Capital Markets Finance Newsletter

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Welcome to CMF New Additions!

Tim Loving joined CMF in October, 2010 as a Finance Assistant.

Allen Yin started at OP on Monday, March 28th as a Finance Officer.

NEW AND NOTEWORTHY

CapEquip – For FY 2011-12, the rate will be 2.99%

Build America Bond Program ended on 12.31.10

10 year US Treasury rates have increased almost 1% over the past 6 months

Market Update – 1st Qtr

High Interest Rate Volatility and Low New Issuance Volume Define Municipal Bond Market

The first quarter has been characterized by high interest rate volatility and low issuance volume as the markets continue to digest the convergence of conflicting domestic economic news and the Fed's stimulus program, disconcerting international financial news coupled with great political unrest, large-scale bond fund outflows and news calling into question the relative safety of municipal debt.

Absolute rates remain very attractive on a historical basis. After rising steadily for about two months, tax-exempt rates reversed course in the middle of February, regaining some lost ground. Year-to-date, the 30-year MMD High Grade is largely unchanged, hovering around 4.75%, which is up about half a percentage point from December but well below the 5.00% barrier it breached last month. Over the past several weeks, tax-exempt rates have generally tracked the direction of Treasury yields, which have rallied on flight-to-quality trades fueled by political turmoil in the Middle East and Northern Africa, and sold off on positive domestic economic data that for the most part continue to support a gradual, steady economic recovery. Both the taxable and tax-exempt curves remain very steep, with the spread between the two- and 30-year MMD Index at about 400 basis points, compared to a 10-year average of about 250 basis points. The vast majority of issuance remains in the fixed-rate mode, with short-term debt accounting for only 3% of volume year-to-date.

At the same time, historically light new issuance supply has also supported low tax-exempt rates, with year-to-date new issuance volume at a very light $39 billion, compared to $76 billion for the same period last year, a 50% decline and the lowest level in over a decade. The decline can be attributed to a combination of factors, including general uncertainty and volatile market conditions, large-scale bond fund outflows, and the year-end expiration of the Build America Bond (BAB) program, which had some public issuers rushing to market and pre-funding capital needs late in 2010 to take advantage of the federal interest rate subsidy. Following years of growth, mutual funds have reduced their holdings of municipal bonds for the past 16 weeks, reducing demand for the product. While Democrats continue to propose various forms of a BABs extension, the likelihood of a subsidized taxable municipal product being passed is considered to be remote given Republican opposition.

Despite some of these recent challenges, the outlook for the higher education sector and for large, diversified, highly-rated institutions, in particular, is generally positive. Most economists forecast a gradual increase in rates throughout the year and beyond, with short-term rates predicted to remain low for the foreseeable future, which will lead to a further steepening of the yield curve.

Courtesy of Barclays Capital

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"Action may not always bring happiness, but there is no happiness without action."

Benjamin Disraeli

Office of the President News

Working Smarter: Ten Distinct Campuses Using One Efficient Administrative Framework

In December 2010, the Commission on the Future made its official recommendations to The President and The Regents regarding achieving University efficiencies. Those recommendations formed the basis for the Working Smarter initiative. In early March 2011, Working Smarter held its first all hands meeting in Oakland, California. Guided by an Executive Steering Committee comprising of Systemwide CFO, Systemwide EVP Business Operations, UC Irvine EVC and Provost, UCSF SVC Finance and Administration, and UC Riverside Chancellor, it is an ongoing administrative efficiency initiative that brings together systemwide, regional, and campus-level efforts under one umbrella. *The University is committed to achieving a level of administrative excellence equivalent to that of its teaching and research enterprises.*

Working Smarter envisions ten distinct campuses using one common integrated approach to financial and payroll systems, time & attendance systems, extramural fund accounting, data warehousing, asset management, e-procurement, energy and climate solutions, indirect cost recovery, library-efficiency strategies, and risk management.

