BOARD OF DIRECTORS DISCUSSION AND ACTIONS

February 13, 2009

Chair Lori Holt Pfeiler (Escondido) called the meeting of the SANDAG Board of Directors to order at 10:05 a.m. The attendance sheet for the meeting is attached.

1. PUBLIC COMMENTS/COMMUNICATIONS/MEMBER COMMENTS

Lorraine Leighton, a member of the public, said that on January 25 as she was on her way to the El Cajon Transit Center, she had a discussion with a bus driver related to the validity of the Compass Card versus a monthly pass. She asked that clarification be given to bus drivers about the various fare media.

Councilmember Lesa Heebner (Solana Beach) provided information about Nature and Culture International, a nonprofit organization that allows Solana Beach residents and businesses to purchase rainforest property in Ecuador to offset their carbon footprint. The goal is to buy enough land to match the size of Solana Beach. The cost of this effort is $50 per acre. If anyone is interested in following this model, please contact her.

REPORTS (2 through 4)

2. *TransNet* EARLY ACTION PROGRAM FINANCING OPTIONS (APPROVE)

Chair Pfeiler announced that Keith Curry with Public Financial Management (PFM) has recently joined the ranks of elected officials in Newport Beach.

Renée Wasmund, Director of Finance, introduced Mr. Curry and Andrew McKendrick with PFM, and noted that Mr. McKendrick is our swap expert.

Ms. Wasmund stated that in December 2005 the Board approved a *TransNet* financial strategy for implementing the Early Action Program (EAP) of projects and for fulfilling ongoing commitments for the existing *TransNet* program. This financial strategy included the expansion of the existing Commercial Paper program from $135 million to $335 million to provide cash flow until the bonds were issued. The strategy also included the issuance of $600 million of long-term variable rate debt in March 2008 along with locking in low interest rates through an interest rate exchange agreement (swap). This strategy has been executed and has resulted in significant progress on the EAP projects over the last three years.

Ms. Wasmund said that we have been providing monthly reports to keep the Board up-to-date on the financial markets. We have two liquidity facilities. A liquidity facility is like a letter of credit. One of them, with JP Morgan, expires at the end of March 2009. We issued a Request for Quotes to 22 banks to replace that liquidity facility. PFM called every bank multiple times encouraging them to bid on this request. However, JP Morgan was the only respondent, and its bid is at 105 basis points. We are currently paying 20 basis points. This bid is reflective of the current market environment and tight credit situation.

Ms. Wasmund reviewed the benefits of accepting this bid, stating that JP Morgan-supported variable rate bonds are trading at near all-time record lows, thereby reducing the cost of borrowing. It also would continue our business relationship with a highly rated credit provider, increasing our opportunity for renewal. The downside is that this bid is 85 basis points higher than the current agreement.

Ms. Wasmund said that we did consider another option, which would be to issue a one-year bond anticipation note. This would allow us to convert $300 million of our variable rate debt into a short-term fixed rate for one year. We would waive 85 basis points and potentially lower our costs, but there also are costs of issuance. The downside is the that we would not know the exact interest rate until closure at the end of March, and we would be subject to whatever the one-year note rate is at that time. Also, the JP Morgan bid would not be valid at that time. Re-entering the variable rate bond market presents a risk. Selling another one-year bond a year from now also presents a risk. In addition, this option would require significant default provisions.

Ms. Wasmund stated that after considering both options, it is our opinion that renewing with JP Morgan would contain less risk than the one-year anticipation bond note option. Our current financial strategy is for the long-term. This liquidity renewal would be for one year. We discussed the bid and the bond anticipation note option with the Independent Taxpayer Oversight Committee (ITOC), and it agreed with the staff recommendation to amend the current SANDAG agreement with JP Morgan to renew the liquidity facility at 105 basis points.

Second Vice Chair Jack Dale (Santee) asked about the risk of the liquidity facilities. Ms. Wasmund replied that we have two liquidity facilities: JP Morgan for one year, and a second one with Dexia for five years. We purposely staggered them so they would not renew all at once. If we had gotten a bid for longer than a one-year term, we would have preferred that, but we only received one bid for a one-year term.

Second Vice Chair Dale asked about the risks associated with the one-year bond anticipation note. Mr. Curry replied that there are different consequences: you might not be able to obtain a bid from other providers, you might not have a comparable bid, there would be a cost of issuance, and there would be costs to resale the note. The perspective to keep in mind is that in this current economic climate, you can no longer sell bonds and forget about them. You have to monitor them closely. Renewing with JP Morgan is a cost-effective, money-saving strategy for SANDAG. It is important to note that both your bonds and the interest rate swaps have performed admirably in the market. Even with this additional cost, SANDAG is well below what it would have paid with fixed-rate bonds.

