Town of Yountville
"The Heart of the Napa Valley"

Agenda Date: March 18, 2008
Agenda Item: 10
Reviewed by Town Manager:
SDC

Yountville Town Council
Staff Report

TO: Mayor and Town Council

FROM: Richard Stranzl, Finance Director

SUBJECT: KNN Community Center Financing Update – Presentation Only

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BACKGROUND / DISCUSSION

This item is for the presentation, by a representative of the public financing firm Kelling, Northcross & Nobriga (KNN), of current conditions in the financial markets as they may relate to the financing of the Community Center/Library Project. The attached memorandum includes information concerning the method of sale of the bonds, and a timeline for the various actions that may be associated with the financing effort.

FISCAL IMPACT

Is there a Fiscal Impact? No

Is it currently budgeted? N/A

Where is it budgeted? N/A

Is it Mandatory or Discretionary? Discretionary

Is there a Staff Resource Impact? No

ALTERNATIVES

N/A

RECOMMENDATION

1. Receive the presentation, and direct questions to the consultant or to staff.

ATTACHMENTS

1. KNN Memorandum, dated March 13, 2008

KNN
public finance

MEMORANDUM

To: Steven Rogers, Town Manager, Town of Yountville
Richard Stranzl, Finance Director/Treasurer, Town of Yountville

From: David Leifer and Bobby Cheung, KNN Public Finance

Re: Method of Sale Memorandum

Date: March 13, 2008

Now that the Town Council has approved moving forward with the Community Center project, KNN has evaluated alternative methods for selling the bonds that will finance the cost of the project. We examined each in light of the ability of the Town to execute the financing relatively quickly and the overall cost of the borrowing to the Town (ie. interest rates and costs of issuance) in order to maximize proceeds for construction.

KNN identified three key decision points: a.) public offering versus private placement, b.) stand alone financing versus pooled financing, and c.) competitive versus negotiated method of sale. KNN's conclusions are as follows:

1. Though private placements are generally best suited for very small financings (ie., under $5 million par amount) or for debt issues which cannot otherwise be sold via a public sale, we believe that the current dislocation and volatility in the municipal market merits further consideration of private placement as a means of selling the Town's COPs;

2. The Town will be best served by a stand-alone financing rather than a pooled financing;

3. The Town will be best served by delaying the decision on method of sale until after it receives its ratings and bond insurance bids. Generally, a competitive sale (whereby multiple underwriting firms compete for the bonds on the day of sale and the winning underwriter is selected based on the lowest combination of interest rates and underwriter's compensation) ensures the lowest overall cost of funds and provides the most pricing transparency. However, in light of current market volatility, we feel it would be prudent to make this decision in light of market conditions closer to pricing.

Market Volatility
The municipal bond market has experienced a period of extreme volatility and dislocation since December of 2007, caused by a variety of factors related to the sub-prime mortgage crisis. Starting in August 2007, the initial fallout from the collapse of the sub-prime mortgage market caused many financial institutions to write down significant losses. The majority of municipal bond insurance agencies wrote policies that covered risky mortgage-backed securities and many insurers have been downgraded, or are at risk of downgrade, as they no longer meet capital requirements to be rated "AAA" by the rating agencies. At the moment, there are only two bond insurers that we would consider for the Town's bonds, FSA and Assured Guaranty (both of which have limited exposure to sub-prime mortgage securities). However, bond insurance premiums have risen steeply in recent months and KNN would be prepared to sell the Town's bonds without insurance on the strength of the Town's underlying ratings.

More recently, the auction rate bond market has collapsed, driven by investor desires to liquidate bonds that no longer carried the "AAA" rating or at risk of downgrade. Auction rate bonds are a form of variable rate debt that was viewed as a "cash-like" instrument due to the perceived liquidity provided by bond insurance. Auctions are now failing across the country as new investors are unwilling to purchase the bonds and existing bond holders are stuck with securities they cannot sell. As a result, there are "AA" rated issuers paying rates as high as 12% in CA, and 20% interest in other states.

Generally, interest rates for fixed rate municipal bonds have increased over the past month due to a reduced willingness among investors to commit capital. Moreover, certain institutional investors such as tender option bond programs and hedge funds, have begun exiting the municipal market as a result of significant increases in their short-term funding costs, contributing to higher municipal yields. Overall, however, long-term municipal bond rates remain relatively low from a historical perspective. We will continue to closely monitor the market conditions as the Town approaches the pricing of its bonds.

Public Offering versus Private Placement
As discussed in our earlier memorandum, KNN has examined the potential benefits of a public sale as compared to a private placement of bonds.

