COUNCIL OF THE CITY OF PHILADELPHIA

COMMITTEE ON FINANCE

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Room 400, City Hall
Philadelphia, Pennsylvania
Thursday, March 6, 2008
1:15 p.m.

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PRESENT:
COUNCILWOMAN MARIAN B. TASCO, CHAIR
COUNCILWOMAN JANNIE BLACKWELL
COUNCILMAN FRANK DiCICCO
COUNCILMAN W. WILSON GOODE, JR.
COUNCILMAN BILL GREEN
COUNCILMAN WILLIAM GREENLEE
COUNCILMAN CURTIS JONES, JR.
COUNCILMAN JAMES F. KENNEY

BILL 080202 - An ordinance authorizing the issuance of one or more series of general obligation bonds to provide funds to refund certain outstanding general obligation bonds of the City of Philadelphia...

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COUNCILWOMAN TASCO: Good afternoon. I'd like to call the Committee on Finance to order and recognize that we have a quorum in the presence of Councilman DiCicco, Councilman Greenlee, Councilwoman Blackwell, Councilman Goode and Councilman Green.

We'll ask the Clerk to read the bill.

THE CLERK: Bill No. 080202, an ordinance authorizing the issuance of one or more series of general obligation bonds to provide funds to refund certain outstanding general obligation bonds of the City of Philadelphia; authorizing the Mayor, City Controller and City Solicitor or a majority of them to sell the bonds at public or private negotiated sale; setting forth the purposes for which the proceeds of the bonds will be expended; providing for the maturities and for other terms and conditions and for the form of the bonds; providing that bonds may be redeemable prior to maturity; providing sinking funds for the bonds and for appropriations to the Sinking Fund Commission for the payment thereof; authorizing agreements to provide credit enhancement or payment or liquidity sources for the bonds, and agreements to manage interest costs and certain other actions.

COUNCILWOMAN TASCO: Thank you very much.

Is there someone here to testify on behalf of the Administration?

(Witnesses approached witness table.)

COUNCILWOMAN TASCO: The Chair recognizes Councilman Curtis Jones, who has joined us.

Good afternoon. Would you please state your name for the record and proceed with your testimony.

MS. RHYNHART: Rebecca Rhynhart.

Good afternoon, Councilwoman

Tasco and members of the Committee on Finance. I am Rebecca Rhynhart, Deputy Finance Director for Debt Management for the City of Philadelphia, and I'm here to testify on behalf of Bill No. 080202.

Bill No. 080202 will authorize the City to issue one or more series of general obligation bonds to provide funds to refund the outstanding general obligation bonds, Series 2003B-1 and B-2, in a principal amount not to exceed $225 million, exclusive of costs of issuance. The City's outstanding general obligation bonds, Series 2003, are auction-rate bonds insured by XL Capital Assurance.

The plan of finance is to issue traditional, fixed-rate refunding bonds to remove the City's risk to the auction-rate market, which is currently experiencing severe distress. This market disruption has affected municipalities, schools, public utilities and other public institutions around the country. The current instability in the auction-rate market is not the result of anything to do with the municipalities' actions, but is the result of investor concern over the bond insurers due to their subprime mortgage exposure and rating downgrades. Five of the seven main bond insurers have had rating downgrades or have been put on watch for a possible rating downgrade over the last few months. XL Capital Assurance, which insured the issue that the Administration is seeking to refund, has been downgraded from AAA to A minus.

Investor concern about the bond insurers has led to a lack of bidders in the auction-rate bidding process for municipalities across the country. According to Bloomberg News, approximately 60 percent of all auction-rate bonds in the $330 billion market have failed to attract enough bidders since mid-February. This has led to much higher interest rate costs on auction-rate bonds. For example, the

Port Authority of New York and New Jersey's interest rate costs rose from four to 20 percent as a result of problems in this market, and the State of California's interest cost has doubled to six percent. Because of these increased costs, municipalities and other public institutions are working towards removing themselves from the auction-rate market.

The refunding bonds would be issued so that the City would not incur additional costs related to this market problem. The interest cost on the City's Series 2003 bonds has risen to approximately 5.5 percent from 3.6 percent in November. If the City does not take action, the City is exposing itself to the problems in this market and to a variable rate of interest which could rise to a maximum rate of 15 percent. Because of this, it is in the best interest of the City to refund the outstanding bonds and issue traditional, fixed-rate bonds.

In addition, I would like to request a suspension of the rules for Bill No. 080202 to allow for first reading at the next meeting of City Council.

This concludes my testimony. I am happy to answer any questions.

