program – notes may be “rolled” upon maturity
  - Maturity limit of 270 days
  - Usually requires “external” credit support

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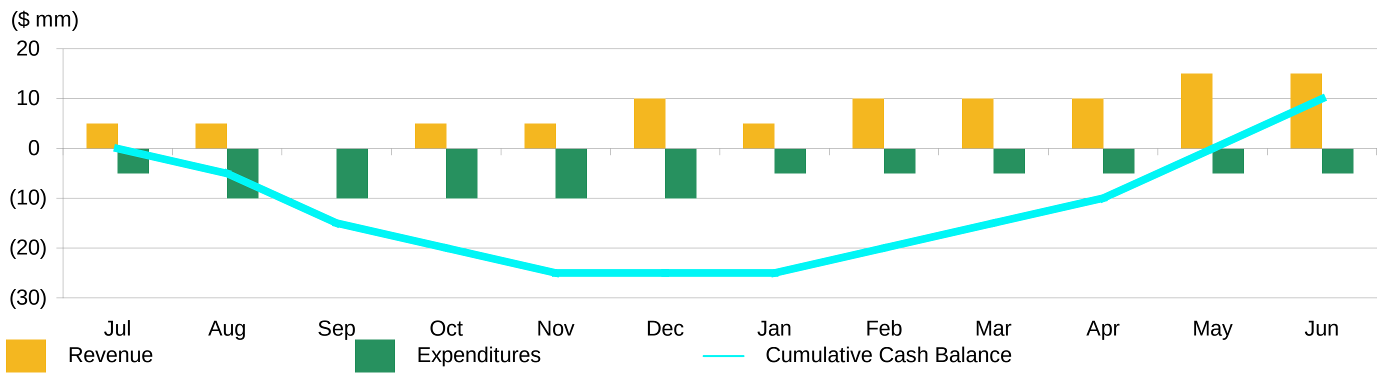
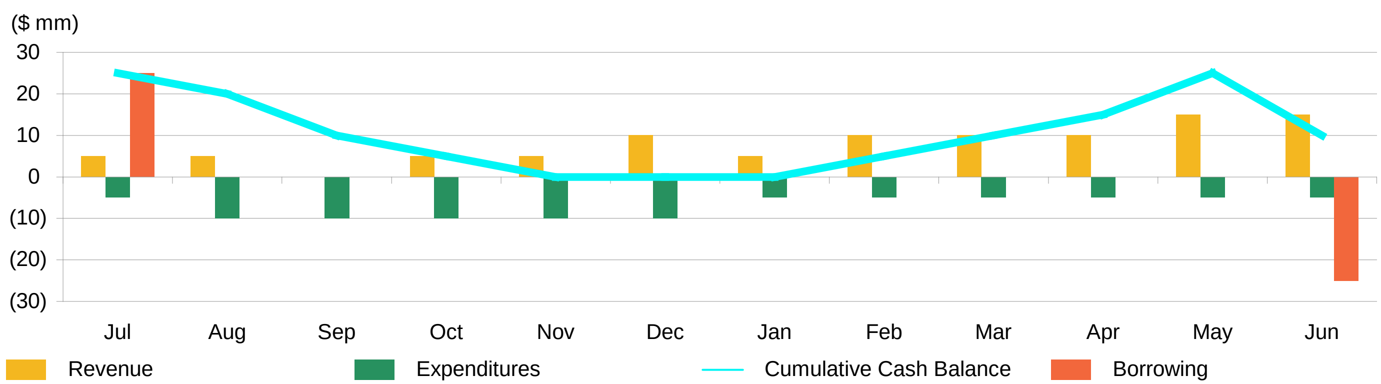
Interim Borrowing for Cash Flow Mismatch

- **Interim Financings for cash flow typically provide funds to solve an intra-year cash flow mismatch**

Without a Cash Flow Note



With a $25 mm Cash Flow Note



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Interim Financing Options for Cash Flow Purposes

- **RANs, TANs and TRANs are issued to solve a projected cash flow mismatch between anticipated revenues and expenditures**

- Revenue Anticipation Notes (RANs)
  - Issued to smooth cash flows from multiple revenue sources
  - State of California issues most years due to income and other tax timing issues
- Tax Anticipation Notes (TANs)
  - Issued in advance of the receipt of tax revenues
- Tax and Revenue Anticipation Notes
  - Local governments and school districts typically issue TRANs to smooth their cash position in advance of receipt of taxes and State funds