Chair Pfeiler reiterated that both options are for one year. Going with the JP Morgan bid appears to be less risky than the one-year bond anticipation note option.

Councilmember Matt Hall (Carlsbad) asked if any other costs are incurred for these transactions besides the interest rate. Mr. Curry responded that your bond cost is increasing, but there is no additional cost above that.

<u>Action</u>: Upon a motion by Councilmember Tony Young (City of San Diego) and Mayor Jim Wood (Oceanside), the Board of Directors authorized the Executive Director to amend the current agreement with JP Morgan to renew the liquidity facility on Series A and B bonds for 364 days through March 23, 2010, at a rate of 105 basis points (1.05%). Yes – 19 (weighted vote, 100%). No – 0 (weighted vote, 0%). Abstain – 0 (weighted vote, 0%). Absent – None.

2A. PROPOSED AMENDMENT TO *TransNet* EXISTING INTEREST RATE SWAPS (APPROVE)

Ms. Wasmund reported that after the voters approved the *TransNet* Extension, in January 2005 the SANDAG Board of Directors started down the path of identifying an EAP to jumpstart high-priority projects. We used our Commercial Paper program to fund that program, in advance of the sales taxes that started in 2008. Also in 2005, we were in a period of historically low interest rates. We couldn't issue any debt prior to when the *TransNet* Extension took effect in 2008, so as part of the Board's financing strategy, we used interest rate exchange agreements (swaps) as a mechanism to take advantage of those historically low interest rates.

She explained how the swaps work. LIBOR (London Interbank Offered Rate) is a taxable rate, so assuming a marginal income tax rate of 35 percent, then 65 percent of LIBOR would approximate the tax-exempt rate, which is what our bonds trade at. SIFMA (Securities Industries and Financial Market Association) is a tax-exempt rate and also should approximate the rate at which our bonds trade. Swaps were set up to convert from LIBOR to SIFMA after ten years (in 2018) in order to limit our tax risk. Tax risk is the risk that income tax rates will be lower in the future, which would cause the LIBOR amount received to be less than the variable rate we pay on the bonds. For example, if the marginal income tax rate dropped to 30 percent, then we would need to receive 70 percent of LIBOR to approximate the tax-exempt rate, but we would only be receiving 65 percent.

Current market conditions have created an unusual situation that may be an opportunity to lower our borrowing costs by amending two of our three swaps. This unique opportunity would allow us to take advantage of the current credit market. Recently, the ratio between LIBOR and SIFMA has increased dramatically due to a number of factors: lack of liquidity, the breakdown in the similar markets for fixed-rate taxable and tax-exempt bonds, and the bankruptcy of Lehman Brothers. This imbalance in the LIBOR and SIFMA swap markets allows us an opportunity to amend the SIFMA piece of the existing swaps by overlaying another swap. This would significantly reduce the cost of financing beginning in 2018, assuming a return to normal or even near to normal trading relationships.

Based on the current market, we could enter into a swap and receive 98 percent of LIBOR and pay SIFMA. We expect our bonds to trade at SIFMA, which is also approximately equal to 65 percent of LIBOR. If we're receiving 98 percent of LIBOR, then the difference of 33 basis points is our positive cash flow. This is effectively changing the future receipt of the swaps from SIFMA to a high percentage of LIBOR.

A table with historical information from the last 19 years was presented comparing a receipt based upon 98 percent of LIBOR versus one based upon SIFMA. It showed that historically 98 percent of LIBOR is 136 basis points more than SIFMA. Translating that into dollars, a receipt based upon 98 percent of LIBOR would mean an annual benefit of $4.4 million for both swaps. This assumes the current marginal tax rate of 35 percent. If marginal income tax rates were to increase, then SANDAG would receive a higher benefit. A reduction would result in a lower benefit.

Ms. Wasmund explained that what we proposed to do is set a target rate, for example, 100 percent of LIBOR, for entering the swap. With a target rate of 100 percent, it's important to understand that the only way SANDAG would be worse off is if tax-exempt rates are greater than taxable rates. That situation has only occurred in four months over the last 19 years. In exchange for this additional benefit, we would be accepting tax risk, but because of the current market anomaly that allows us to receive 100 percent of the taxable rate, there really is no tax risk. We reviewed this proposal with ITOC at its meeting this week. ITOC did not take any action but asked us to give them an update at its March meeting.

Our recommendation at this time is that the Board concur with the recommendation from our financial advisors, PFM, to solicit interest for a transaction such as the one just described. We plan on returning to the Board on February 27 with further discussion and possible action.