COUNCILWOMAN TASCO: Yes. For the record, could you please explain the auction market and why is that -- how it differs from the fixed-rate market, for the record?

MS. RHYNHART: Sure. Auction-rate bonds are variable-rate bonds so that they have an interest rate that resets periodically. In our case, it's every 35 days. So on a fixed-rate bond, you're paying a fixed rate of interest, just like on a mortgage. And the auction-rate bonds are variable rate, so they reset.

Does that answer your question? Would you like more information?

In terms of how the auction

works, every 35 days bondholders that want to sell the bonds are matched up with potential buyers and the new rate is established by the lowest rate that clears the market. So when there's not enough bidders, as has happened lately, the rate goes to what's called a fail rate, which is a rate set in a document, which is much higher. When the market is healthy, it's set by market demand, but since there's not demands anymore, it's going to what's called a fail rate.

COUNCILWOMAN TASCO: The Chair recognizes Councilman Green.

COUNCILMAN GREEN: Thank you, Madam Chairman.

Thanks for coming here to testify today. A couple of questions for you. What is the interest rate now of the Port Authority of New York and New Jersey's bonds?

MS. RHYNHART: It has gone down, I believe, to the single digits when it reset again. So it went up to 20 percent and then some more investors came in and it did go down.

COUNCILMAN GREEN: So for one month it went to 20 percent.

MR. DUBOW: I think it's still close to nine. So it's still very high.

COUNCILMAN GREEN: So for two months, it's at an average of nine percent.

What are the underwriting fees going to be for this transaction?

MR. DUBOW: Well, just to -- the nine percent may not be just for a month. There's no sign yet of when this is going to correct itself, so it could stay at nine percent for months. So there's a heavy cost to that.

COUNCILMAN GREEN: Right. I'm just asking what the underwriting fees will be for this transaction and legal fees, total cost of issuance.

MS. RHYNHART: I think the latest estimate for an all-in interest cost I believe was about 4.8 percent from our financial advisors, which was early February. It's not a dollar amount. That's an all-in interest rate cost. That might change because the market is so volatile.

COUNCILMAN GREEN: I don't understand "interest rate cost." What does that mean? Is that the expenses of the offering, 4.8 percent?

MS. RHYNHART: That would be the interest costs together with the expenses related to the cost of issuance.

MR. DUBOW: That would be our total cost after we've done the refinance.

COUNCILMAN GREEN: What portion of that is expenses, including underwriting and legal, et cetera?

MS. RHYNHART: I would have to get back to you on the exact cost.

MR. DUBOW: Right now we're paying about five and a half percent. So afterwards we'd be paying much less, but we'll get you the breakout.

COUNCILMAN GREEN: We're paying five and a half percent, though, in an auction that resets every 35 days, and before this even gets issued, we could be below 4.88.

MS. RHYNHART: It's possible, but it's unlikely, because right now we're actually in a fail mode, which means there hasn't been enough buyers, like 60 percent, even it went up to 70 percent of the market. So our rate is being set as a percentage. We're in a fail rate, so it could go much higher. It could go up to 15. I mean, it could go lower, but it's unlikely.

MR. DUBOW: And if it went lower, if somehow the market corrects itself over the next month and a half, which no one sees happening, but if that did happen, then we wouldn't issue.

COUNCILMAN GREEN: Okay. If you could get back to me prior to final passage the information that I'm going to request from you, I'd appreciate it.

MS. RHYNHART: Sure.

COUNCILMAN GREEN: So, that is, the total expenses of this offering and how much the additional interest rate or the additional interest payments cost us on a 35-day basis, if you follow me. In other words, the difference between 4.88 and what we're currently paying and how long it would take to make up the expenses of the offering in the issuance.

MS. RHYNHART: We could do that. I mean, I think part of it, though, also just to keep in mind, is that part of this process is for cost avoidance, because the rate could go so much higher.

COUNCILMAN GREEN: I understand it's also being used as a risk management tool.

MS. RHYNHART: Right. Exactly.

COUNCILMAN GREEN: Okay. My next question is, didn't we pre-pay all of the insurance to XL?

MS. RHYNHART: Yeah.

COUNCILMAN GREEN: How much money was that?

MS. RHYNHART: I don't know the exact cost.

COUNCILMAN GREEN: If you could get back --

MS. RHYNHART: And that's a problem with the insurance market in general and municipalities across the country. Everyone has prepaid, and for the insurers that have had problems, the ones that have had the most problems are FIGC and XL, and for those two insurers, it's a cost. But we can get the exact amount.

COUNCILMAN GREEN: So that's money we've lost.

MS. RHYNHART: It's some cost, yes.

MR. DUBOW: Yes.