Tax and Revenue Anticipation Notes

- **Deficit Comparison – Actual to Projected Deficit will be compared**
- **Must have a *Reasonable Explanation* if Projected Deficit is Greater than Previous Year's Actual Deficit**

Short-Term Borrowings	Up to 12 Month Borrowing
Issue Date	On or after July 1
Maturity Date	Within 12 months
Purpose	• Even out monthly cash flow of general fund • Cover temporary cash flow deficits
Potential Market Benefit	• Potential revenues from "arbitrage"
✓ California Government Code 53650	• Limits borrowing amount to 85% of budgeted revenues • Limits term to 15 months
✓ Federal Regulations	Exempt from Arbitrage Rebate if sized within regulations

	Projected Cash Flow Deficit
Plus (+)	Working Capital Reserve
Equals (=)	Maximum TRANs Size

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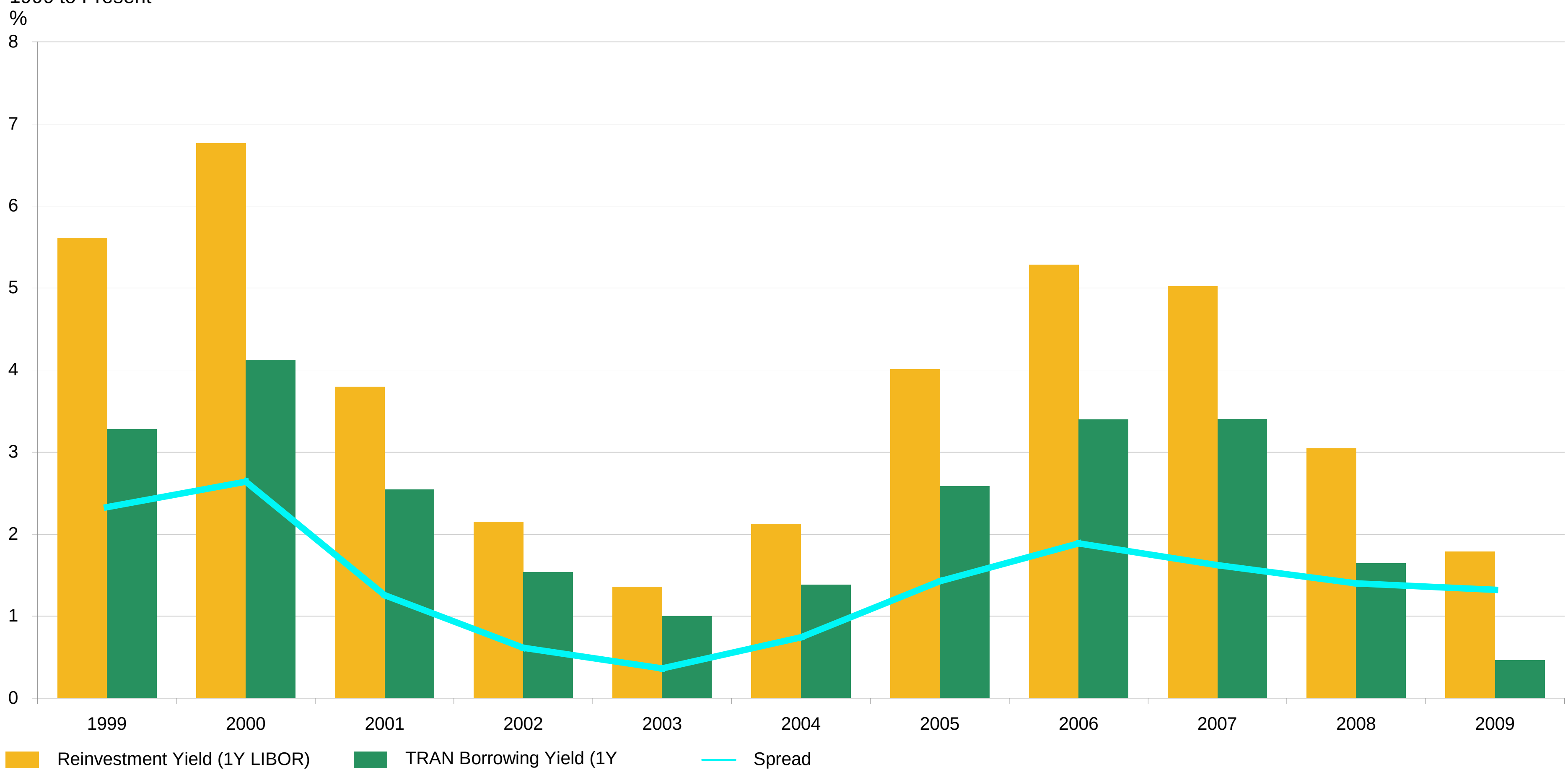
Tax and Revenue Anticipation Notes