Interest rates for private placements are generally higher than interest rates for public offerings due to the restrictions imposed on the transferability of privately placed bonds. KNN solicited private placement rates for a Stanislaus County COP refunding in mid 2007 and the rate indications were at least 67 basis points higher for a private placement than for an insured public offering. That spread continues to widen as a result of the fall-out from investor exposure to sub-prime mortgage risk.

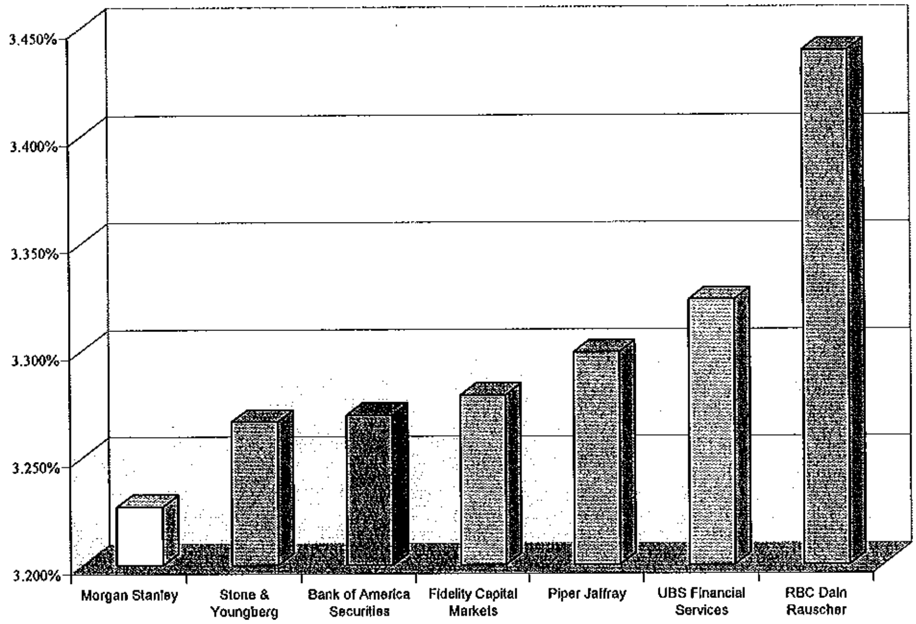
For very small financings, this added interest cost is offset by reduced costs of issuance. This was the case for the Town's floodwall financing in 2004, which was sold by way of a private placement. However, it is rare for local governments to utilize a private placement for financings over $3-5 million in par unless the credit is troubled or there are other unique circumstances. Other than for very small issuances, the private placement alternative is traditionally reserved for debt issuances that cannot be sold via a public sale. For instance, issuers with poor or no financial history frequently choose the private placement option because the risk is too high for a public investor to purchase the debt. Issuers which do not have current financial statements or which cannot obtain an investment-grade bond rating are also good candidates for private placements. We do not think this is the case for the Town and thus we recommend that the Town pursue a public offering.

While we believe that the Town will qualify for investment grade ratings and could sell its bonds by way of a public offering, the current municipal market dislocation and limited availability of bond insurance merits further consideration of private placement as a means of ensuring timely completion of the Town's financing.

Stand Alone Financing versus Pooled Financing
KNN has examined the potential benefits of pursuing a stand alone capital markets financing versus participating in a pooled financing, specifically, the ABAG Credit Pooling Program. We have determined that a stand-alone financing will best serve the Town in its goal to minimize the overall cost of the financing and to sell bonds on an aggressive timetable.

KNN advocates a stand alone financing due to several key factors. First, in a pooled financing, the weakest credit included in the pool is often viewed by the market as the credit of the entire pool, as the pool takes on the credit qualities of "the weakest link". With the limited availability of bond insurance in the current market, this concern is paramount. We feel that the Town's credit alone will likely be strong enough to pursue a stand alone financing and should not be weakened by an inferior credit. Second, the ABAG Pooling Program for COPs is relatively inactive, with no current sales planned and zero bond sales since October of 2004. The October 2004 sale itself consisted of only one issuer and one project. We spoke with ABAG's Public Finance Director and he indicated that there are currently no other scheduled financings in the pool and it would likely take additional time to attract other issuers to the financing pool, if any. Moreover, the ABAG administration itself does not actively market this program. We understand that ABAG's tax-exempt Redevelopment Agency and Water and Wastewater pooled financing programs are more active and those may the ones to which Mimi Henderson was referring. Moreover, we see no potential for cost savings in a pooled financing with only one or two participants; in fact, the pool involves moderate additional costs that do not exist in a stand-alone financing. For example, the ABAG Pooling Program charges 0.05% as a "closing fee" and 0.02% as an "annual fee", both of which are in addition to all of the other costs associated with a sale.