COUNCILMAN GREEN: That is money we've lost if we don't continue the Dutch auction -- if we don't continue to roll over these bonds.

MR. DUBOW: It's money we've lost really either way, because the way the market is viewing itself is that they're not giving any security to the market at all. So the bonds are trading as though -- it's actually worse than there's no insurance. So that money is gone regardless of what we do with the refunding and we're not getting any benefit out of it.

COUNCILMAN GREEN: That brings up a question I think the Chairwoman asked at the meeting yesterday, or somebody did. I can't recall who it was, which is, is there any legal recourse for the City over the fact that auctions have failed? I would suggest to you that the investment bankers and the insurance company probably did not give the City appropriate risk disclosure with respect to the possibility of failed auctions or what would happen if the insurers' credit rating went down, and I would think that our city, together with every other city and municipality going through this, would have a class-action suit against the investment bankers and the bond insurers that aggressively sold this Dutch auction process to municipalities and states.

And so I suggest you look into that. I think we can recover some money here by going after the insurers and potentially the investment banks who aggressively sold us these deals.

MR. DUBOW: We'll look into that.

COUNCILMAN GREEN: And if you could get back to me before final passage.

MR. DUBOW: Okay.

COUNCILMAN GREEN: I had one more suggestion that I made to you yesterday afterwards that I just want to make on the record, and, that is, there's been a lot of articles about the fact since this whole crisis came up that municipalities really don't need bond insurance to insure their bonds because the failure rate has been extremely low. I'd suggest that we work with other major municipalities to start a pool of self-insurance of bonds where we could all cover each other's insurance, all the municipalities in the country, or those that would participate. That would be far cheaper than paying private operators.

That's all I have, Madam Chairman.

COUNCILWOMAN TASCO: Thank you very much.

The Chair recognizes Councilman Kenney.

COUNCILMAN KENNEY: Thank you, Madam Chair. I'm not at the table because there's no room, so that's why I'm over here.

In reality, what choices are there? Based on what we know and based on the fact that none of what happened to put us in this situation happened under this Administration's watch, what real choice do we have?

MR. DUBOW: Really two. One is to do something to mitigate the risk, which is what we're proposing today, and the other is to sit back and wait and hope that it doesn't keep getting worse, which is what it's been doing over the last month, month and a half.

COUNCILMAN KENNEY: And in your considered opinion, both of you, and all of your other professionals, it's best to do something?

MR. DUBOW: Yes. It would be very bad risk to take.

COUNCILMAN KENNEY: Thank you.

COUNCILWOMAN TASCO: In your testimony you talk about that the series -- the cost would not exceed $225 million, exclusive of cost of issuance. So it could be more. So do you want to say that?

MS. RHYNHART: To say in the testimony that it could be more?

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COUNCILWOMAN TASCO: Right. Now, is it going to cost you additional money -- the expenses, as the Councilman asked you for.

MS. RHYNHART: Right.

COUNCILWOMAN TASCO: Do you include that in the bond issue, the cost of issuance, all the costs associated with it?

MS. RHYNHART: Right. We do.

COUNCILWOMAN TASCO: So how much are you going to refinance? Is it 225 million?

MS. RHYNHART: We finance the outstanding --

COUNCILWOMAN TASCO: The debt.

MS. RHYNHART: Right.

COUNCILWOMAN TASCO: The debt does not reach 225 million.

MS. RHYNHART: No, it doesn't. I think it depends on how the bonds are structured and if they're structured using premium or discount bonds.

COUNCILWOMAN TASCO: But we're

trying to get to the cost. Would the cost be a part of the 225 million max?

MS. RHYNHART: I think the 225 million is exclusive of cost of issuance. So that would be in addition, and we will get that information as to what those costs could be.

COUNCILWOMAN TASCO: Okay. You'll get that information to the Chair?

MS. RHYNHART: I definitely will. I'll get that to both of you.

COUNCILWOMAN TASCO: Due to the current market conditions and bond insurers, do you anticipate future refunding?

MS. RHYNHART: Do you mean with other series of our debt?

COUNCILWOMAN TASCO: Yes.

MS. RHYNHART: We have a few other series of debt that have some insurer issues. We have the PAID Series 2007 bonds, which are insured by FIGC. We're not looking to refund them. We're looking to get actually a wrap from a well-rated bank, but that's still in the beginning process. And in addition to that, we have some airport bonds as well as some water and sewer bonds which have Ambac and MBIA insurance. Those two insurers are doing better than XL and FIGC, but they're not stellar. So we are looking toward solutions on those as well. I don't think they will involve refunding, but we'll definitely keep you up to date on what actions we're taking on those.