Sample Interest Rate Spreads

Borrowing Costs vs. Reinvestment Rates

1999 to Present



Tax and Revenue Anticipation Notes

Examples of Restricted Cash

Good

- Capital Projects
- Encumbrances
- Substantiated Liability Reserves
- Debt Service Funds
- “Other People’s Money”

Bad

- **Contingency Reserves**
- **Emergency Reserves**

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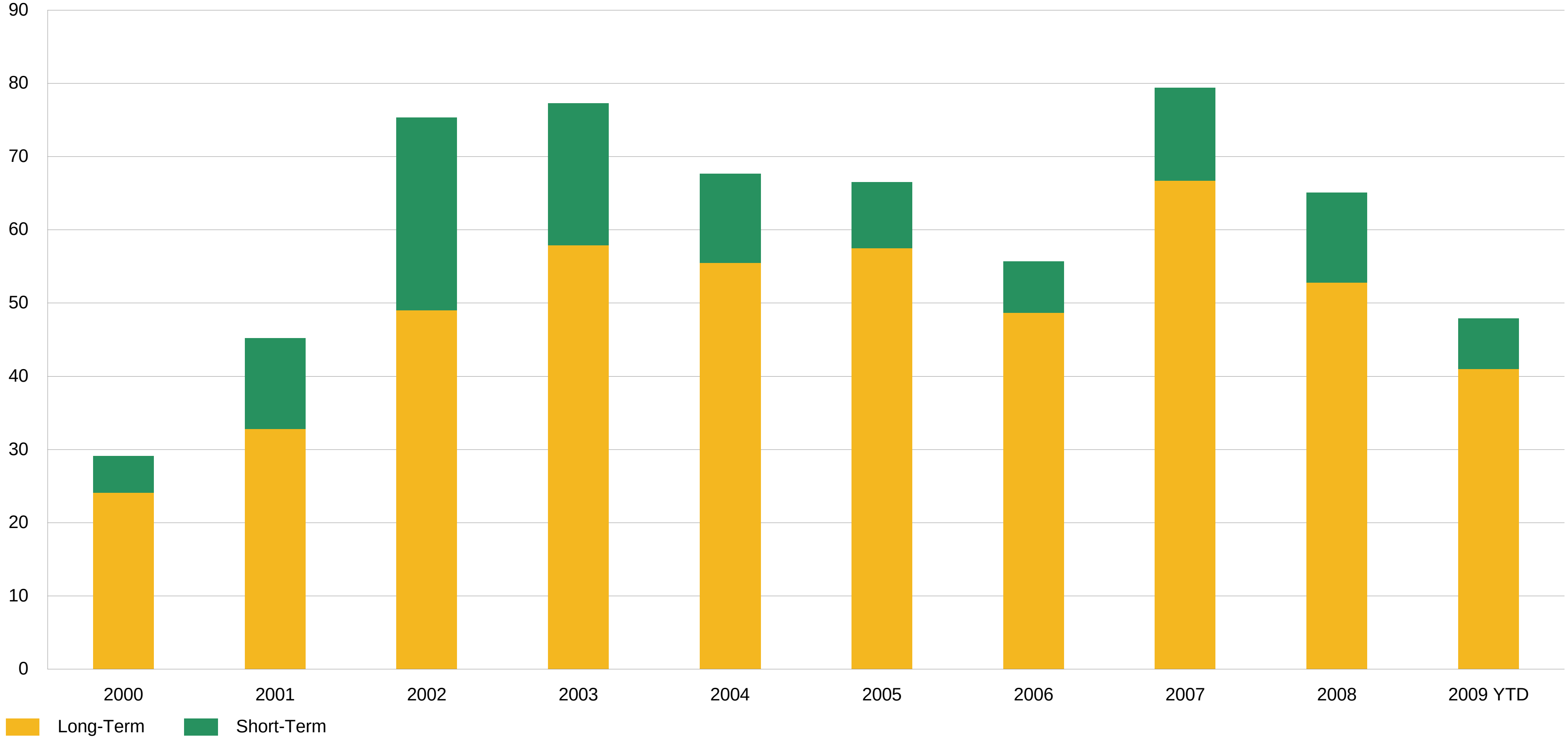
Short Term Financings

