08/05/08-12.

Agenda Item #:

Staff Report
City of Manhattan Beach

TO: Honorable Mayor Montgomery and Members of the City Council

THROUGH: Geoff Dolan, City Manager GD

FROM: Bruce Moe, Finance Director
Sharon Koike, Assistant Finance Director
Henry Mitzner, Controller

DATE: August 5, 2008

SUBJECT: Status Update on the Reinvestment of the Debt Service Reserve Fund for the Metlox Parking Structure Bonds, and Current Status of the Investment Contracts for the Police & Fire, and Water/Wastewater Debt Service Reserve Funds

---

RECOMMENDATION:
Staff recommends that the City Council receive and file this report.

FISCAL IMPLICATION:
The total principal amount of funds held in debt service reserves in investment contracts totals $1,988,575. This includes funds for the Water/Wastewater, Police/Fire and Metlox bond issues.

DISCUSSION:
As a result of the issuance of debt for various projects, legally required debt service reserve funds were established, and are held by the trustee for each issuance. These funds are invested, with the income generated utilized to reduce the overall debt service. The funds will be held in reserve until the final year of debt service payments, at which time the funds will be drawn down and used for the debt service payments.

Several of the City's debt issues involved investing the reserve funds in Guaranteed Investment Contracts (GIC's) with insurance carriers. These include:

City of Manhattan Beach Debt Service Reserve Investment Agreements

Issue	Provider	Rating	Par Amount	Interest Rate	Status
Police/Fire COPs	AIG	AA-/Aa3	$ 817,075	4.55%	Collateralized
Metlox	MBIA	AA/A2	$ 871,500	4.95%	Cancelation in Progress
Water & Waste Water	AIG	AA-/Aa3	$ 300,000	6.06%	Collateralized

Recent turmoil in the financial markets have impacted the credit rating of these insurers, both of which were once rated AAA/Aaa, but have since been downgraded to AA/A2 (MBIA) and AA-/Aa3 (AIG). In the case of MBIA, the downgrades have resulted in the City having the option of cancelling the investment agreement since their financial outlook has deteriorated. AIG, while having been downgraded, has not reached the point where we have the ability to cancel the GIC. However, they have been required to collateralize the agreement.

In reviewing our options, staff concluded, as did the Finance Subcommittee, that the most cautious and conservative action to take at this time is to cancel the investment agreement with MBIA, and move the funds to the Trustee, U.S. Bank. That decision was based upon the fact that MBIA is a mono-line insurance company, whose sole business is insuring municipal debt issues. Given their downgrade by the rating agencies, it is clear that their potential for future business is greatly reduced, which could potentially lead to financial failure. While we considered allowing MBIA to collateralize the GIC, there was some concern that in the event of bankruptcy, we may not remain whole. As a result, the most prudent action is to cancel the contract and move the funds.

Our GIC requires MBIA to perform a make-whole calculation if we choose to cancel the contract due to downgrades. While the make-whole calculation is intended to offset any loss in earnings we may experience from cancelling the GIC with MBIA and reinvesting at a lower rate, it does not guarantee that we will be able to enter into another GIC, or that what we actually reinvest in will be supplemented in order to receive parity with the original instrument. Staff will be negotiating the final make-whole amount with MBIA, as well as determining the appropriate replacement investment instrument.

Staff will keep the City Council apprised of any further developments with this issue.