To reach this objective, the University will: (1) redirect $500 million of positive fiscal impact in five years from administrative costs to the academic and research missions of the University; (2) streamline operations in order to address both state funding cuts and the need for commonality among campuses; (3) implement operational efficiencies that enhance the quality of services that support our students, faculty, and staff; and (4) build a sustainable financial model to carry the University forward.

Sponsors for this initiative have been identified and are responsible for achieving the goals and objectives as outlined by the Working Smarter initiative. This will include developing and/or finalizing work plans, achieving milestones, overall implementation and for providing project-specific content for the Working Smarter website, which will function as the hub for all communications both internal and external. Working Smarter has already manifested itself across a myriad of levels and functional areas of the University. For instance, the CapEquip program is the University's first-ever capital equipment financing program, which is expected to save campuses $1-2 million in interest costs annually. UC Davis and UCLA have borrowed under CapEquip, and more campus utilization of the program is anticipated.

Check out the website for the latest news on this systemwide initiative *http://workingsmarter.universityofcalifornia.edu*

Relative Financing Costs

For Various Credit Structures

Every so often, a question is asked about the cost of different financing alternatives. While tax-exempt financing requirements imposed by the IRS can be onerous, the tax-exempt market continues to be valuable to municipal bond issuers such as the University. In the current market, a 30 year tax-exempt General Revenue Bond issue (rated Aa1/AA/AA+), structured with level annual debt service, would procure an interest cost about 1.2% lower than a taxable bond issue (about a 4.9% versus 6.1%). While the tax-exempt market does not quite provide issuers with all of the theoretical benefit of the tax-exemption (assuming a top marginal tax rate of 35%), tax-exempt financing is generally the lowest cost of funding for the University's capital needs.

As a reminder, the current tax-exempt planning rate is 6.0% and the taxable planning rate is 7.25%. As it is often uncertain when permanent financing will be obtained for any particular project, planning rates attempt to build in a cushion to accommodate rate volatility ahead of a bond issue. The volatility can be considerable; for example, over the past six months, 10 year US Treasury rates have increased almost 1%. Please check http://www.ucop.edu/capmarketsfin/planning_rates.html for current planning rates.

For those campuses with medical centers, it may be helpful to note that tax-exempt Medical Center Pooled Revenue Bonds (rated Aa2/AA-) currently trades about 60 basis points (0.60%) higher than General Revenue Bonds, reflecting the higher risk investors associate with healthcare revenue bonds.

Finally, when considering alternative project-dependent financing structures (such as the Financing Trust Structure used at UCI for off-campus housing projects), we note that financing costs for such projects are well over 1% higher than a General Revenue Bond financing alternative.

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"Whenever you find yourself on the side of the majority, it is time to pause and reflect.

Mark Twain

Private Use Training

Managing Compliance in Adherence to Tax Exempt Policies

As an issuer of tax-exempt and Build America Bond financings, the University is responsible for ensuring that financings satisfy all applicable federal tax requirements both at the time of issuance and for as long as the bonds remain outstanding. Post-issuance certifications require that the University continually monitor private activity in tax-exempt and Build America Bond financed facilities. In order to best assist campuses in understanding activities that may constitute private use, the Office of the President has developed an online tutorial and training. The online tool will help campuses understand the context and importance of monitoring private use in bond financed facilities, types of private use, and allowable amounts of private use as well as provides relevant examples. In addition the tool will highlight differences between how the University's revenue bond program differs from the state general obligation and state lease revenue bond funding when interpreting how to manage current or potential private use in a facility. The tool will be available online in the near future.

Recent University Bond Issues (since November, 2010)

$757,315,000 Medical Center Pooled Revenue Bonds 2010 Series G,H,I
$200,000,000 General Revenue Bonds 2010 Series V
$3,725,000 General Revenue Bonds 2010 Series W (Clean Renewable Energy Bonds)
$48,700,000 General Bonds 2010 Series X (CSCDA Recovery Zone Economic Development Bonds)