Short vs. Long-Term Financings

California Municipal Issues

2000 - Present
($ Billions)



Source Thomson Financial. 2008 figures reflect YTD volume as of 8/18/2009. Short term = 13 months or less

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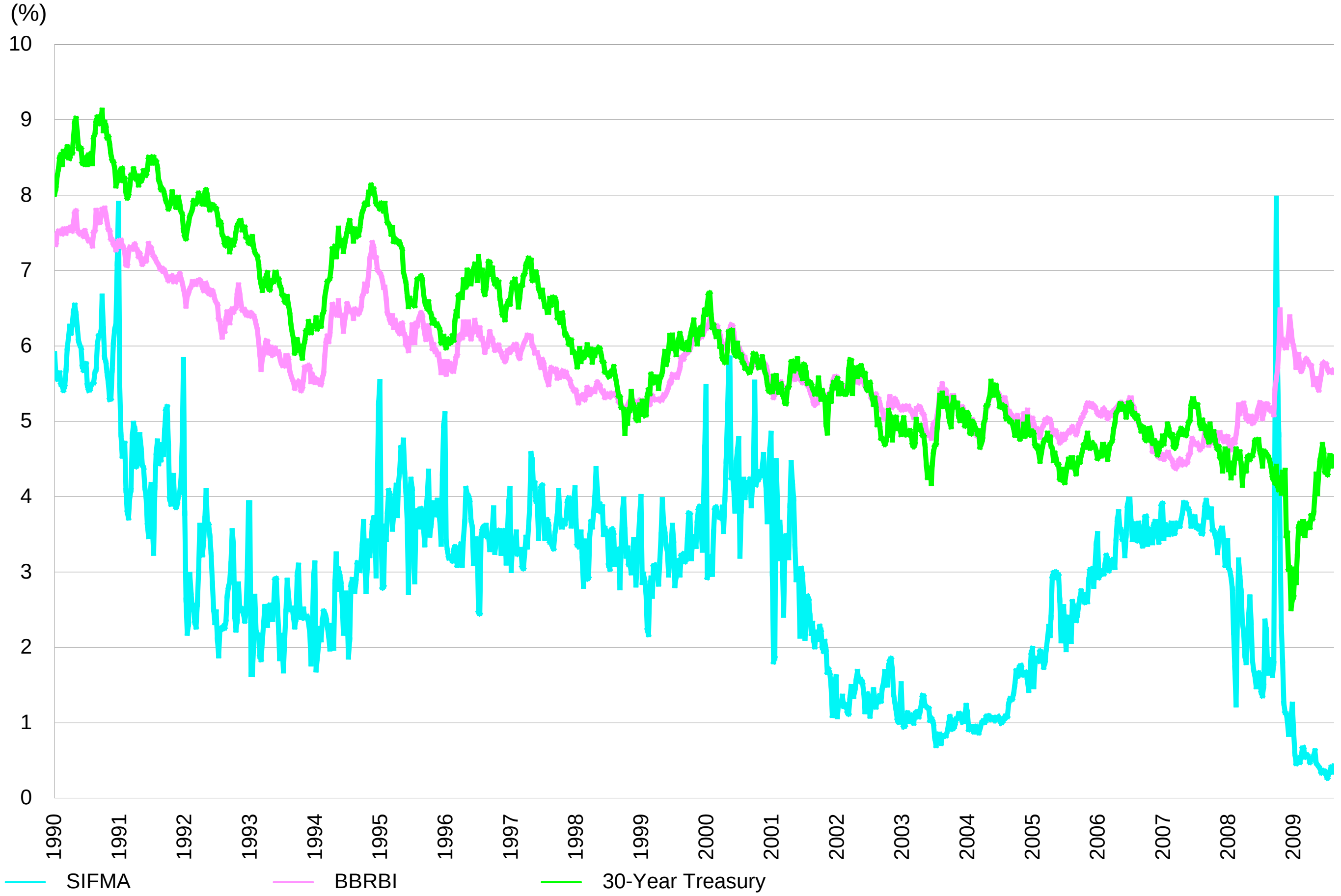
Historical Review of Interest Rates

Why Short Term?

