January 24, 2019

Memorandum

To: Randy Kenyon, Los Altos School District

From: Dave Olson, PFM Financial Advisors LLC

Re: Los Altos School District - 2019 Financing Plan

Purpose of the Memo. In preparation for its upcoming bond sale, the District requested PFM's assistance in conducting a selection process for bond underwriter. As part of the selection process, PFM drafted an RFP, received responses, shared and discussed the responses with District staff, and assisted in developing a recommendation to the Board. This memo summarizes that process.

2019 Bond Sale. In terms of context, it's worth describing some complications associated with the 2019 bond sale. The financing will need to provide funds on a date specific, and that date is currently both unknown and unknowable. Because the land deal involves the anticipated receipt of transferable development rights, the financing team has proposed a bifurcated structure involving both traditional fixed rate general obligation bonds and interim financing in the form of bond anticipation notes. Tax counsel has advised us that the bond anticipation notes will need to be sold on a taxable basis. This is not a vanilla transaction.

Negotiated Sale. As a result of these complications, we have recommended that the 2019 bonds (both components) be sold through negotiated sale. In a negotiated sale, a bond underwriter (or team of underwriters) is selected and integrated into the financing team in advance of the sale date and given the exclusive right to establish interest rates through negotiation with the District and its financial advisor and distribute bonds to investors on the sale date. Most California school district bond issues are sold through negotiated sale.

Advantages of Negotiated Sale. In this case, we believe there are three clear advantages to negotiated sale (1) the added flexibility in terms of timing, (2) the interest rate benefit of being able to engage investors in additional pre-sale dialogue, and (3) the potential that new ideas will emerge from expanding the team. In terms of the bottom line, specifically, we believe that the negotiated sale process, given the specifics of this transaction, is likely to produce better results on an overall cost basis (upfront fees and present value interest costs).

Role of the Bond Underwriter. The role of the bond underwriter is to purchase bonds from the District and to distribute such bonds to investors and/or other underwriters. A critical part of the process is the establishment of interest rates. In order to have a successful transaction, interest rates must be established at levels that are high enough to attract sufficient investor interest but low enough to satisfy the underwriter's issuer client. An issuer wants to hire a firm with strong relationships with the type of investors that will be buying their bonds and a track record of achieving low interest rates for clients similar to them. The issuer will also want to consider the ideas that an underwriting firm might bring to the table and any additional banking services that the firm might be able to provide.

Co-Managed Transactions. Under resolutions approved in December, the District is authorized to sell up to $150 million in bonds (up to $70 million in general obligation bonds and up to $80 in bond anticipation notes). In the current market, almost all large bond issues ($200 million or more) hire one lead manager and one or more co-managers. A significant portion of bond issues between $60 million and $200 million do the same. In theory, a co-managed transaction will provide added distribution capabilities for no additional upfront costs (the underwriting team shares the negotiated underwriter's fee). Many financial advisors also believe that co-managed transactions encourage competition both during the sale process and after. In this instance, our view is that, while the pricing advantage may well be minimal, the size of our transaction provides an opportunity to expand the team, the potential for new ideas, and the capabilities that might be applied to unanticipated challenges.

Request for Proposals. We knew that, given the size of the transaction, the high credit quality of the issuer, and the complexity of the structure, the District's 2019 bond issue would be very attractive to underwriters. We designed a request for proposals that focused on four elements: (1) firm capabilities and experience, (2) ideas that they might propose given our circumstances, (3) demonstrated ability to achieve low interest rates, and (4) upfront fees. We distributed an RFP to eight firms: Barclays, Citigroup, Morgan Stanley RBC Capital, Ramirez & Co., Raymond James, Stifel, and Wells Fargo. In our judgment, all of these firms were qualified based on experience and capabilities of providing high quality service to the District.

Responses and Evaluation. All eight firms provided responses which we reviewed with District staff. Two proposals stood out: Raymond James and Barclays. Raymond James is one of three firms (along with RBC Capital and Stifel) that dominate the California school district bond market. They have done work for a number of highly rated local school districts (including Mountain View-Los Altos HSD and Fremont HSD). The examples they provided to demonstrate their pricing capabilities were compelling. Barclays has a significant experience in working with large sophisticated issuers in the Bay Area (including UC Regents and BART). Their proposal recommended a concrete proposal with regard to investor outreach that was notably robust and disciplined and that we believe will provide some value to the District. In addition, they were one of four firms (Citigroup, RBC, and Wells Fargo being the others) willing to commit bank-sized capital to a direct lending solution if necessary.

Final Points and Recommendation. I want to close by making two points. The first is to point out again that these are all high quality firms capable of achieving good results for the District. To a significant extent, the differences described above are differences of degree rather than substance. And there is some subjectivity in the evaluation. The second is to say that differences in upfront costs (also known as underwriter spread) were not considered significant in this evaluation. Proposed fees fell in a fairly narrow range. All proposers agreed to negotiate to a different fee, if the District had a fee in mind. It's true that the cost savings from lower upfront costs can be lost in the decrease of leverage that an atypically low fee has in negotiating interest rates. That being said, our recommendation is to select Raymond James as lead manager for the District's 2019 bond financing and Barclays as co-manager and to convene an underwriting team meeting before the end of the month.