

**REDEVELOPMENT AGENCY
AND THE CITY OF OAKLAND**
AGENDA REPORT

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OFFICE OF THE CITY CLERK
OAKLAND
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TO: Office of the City Administrator
ATTN: Dan Lindheim
FROM: Finance and Management Agency
DATE: October 14, 2008

RE: **Supplemental Report to the Cash Management Report for the Quarter Ending
June 30, 2008**

SUMMARY

At the October 2, 2008 Rules Committee meeting, the Committee asked staff to provide information about the current national financial crisis and its impact on the City of Oakland's (the "City") and the Oakland Redevelopment Agency's ("ORA") holdings.

City staff is actively exploring options to address the volatile financial market that started with the fallout of the subprime mortgage collapse. Of particular concern is that the current crisis has created a national credit crunch with no liquidity in the market. This lack of liquidity makes it difficult for the City to manage its debt as effectively as it has in the past. Due to the severe dislocation of the financial market, the City and ORA have experienced the following:

- 1) Illiquid money market fund when ORA's money market fund (American Beacon) suspended accepting redemptions;
- 2) Failure of the remarketing of the Oakland-Alameda County Coliseum Authority, Coliseum Series 2000 C-1 and Coliseum-Arena Series 1996 A-1 and A-2 bonds; and
- 3) Limited diversification because the City and ORA have 64.20% and 68.75% respectively of their portfolios in Federal Agencies.

Staff is looking at several options to provide short-term liquidity and diversification of the City and ORA's portfolios by investing in United States Treasury Securities ("U.S. Treasuries") and by restructuring variable rate bonds to fixed rate bonds.

BACKGROUND

Dating back to 2007, the collapse of the sub-prime mortgage market had started to create a credit squeeze in the financial market. The domino effect has now spread to all aspect of the financial industry leading to the current credit crunch in the United States economy. The turmoil in the market has caused many financial companies to file for bankruptcy or force their sale to other banks to stay afloat; such as Lehman Brothers, Washington Mutual, Wachovia, and Merrill

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Lynch. Money market funds, traditionally viewed as a safe haven for money funds, are losing value and closing. The Reserve Primary Fund, a pioneer of money market funds and long-considered to be one of the most stable of these funds, was the first to announce it had reduced the value of its shares to below \$1. By cutting its share value by 3 cents, to 97 cents, all investors in the fund suffered that loss.

The national financial crisis has also lead to large-scale government intervention. The takeover of the country's two largest mortgage companies, Fannie Mae and Freddie Mac, along with an emergency loan of \$85 billion to AIG to rescue the company from bankruptcy, and the \$700 billion bailout plan that was passed on October 3, 2008, were attempts by the US government to stabilize the market. On October 8, 2008, the Federal Reserve and other major central banks from around the world made an emergency cut to interest rates in an attempt to prevent a global recession.

FISCAL IMPACT

Illiquidity in the market causes a loss of flexibility for debt financing and can result in higher interest rates at greater cost to the City. The City has recently experienced the effects of illiquidity when one of ORA's money market funds (American Beacon) suspended accepting redemptions. The securities held by the American Beacon Fund were transferred to ORA's custodial bank, Wells Fargo Bank. There was **no loss** in asset value but ORA's portfolio does not have full liquidity. Fortunately, none of the City and ORA's money market funds have lost value at this point.

The County of Alameda (the "County") along with the City issued Lease Revenue Bonds (Oakland Coliseum) Series 2000 C-1 and Lease Revenue Bonds (Oakland Coliseum Arena Project) Series 1996 A-1 and A-2 (collectively, the "Coliseum Bonds"). These bonds have failed to remarket due to the turmoil of the financial market. When remarketing fails, the County and City have to pay higher interest rates plus penalties associated with drawing on the Letter of Credit ("LOC"). These costs are expensive and burdensome if the failed remarketing condition continues. Staff has spoken to the remarketing agents on these bonds. Goldman Sachs, who remarkets the Coliseum Arena Series 1996 A-1, appears to have regained market standing and is able to remarket some of the bonds. Barclays, who took over Lehman Brothers, Inc., may not be able to remarket the Coliseum Series 2000 C-1 and Coliseum Arena Series 1996 A-2. The table below presents the failed remarketing bonds:

Remarketing Status Chart

Bonds	Fail Date	Par	Agent	Previous Rate	Current Rate	Additional Cost of LOC	Remarketing Status
<u>Coliseum</u>							
Series C-1	9/15/2008	\$100,000	Barclays	1.25-2.58%	1.63%	\$262.30	Outstanding
	9/25/2008	\$100,000		1.25-2.58%	5.50%	\$98.36	Outstanding
	9/29/2008	\$900,000		1.25-2.58%	7.75%	\$295.08	Outstanding
	10/1/2008	\$187,000		1.25-2.58%	6.50%	TBD	Outstanding
<u>Coliseum-Arena</u>							
Series A-1	9/17/2008	\$11,850,000	Goldman Sachs	2.82%	5.50%	\$31,081.97	Remarketed
Series A-2	10/2/2008	\$38,700,000	Barclays	3.07%	6.00%	\$43,881.15	Remarketed

Costs associated with the challenges of remarketing short-term bonds in the current market include higher interest rates and LOC costs. At this time, it is unclear what the overall fiscal impact of the US market's instability will be on the City's and ORA's debt management. Staff recommends prompt action to restructure the City's and ORA's debt in order to minimize any negative impact.

KEY ISSUES

1. In 1988, Oakland voters passed the "Oakland Nuclear Free Zone Act" (Ordinance No. 11062), which prohibits the City of Oakland and the Oakland Redevelopment Agency from investing in US Treasuries unless it is found that such investments are necessary to avoid substantial financial losses. It is very important that the City and ORA diversify their portfolios by investing in US Treasuries at this time to minimize exposure to Federal Agencies. While the market continues to be volatile, it may be quite some time before it is stable again. In the meantime, staff recommends that the City and ORA invest in US Treasuries to avoid potentially substantial losses. Once the market recovers, the City could again make other investment choices consistent with the intention of the City's Nuclear Free Zone Act. Staff is in the process of submitting a resolution to City Council for approval of investing in US Treasuries to provide the City and ORA with short-term liquidity and diversification of their portfolios.
2. Since long-term rates are still historically low, restructuring the Coliseum Bonds with fixed rate bonds will hedge against further interest rate increases and LOC penalties due to the failed remarketing. If the County and City do not restructure the Coliseum Bonds to fixed rate bonds, the County and City will continue to experience the uncertainty of not being able to remarket the Coliseum Bonds. Staff is researching all alternatives available.
3. The Federal Reserve has cut its rate by 50 basis points from 2 percent to 1.5 percent and reduced its emergency lending rate to banks by half a percentage point to 1.75 percent on

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October 8, 2009. The Federal Reserve hopes its actions will loosen the tight credit crunch and provide liquidity in the market. Other major central banks from around the world have joined the Federal Reserve in slashing interest rates as well to prevent a global economic meltdown.

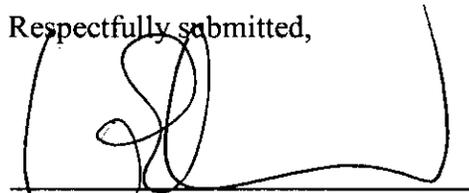
RECOMMENDATION

Staff recommends Council's acceptance of this informational report.

ACTION REQUESTED OF THE CITY COUNCIL

This is an informational report only and requires no action.

Respectfully submitted,



WILLIAM E. NOLAND

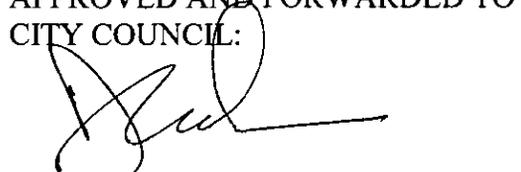
Director

Finance and Management Agency/ Treasurer

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APPROVED AND FORWARDED TO THE
CITY COUNCIL:



Office of the City Administrator

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