- In general, short term interest rates have been lower than long term interest rates historically, providing interim financing techniques with lower costs until a long term financing solution can be implemented
- Flexibility of repayment also key feature

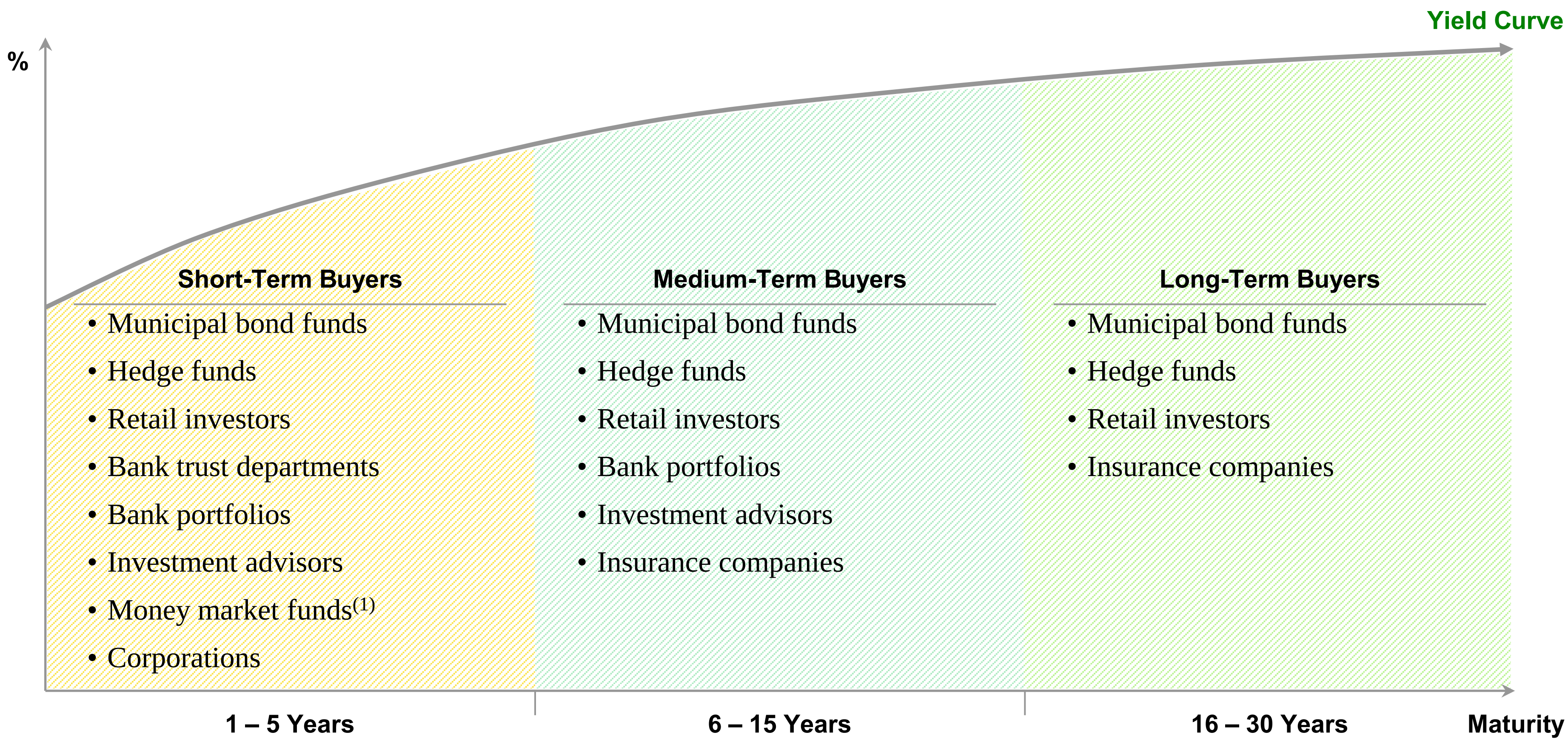
Short and Long Term Rates

1990 to Present



Source Bond Buyer; Morgan Stanley

Bond Buyers Vary by Maturity



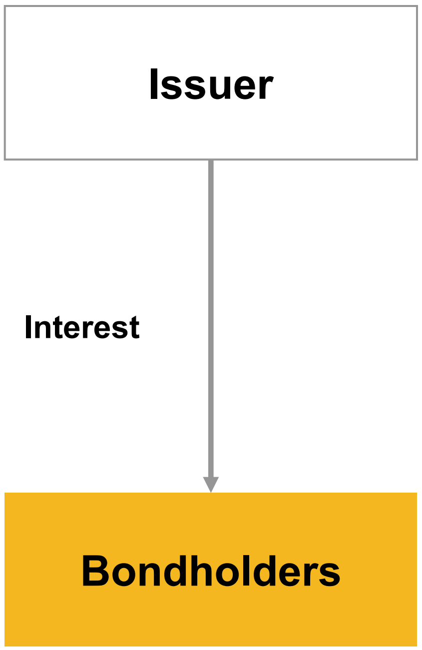
Source Morgan Stanley

Notes

1. Buyers of bonds maturing in thirteen months or less.

Long-Term Financing Options

Fixed vs. Variable Rate Debt



Fixed vs. Variable Rate Debt

	Pros	Cons
Fixed Rate Bonds	• Future credit and rate risk shifted to investors • Most common form of tax-exempt debt • Budget certainty	• Historically higher cost • Potentially expensive to restructure - typically not callable for 10 years • Little flexibility for borrower once the bonds are issued
Variable Rate Bonds	• Typically callable on any interest payment date at par • Historically lower rates than fixed rate debt • More efficient use of the yield curve – no premium built in for tax risk • Natural hedge results from short-term investments/operating cash	• Interest rate risk • Remarketing / liquidity risk • Element of budget uncertainty resulting from potential rate volatility

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State of California 2005-06 RANs

Transaction Summary

- **More than 50% of the notes were placed with retail investors, which was a record for the State's RANs program**

2005-06 RANs

Distribution

	($000)	%
Retail Sales	$1,613,790	53.8%
Institutional Sales	1,386,210	46.2%
	$3,000,000	**100.0%**

State of California

2005-06 Revenue Anticipation Notes

$3,000,000,000

State of California

2005-06 Revenue Anticipation Notes

Fixed Rate Notes

Interest Rate	Yield
4.50%	**3.00%**

Book-Running Senior Manager

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Transaction Summary and Results

- Morgan Stanley acted as book-running senior manager and led a syndicate of 12 firms in the pricing of this transaction.