Competitive versus Negotiated Method of Sale
In a competitive sale, the Financial Advisor prepares the financing (i.e., assists the Town in structuring the bonds, preparing its disclosure document, and securing ratings and bond insurance bids, etc.) and multiple underwriters submit bids to purchase the bonds on the day of sale with the winning underwriter submitting the lowest True Interest Cost (i.e., combination of interest rates and underwriter's compensation). The graph below illustrates the results of a competitive sale for a $13.58 million Napa County Refunding COP sold in 2005. The winning underwriter's bid produced interest cost savings of approximately $300,000 over the highest bidder.



In a negotiated sale, a single underwriter would be selected to "negotiate" interest rates with the Town on the day-of-sale by soliciting orders from investors based on a recommended interest rate scale. The underwriter can be selected at the outset of the financing and assist the Financial Advisor with the structuring of the financing or they can be selected after ratings and bond insurance bids are secured immediately in advance of pricing.

Generally, a competitive sale is best suited for well established security structures (i.e., COPs and revenue bonds), highly rated credits (i.e., "A" category or better) and par amounts that are neither very small (i.e., under $1.0 million) nor very large (i.e., over $200.0 million). Negotiated sales are best suited for novel or unique security structures, unrated or weaker credits with limited market access (i.e., Assessment District and CFD financings) or very small and very large par amounts. Negotiated sales are also well suited for financings where the sale date may need to be adjusted day-to-day to meet market conditions, such as bond refundings.

The benefits of using a competitive sale for the Town's upcoming financing are that it: 1.) ensures the lowest rates in the market on the day of sale; 2.) typically produces the lowest combination of interest rates and underwriter's discount, and 3.) represents the most transparent pricing process.

KNN believes that the credit qualities of the Town and the size and structure of the anticipated financing favor a competitive sale. However, the current market volatility and limited availability of bond insurance are such that we propose making a final decision regarding the method of sale after the Town obtains its bond ratings and bond insurance bids and in light of market conditions at that time.

We have attached a draft financing schedule to this memorandum for your consideration.

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Town of Yountville
"The Heart of the Napa Valley"

Town of Yountville
Certificates of Participation, Series 2008
(Community Center)

Financing Schedule
(As of March 12, 2008)

February 2008

S	M	T	W	Th	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	$\boxed{18}$	19	20	21	22	23
24	25	26	27	28	29	

March 2008

S	M	T	W	Th	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

April 2008

S	M	T	W	Th	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			

May 2008

S	M	T	W	Th	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	$\boxed{26}$	27	28	29	30	31

$\boxed{}$ = Holiday

Working Group:

Issuer (Authority):	Town of Yountville
Financial Advisor (FA):	KNN Public Finance
Bond Counsel/Disclosure Counsel (BC, DC):	To Be Determined
Trustee (Trustee):	To Be Determined

Date	Activity	Responsibility
Week 1	Select Bond and Disclosure Counsel.	Town
Week 1	Kickoff meeting to review financing schedule, review project to be financed, discuss preliminary structure of COP.	All
Week 2	Conference call to review alternative financing terms.	FA, Town
Week 3	First draft of financing and disclosure documents distributed to working group for review.	DC, BC
Week 3	Send rating agency presentation outline.	FA, Town

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Date	Activity	Responsibility
Week 4	Conference call to review financing and disclosure documents and submit comments.	All
Week 5	Second draft set of financing and disclosure documents distributed to working group for review.	DC, BC
Week 5	Conference call to review second draft of financing and disclosure documents and submit comments.	All
Week 6	Third draft set of financing and disclosure documents distributed to working group for review.	DC, BC
Week 6	Information packages sent out to rating agencies and insurers.	FA
Week 7	Provide status report to Town Council.	FA, Town
Week 7	Meeting/conference call to rehearse presentation to insurers and rating agencies.	FA, Town
Week 8	Meet with rating agency(ies) and bond insurers.	FA, Town
Week 9	Receive bond rating(s) and bond insurance bids.	Rating Agency
Week 9	Financing resolution, POS and form of bond documents delivered to Town for placement on agenda for Town Council and Financing Authority meetings on [DATE].	DC, BC
Week 10	Receive bond insurance premium quotes, and surety bond premium. Determine cost effectiveness of bond insurance & surety bond.	Insurers
Week 10	Town Council and Financing Authority approve financing resolution and form of bond documents.	Town
Week 11	Investor conference call or meetings as necessary.	FA, Town
	Evaluate investment options for funds held with Trustee	FA
	Printing and electronic posting of POS and Official Notice Inviting Bids.	FA, DC
	Sign up for Sure-bid.	FA
Week 12	Pre-pricing call. Provide Town with market update.	FA, Town
	Pricing, subject to market conditions.	FA, Town
Week 13	Pricing of investment alternatives for trustee held funds.	FA, Town
	Final Official Statement distributed.	DC
Week 14	Closing.	All