Supervisor Jacob asked about the potential risks of doing this. Mr. Curry responded that the reason why you want to convert swaps to the SIFMA index is that we cannot predict federal tax rates. If tax rates are lower, a rate of 65 percent of LIBOR is less than your bond payment. 100 percent of LIBOR assumes there is no income tax. That best imitates the risk in the market. This transaction would provide about $4 million in annual cash flow to SANDAG. The market disruption has disadvantages due to the cost of liquidity. The disruption in the market is providing an opportunity for a benefit.

Councilmember Hall asked about the state of the economy during those four times in the past when tax-exempt rates were higher than taxable bond rates. Mr. McKendrick replied that three of those months were recent and relate to the liquidity roles in the tax market. As the poor performing banks have been replaced as liquidity providers with better quality banks, the relationships are starting to realign. There was a problem in the last year in the disruption of the tax-exempt variable rate market.

Mayor Crystal Crawford (Del Mar) pointed out that the chart begins in 1990 and asked if that is when this information first became available. Mr. McKendrick answered that LIBOR has been around longer. The index for weekly tax-exempt municipal debt has been around, but it has not been a reliable index.

Mayor Crawford asked if the numbers in the chart are representative or if they are anomalies. Mr. McKendrick replied that tax rates were substantially different in earlier years, which would make this strategy look more advantageous.

Mayor Crawford commented that she felt confident you wouldn't ask for this transaction if you weren't sure this is a good strategy. She asked if there is any historical information this

Board should be aware of that might give us pause. Mr. McKendrick stated that some of the older data would actually make this opportunity look even more attractive.

First Vice Chair Jerome Stocks (Encinitas) asked why the swap counter party would be interested. Mr. McKendrick said that from a bank's point of view, we would be acting as a market banker. On the other side of the market is two pieces: taxable and tax-exempt. Interest rates for tax-exempt are higher than the taxable market. It is pulling together those two markets for one transaction for us. Usually the intermediary is making a small spread, and that's where the profit is made.

Councilmember Heebner clarified that we would be using this overlay to protect ourselves even more and make some money. Mr. Curry said that when we entered into the swap four years ago, it was at 65 percent of LIBOR. If we had tried to get 98 percent or 100 percent of LIBOR at that time, we would have paid more. The ratio has changed, and therefore we would like to restructure the swap structure to take advantage of this opportunity.

Supervisor Ron Roberts (County of San Diego) commented that we got into this because we wanted to get started before the *TransNet* revenues became available. Ms. Wasmund said that we took advantage of historically low rates at that time.

Supervisor Roberts clarified that the cash flow from *TransNet* could not be borrowed against before 2008. He asked if we are in a position to borrow now.

Mr. Curry stated that you went into this transaction for purposes of locking in capital at low interest rates. Had you not done that you would have paid $5.5 million more than what you did four years ago. This did not advance money, but locked in the cost for another 29 years at low interest rates. We think we can improve upon this result for the future with the proposed swap agreement.

Supervisor Roberts reiterated that this transaction will save money compared with going out to the bond market at this time. Mr. Curry replied that it would be saving SANDAG money. If SANDAG were to sell bonds now, it would pay an interest rate of 5 to 5¼ percent. The current proposal would result in one of the lowest possible rates of any entity in California.

Action: Upon a motion by Mayor Wood and second by Mayor Mark Lewis (El Cajon), the SANDAG Board of Directors concurred with the recommendation from our financial advisor, Public Financial Management, to solicit interest to possibly amend the existing interest rate swap. Yes – 19 (weighted vote, 100%). No – 0 (weighted vote, 0%). Abstain – 0 (weighted vote, 0%). Absent – None.

3. COMPASS CARD STATUS UPDATE (INFORMATION)

James Dreisbach-Towle, Principal Technology Program Analyst, stated that since the last report in December 2008, we have completed installation of the necessary equipment for the Compass Card system. We began a testing phase to get ready for public launch. We had designed a series of soft launches with COASTER and Premium Express services to work up to the complete rollout in July 2009. Testing has revealed two issues. One is a software bug that results in intermittent software problems with stand-alone validators on contract and suburban buses, preventing Compass Cards from functioning properly. The second issue is one related to configuration, which has resulted in inconsistent test results when cards are tapped for rides on, and transfers between different services. We have since applied a patch to the software issue and it is under testing. Early indications are that this software patch is working. We will wait ten days, then will push the patch out to the remainder of the vehicles in the region. We want to have a good 30 days of testing.

Mr. Dreisbach-Towle said that we have changed our business rules over the last few years. We made a decision that our monthly pass users would only tap on when boarding a service. However, we discovered an issue in transferring between services. If you didn't tap off it would allow you to continue the ride on a different mode. Transferring between modes needs to be seamless to our passengers yet protect operator revenues. We have identified the issue and will implement new business rules beginning next week.