COUNCILWOMAN TASCO: So these are the only other bond insurers that give us exposure or who had ties with the subprime market?

MS. RHYNHART: That's right.

COUNCILWOMAN TASCO: The ones you named?

MS. RHYNHART: Right. There's two other insurers, FSA and Assured. We have deals insured by FSA. They didn't get involved in the subprime mortgage insurance business, so their reputations are much stronger and their ratings are much stronger.

COUNCILWOMAN TASCO: By doing this refunding how much exposure is the City avoiding?

MS. RHYNHART: How much exposure is the City avoiding? Well, being that the interest cost could rise to 15 percent, it's a lot. I mean, if you think on $200 million over 25 years. It's unknown what it could be, and that's part of the issue here, but it could be that high.

MR. DUBOW: So it could be up to 20 million a year for the life of the bonds.

COUNCILWOMAN TASCO: Any other questions from members of the Committee?

Councilman.

COUNCILMAN GREEN: Thank you, Madam Chairman.

Who was the underwriter of the series of bonds that we're replacing?

MS. RHYNHART: Morgan Stanley

was the lead underwriter.

COUNCILMAN GREEN: Those are the people that sold us the Dutch auction bonds or they presented -- are we using the same underwriter that put us in this mess?

MS. RHYNHART: I'm not sure who presented the idea back in '03 and who to put blame upon. Morgan Stanley was the underwriter. I don't know if you want --

COUNCILMAN GREEN: And now they want to earn additional fees to get us out of the mess that they sold to us in 2003?

MR. DUBOW: We would also say, to be fair to them and the other professionals who were involved in the deal, there was no one who foresaw the problem with the insurers, which is really what has driven the problem. It wasn't a problem so much with the structure of auction rates as a problem with insurers who basically failed. That's really what the issue is here.

COUNCILMAN GREEN: But that is the underwriter's job, to let us know what the risks are of an offering that we're undertaking.

MR. DUBOW: Right. And I don't know -- I mean, I wasn't involved with that deal and neither was Rebecca, so we don't know --

COUNCILMAN GREEN: No. I understand that. I'm not being critical at all of you. I'm just wondering why we'd use the same underwriter.

MS. RHYNHART: Well, I think the whole market, going off what Rob said too, the whole market was looking to the rating agencies and saying -- the rating agencies that -- the insurers were rated AAA by the rating agency. So even if that was a risk, it would be minimal, but that's all changed.

COUNCILWOMAN TASCO: But nobody but the Council of Philadelphia foresaw the problems with the subprime market.

MR. DUBOW: Correct.

COUNCILWOMAN TASCO: Let's hope they listen to us. Maybe we wouldn't be in this mess. I'm not sure that anybody foresaw the bottom drop on the housing market.

COUNCILMAN GREEN: No.

COUNCILWOMAN TASCO: Which has led to this.

COUNCILMAN GREEN: And other than the -- just to get on the record the question I asked you yesterday, could you please let me know whether or not if you're going to bid these, which I understand you're going to do an RFP, whether or not the -- for co-underwriters counsel whether or not the LBE preference will apply?

MR. DUBOW: Yes. We will get back to you on that.

COUNCILMAN GREEN: Thank you.

COUNCILWOMAN TASCO: Thank you very much.

Is there anyone else here to testify on this bill?

(No response.)

COUNCILWOMAN TASCO: Thank you. There being no further testimony, we will close out our public hearing and go into our public meeting.

The Chair calls on Councilwoman Blackwell to move the bill out of Committee.

COUNCILWOMAN BLACKWELL: Thank you very much.

MS. RHYNHART: Thank you.

COUNCILWOMAN BLACKWELL: We move that Bill No. 080202 be reported out of Committee with a favorable recommendation and, furthermore, that the rules be suspended in order to permit first reading at our next session of Council.

(Duly seconded.)

COUNCILWOMAN TASCO: It has been moved and seconded that Bill 080202 be reported out of Committee with a favorable recommendation and that the Council rules be suspended so that this bill can have its first reading at the next Council session.

All in favor will say aye.

(Aye.)

COUNCILWOMAN TASCO: Is there any opposition?

(No response.)

COUNCILWOMAN TASCO: There being none, the motion is carried.

Thank you, and this meeting is adjourned.

(Committee on Finance adjourned at 1:35 p.m.)

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CERTIFICATE

I HEREBY CERTIFY that the proceedings, evidence and objections are contained fully and accurately in the stenographic notes taken by me upon the foregoing matter on March 6, 2008, and that this is a true and correct transcript of same.

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MICHELE L. MURPHY

RPR-Notary Public

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