- The 2005-06 RANs were structured as fixed-rate notes with a maturity date of June 30, 2006, and were priced with a 4.50 percent coupon and a 3.00 percent yield.
- Utilized a two-day retail order period to maximize retail investor demand.
- During the retail order period, more than 50 percent of the notes were placed with retail investors, a record for the State's RANs program.

County of Los Angeles 2007-08 TRANs

Transaction Summary

- **The County issued TRANs to help meet Fiscal Year 2007-08 General Fund Expenditures**

County of Los Angeles
2007-08 Tax and Revenue Anticipation Notes

$500,000,000

County of Los Angeles

2007-08 TRANs

Fixed Rate Notes

Interest Rate	Yield
4.50%	3.62%

Book-Running Senior Manager

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Transaction Summary and Results

- The Notes were structured as fixed-rate, with a maturity date of June 30, 2008, and were priced with a 4.50 percent coupon and a 3.62% yield.
- The Notes provided moneys to help meet General Fund expenditures, including:
  - –current expenses
  - –capital expenditures
  - –the discharge of other obligations or indebtedness of the County

County of Los Angeles Commercial Paper

Transaction Summary

- **Los Angeles County created a Commercial Paper Program in 1997 that is still used today**

County of Los Angeles

Commercial Paper Program

$335,000,000

County of Los Angeles

Commercial Paper Program

Co-Dealer:

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Transaction Summary and Results

- In July 1997, the Los Angeles County Capital Asset Leasing Corporation began issuing tax-exempt commercial paper to refund BANs issued by Health Facilities in the County
- The program was one of the first to utilize a lease revenue structure and includes abatement provisions in the lease documents
- The program has remained outstanding since that time, and was recently increased to $335,000,000 (authorized), in order to finance additional capital expenditures