Therefore, we will not make the start rolling out the Compass Card to COASTER and Premium Express services on March 1 as originally planned. We will start retesting systemwide. When all three agencies are comfortable, we will start the COASTER and Premium Express service launch. The overall July 1 implementation date is still on track. We are in constant communication with the transit operators, and are holding weekly and daily team meetings.

We also have a whole marketing campaign to reach out to our customers. We are implementing a very extensive ambassador program, with people on rail platforms and on buses.

The delay in implementation of the Compass Card will not conflict with the amended language of the Regional Comprehensive Fare Ordinance. We will provide a status report every month. Next steps are to get the software patch out to the remainder of buses and get comfortable with the new business rules.

Supervisor Roberts said that he recently had a meeting with Walt Zable of Cubic Corporation. Cubic is the largest company providing automated technologies. He received reassurance that Cubic is cooperating with us to get this program operational.

Supervisor Roberts said that we should do everything possible to help our passengers through the transition to this new system. He suggested a business plan be developed to handle unanticipated problems that might arise. We also should figure out how to deal with situations so passengers are not placed in fare conflicts with drivers. He thought that a lot of people may not initially understand the new system, and we have more work to do to get ready for systemwide implementation. He was glad to hear about the ambassador program.

Mayor Art Madrid (La Mesa) asked what type of training is in place for drivers. Mr. Dreisbach-Towle replied that we developed a training package and have met with each driver. That training will continue on an annual basis, at a minimum. In the interim, we will continue to meet with drivers.

<u>Action</u>: This item was presented for information only.

4. CLOSED SESSION: CONFERENCE WITH LEGAL COUNSEL CONCERNING INITIATION OF LITIGATION: Pursuant to Government Code Section 54956.9(c) - ONE POTENTIAL CASE

Chair Pfeiler convened the meeting into a closed session at 10:55 a.m. She reconvened the meeting into open session at 12:06 p.m. Chair Pfeiler stated that there were no reportable actions from closed session.

5. UPCOMING MEETINGS

The next Business meeting of the Board of Directors is scheduled for Friday, February 27, 2009, at 9 a.m. The next Policy meeting of the Board of Directors is scheduled for Friday, March 13, 2009, at 10 a.m.

6. ADJOURNMENT

The meeting was adjourned at 12:06 p.m.

DGunn/M/DGU

ATTENDANCE
SANDAG BOARD OF DIRECTORS' MEETING
FEBRUARY 13, 2009

JURISDICTION/ ORGANIZATION	NAME	ATTENDING
City of Carlsbad	Matt Hall (Member)	Yes
City of Chula Vista	Cheryl Cox (Primary)	Yes
City of Coronado	Carrie Downey (Primary)	Yes
City of Del Mar	Crystal Crawford (Primary)	Yes
City of El Cajon	Mark Lewis (Primary)	Yes
City of Encinitas	Jerome Stocks, 1st Vice Chair (Primary)	Yes
City of Escondido	Lori Holt Pfeiler, Chair (Primary)	Yes
City of Imperial Beach	Jim Janney (Primary)	Yes
City of La Mesa	Art Madrid (Member)	Yes
City of Lemon Grove	Mary Sessom (Primary)	Yes
City of National City	Ron Morrison (Member)	Yes
City of Oceanside	James Wood (Member)	Yes
City of Poway	Don Higginson (1st Alt.)	Yes
City of San Diego – A	Tony Young (1st Alt.)	Yes
City of San Diego - B	Ben Hueso (Primary, Seat B)	Yes
City of San Marcos	Jim Desmond (Member)	Yes
City of Santee	Jack Dale (2nd Vice Chair)	Yes
City of Solana Beach	Lesa Heebner (Primary)	Yes
City of Vista	Judy Ritter (Primary)	Yes
County of San Diego - A	Dianne Jacob (Primary, Seat A)	Yes
County of San Diego - B	Ron Roberts (1st Alt.)	Yes
Caltrans	Pedro Orso-Delgado (1st. Alt.)	Yes
MTS	Harry Mathis (Member)	Yes
NCTD	Bob Campbell (Primary)	No
Imperial County	Victor Carrillo (Member)	No
US Dept. of Defense	CAPT Steve Wirshing (Member)	No
SD Unified Port District	Laurie Black (Member)	Yes
SD County Water Authority	Mark Muir (Primary)	Yes
Baja California/Mexico	Remedios Gómez-Arnau (Member)	No
Southern California Tribal Chairmen's Association	Robert H. Smith (Member)	No