

CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY

June 27, 2002

Agenda Item No. 5

Resolution No. 2002-04

Issue: Staff is requesting approval to complete the steps necessary to obtain bondholder consent for technical amendments to loan documents on certain CEFA pool and stand alone bond issues necessary to clarify security positions on existing and future debt.

Background: The Authority has issued over the past several years bonds for various colleges and universities having ratings below the “A” category. Bonds of this type require, by Authority policy, a gross revenue pledge as a form of security for bondholders. Language in the Indentures and Loan agreements normally permit the issuance of additional bonds for the borrowers, conditioned on meeting certain additional debt tests, that are on an equal or “parity” basis with the initial bonds as to revenue, deeds of trust and other security features.

It has been determined that on several CEFA bond issues, however, documents do not contain language that specifically allows additional debt on a parity basis, as was intended. Approximately 11-12 colleges and universities have CEFA bonds issued either as pools or stand alone transactions where the necessary security language requires amendment. The Authority previously worked with underwriters, bond counsel, the Attorney General’s Office and Moody’s Rating Agency to amend documents on two prior bond issues where the offering documents indicated that the new bonds would be on parity with the prior issues but the Indentures and Loan Agreements did not. In these cases, amendments were made to correct the documents based upon confirmation by Moody’s that they rated the bonds as parity debt and would not change the rating solely because of the proposed amendments. However, that procedure, which did not involve bondholder consent, was in response to an urgent situation because new bonds were already being sold when the document problem was identified. Due to the significant number of borrowers and issues that have now been determined to contain the limited language in the bond documents, staff believes obtaining bondholder consent is a more appropriate approach to solving this problem for the remainder of the borrowers.

Existing borrowers are impacted in various ways by this condition. For example, borrowers that have only one bond issue outstanding are not currently effected since their

secured debt has no other bondholders. If additional bonds are issued, however, the existing documents would at that time require amendments and bondholder consent. Conversely, if this borrower refinances its existing bonds, new bond documents would eliminate the problem language without the need to amend the old documents.

Some existing borrowers are directly impacted, however, because they have multiple bond issues already outstanding. Issues that were completed subsequent to the initial bonds in each case were intended to be parity debt, but, again, the language in the initial documents does not clearly allow the borrower to incur additional bond debt with equal security. Thus, there are some borrowers that are currently in technical default situations, needing amendments to bring bond documents into compliance with the intended security provisions.

Further, several CEFA borrowers have bonds outstanding through pools, where multiple colleges and universities participate in a single issue. While not all participants have multiple bond issues outstanding, they may still be impacted directly because bondholders own bonds of the entire pool, not bonds specifically designated to a certain college. Obtaining bondholder consent to amend documents relating to the pool would include documents for all borrowers in the pool.

Other Information: Staff has determined that certain borrowers having bond issues with the limited language are currently in the process of preparing for new bond issues while others are in preliminary stages for issues in the near future. For these borrowers, it is critical to assist with the technical corrections of the existing documents now, so that new bonds can be issued as parity debt. For other affected borrowers, correcting the problem now will keep them from having to do amendments at the time of future issues. Further, most CEFA bonds are held by a limited number of funds. Obtaining consent to amend all borrower documents at once will eliminate the need to return to those same bondholders multiple times for the same consent on different bond issues.

CEFA has been working with Prager, McCarthy & Sealy, the investment banking firm that sold all of the bond issues under discussion, and Orrick, Herrington & Sutcliffe, Bond Counsel on Western University, which is one of the colleges currently trying to issue new bonds but caught in the parity debt problem. We have agreed to begin the process of identifying bondholders through the DTC registration system in anticipation of requesting consent for the amendments to bond documents. Staff is also in the process of preparing letters from CEFA to each college and university impacted by the Indenture and Loan Agreement language. The letters would explain the situation as it effects each particular borrower and would request their acknowledgement of the proposed approach of obtaining bondholder consent to resolve this issue, or their response regarding other action the college may want to pursue.

Another minor task for the Authority has been identified as a result of reviewing these bond documents. For a gross revenue pledge by a particular college to be enforced, each bond issue secured by the pledge must have the same Indenture Trustee. It has been determined that some borrowers participating in CEFA pools have more than one

Trustee, due to participation in multiple pools or having other stand-alone bond issues outstanding. It is likely CEFA will need to replace the Trustee on one or more pools, depending on the mix of participation by various colleges in each pool.

One final item of this discussion is that of cost. Significant costs have already been incurred in the review of bond documents and identification of those borrowers that are impacted by this parity debt issue. Prager, McCarthy & Sealy has contracted with Bondholder Communications Group, a firm specializing in the identification of bondholders and assisting with obtaining consent for document amendments. Prager, McCarthy & Sealy and Orrick, Herrington & Sutcliffe have proposed an overall cost of reviewing the existing bond documents, obtaining bondholder consent and making the technical corrections for each college and university to not exceed \$350,000. They have also suggested a sharing of the cost by all parties involved with the original bond documents, including bond counsel, the underwriters and underwriter counsel, CEFA/CEFA's counsel and the borrowers/borrower's counsel. Staff believes that while the bond documents in question were initially prepared by bond counsel and a majority of the responsibility should rest there, all other parties in the transactions had the opportunity and responsibility to review the documents on each and every transaction and that some shared arrangement of costs may be appropriate.

Staff, however, is not at this time comfortable with either the estimated costs or the firms that are being utilized. Prager, McCarthy & Sealy, as the investment banker on all of the bonds discussed, is properly in one of the leading roles on this project. However, staff believes that the bond counsel firm, which was also on all of these bond issues and will be sharing in the costs associated with the corrections, should be utilized for this process, rather than having other bond/underwriter counsel firms making corrections and adding to the costs. Staff believes that the existing document irregularities must be corrected and that the bondholder consent process is the correct cure. Moving forward on this process will allow Western University to complete the previously approved bond issue without having to refinance other outstanding debt. However, staff believes that further discussion is necessary to determine the appropriate parties to assist with this overall process, the costs associated with the corrections, if any, and the proper distribution of those costs.

Recommendation: Staff recommends the Authority approve the request to authorize staff to take the necessary steps in obtaining bondholder consent for amendment of those bond documents determined to lack the intended security provisions. Staff additionally recommends the Authority direct staff to determine the appropriate parties for this process, reasonable overall costs, if any, and shared percentages among the parties and provide the results to the Chairperson.