

**SAN DIEGUITO UNION HIGH SCHOOL DISTRICT
BOARD OF TRUSTEES**

**BOARD FACILITIES WORKSHOP
MINUTES**

The Board of Trustees of the San Dieguito Union High School District met in a Special Meeting/Facilities Workshop on Tuesday, May 18, 2006, at 3:00 p.m. in the San Dieguito District Office Board Room, 710 Encinitas Boulevard, Encinitas, California.

Members Present

Linda Friedman, President
Beth Hergesheimer, Clerk
Joyce Dalessandro
Barbara Groth

Member Absent

Deanna Rich, Vice President

Student Board Members Present

None

Student Board Members Absent

Melissa Sweet, Torrey Pines High School
Katie Bendix, La Costa Canyon High School
Maggie Roberts, San Dieguito High School Academy
Kelly Kean, Canyon Crest Academy
Danny or Adelle Uhlmeier, Sunset High School

Administrators Present

Peggy Lynch, Ed.D., Superintendent
Eric J. Hall, Associate Superintendent/Business
Steve Ma, Executive Director/Business Services
John Addleman, Business Services Analyst
Sue Gleiforst, Recording Secretary

Guests

Craig Underwood

Glenn Casterline

CALL TO ORDER

The meeting was called to order at 3:05 p.m.

INFORMATION ITEMS

UPDATE ON REFUNDING PLAN OF 1998 AND 2004 MELLO ROOS BONDS

1.

Dr. Lynch introduced Craig Underwood and Glenn Casterline from Bond Logistx. Mr. Underwood reported that this is a continuation of the workshop held on April 4. Approximately a week after that workshop, long-term rates increased, which meant the economics of the fixed rate structure has become more expensive. During the past three or four weeks, the bond team has been working to narrow down the options available and they will spend some time talking about one of the alternative financing vehicles.

Entering into an "interest rate swap" would allow the district to achieve and enhance financial objectives discussed during the April 4 workshop. Using the interest rate swap will mean that approximately \$17.9 million will be immediately available for facilities and the district will save approximately \$4.4 million in present value savings.

Mr. Underwood explained that an interest rate swap is a contract between two parties to exchange cash flows. Cash flows are calculated based on the product of fixed and floating rates, and a set notional amount. The issuer would be the school district; the counterparty would most likely be Morgan Stanley. The district will pay the counterparty the fixed rate and the counterparty will pay the district back the floating rate to be matched against the variable floating rate provided to the bond holders.

Mr. Underwood reviewed and explained examples of swap cash flows to the Trustees. One party agrees to pay the notional amount multiplied by the LIBOR index. The other party agrees to pay the notional amount multiplied by the fixed 3.77%. The party paying the least of the two amounts pays the other party the difference. Swaps are generally not used for speculative purposes; neither party enters into the transaction expecting to receive more than they pay. The district would want the floating payment swap to match, as best it can, the district's floating payments on the bonds. Mr. Underwood also reviewed how swap dealers make money. The counterparty profit comes from the hedge it places with other investment banks.

The risk the counterparty pays to hedge is slightly less than the rate paid to the insurer, therefore, a profit is gained. There are two sides to any hedge.

The district would be on the "offered side" of the transaction. When the counterparty states that the rate will be 3.77%, and the district accepts, the trade instantly locks in the "bid side" at 3.70%. As long as the district does not default on their obligation, the counterparty will have a guaranteed profit.

Mr. Underwood explained the most common derivative application otherwise known as a synthetic fixed rate structure. There is one fixed rate leg and two variable rate legs. The issuer pays the fixed swap rate of 3.77%, plus the administrative costs of .26% and the variable swap rate (LIBOR formula). The issuer receives the variable swap rate (LIBOR formula). The all-in cost is 4.03% in this particular example.

He explained the fixed rate bonds vs. the synthetic fixed-rate swap. In the synthetic fixed scenario, there are two options the district would have:

- (1) A swap where the floating payment is based on the BMA (Bond Market Association) floating index. This is a tax-exempt index that is very likely to replicate the bond rate. The problem with a BMA swap is the fixed rate the district would have to pay, factoring in all cost rates, is 5%. So, this is more costly than a fixed rate bond.
- (2) A variable swap rate based on LIBOR is a taxable rate. 100% of LIBOR is going to be substantially more than the district's tax exempt floating rate. Whoever would buy the bond would accept roughly 65% of LIBOR because the district would be issuing tax exempt bonds. If LIBOR is 5%, and the district bond is going to trade at 3.3% or 65% of LIBOR. These percentages are based on a compilation of data from a period of ten to 30 years to determine where LIBOR has been relative to the tax-exempt floating rate debt. They determine what percentage would be the best representation of the floating rate debt; in this case it is 65%.

Mr. Underwood reviewed understanding swap risk factors and quantifying basis risk for the Trustees. The issuer is not immediately worse off if bonds exceed swap receipts because of initial 56 basis point advantage over fixed rate bond alternative. A high rate/high ratio scenario such as 8% and 80% of LIBOR is unprecedented. It is generally believed that only a significant change in the value of tax exemption could cause such an outcome.

Mr. Underwood reviewed potential for early termination and termination considerations.

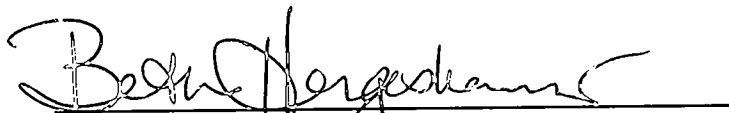
He also reviewed the Swap Termination Payments, which indicated termination values based on certain future market conditions. The actual swap unwind values would depend on Insurer, Issuer, and counterparty credit situations, and other factors.

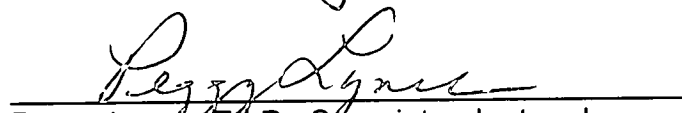
Mr. Ma reported that the bond deal is on hold right now. The administration needs direction from the Trustees as to what the staff should do now. Mr. Ma and Mr. Underwood concurred that the "interest rate swap" transaction is the method the district should use subject to the Board's adoption of a swap policy regulating the use of such financing structure.

The Board concurred that the administration move forward with the "interest rate swap." Staff would bring back a swap policy for adoption at the June 8 meeting.

ADJOURNMENT
2.

There being no further business to come before the Board, the meeting was adjourned at 4:15 p.m.


Beth Hergesheimer, Clerk


Peggy Lynch, Ed.D., Superintendent and
Secretary to the Board