August 13, 2008

To: Martha Kanter
From: Andy Dunn

Re: Continuing Discussion about Underwriters for Measure C

As I wrote to you in July 2008, UBS Securities LLC (UBS) has elected to get out of the municipal bond business. Our contact at UBS, Jim Roth — as well as a number of his colleagues — has moved to Piper Jaffray & Company.

The range of options discussed with General Counsel John Shupe and outlined in the July memo included staying with one underwriting firm, entering into a qualification-based selection process by issuing a Request for Qualifications (RFQ) to identify and secure a second underwriter, or simply picking a firm and directly entering into negotiations. If the district desires to acquire a second underwriter, counsel has advised that we follow the qualifications-based selection process outlined above.

Completing this process to identify a co-banker, negotiating contract terms and getting to the stage of having a recommendation in front of the Board of Trustees could be accomplished in three months. While it is a standard practice for districts to have a contractual relationship with only one underwriter, if the Board continues to feel a critical public purpose is being met by continuing with co-underwriters, staff can facilitate that direction. None of the approaches outlined above impact our relationship with Morgan-Stanley.

I have continued to research this matter and took the opportunity to speak with former Vice Chancellor Mike Brandy in an effort to better understand the working relationship that existed between the two firms. Morgan Stanley was the lead underwriter on the first issuance and as such incurred the fees for the management costs to prepare to issue the bonds. The decision to use Morgan Stanley as the lead underwriter on Series A and B was determined as part of the underwriting agreement with UBS at the inception of the bond issuance process. The administrative and managerial costs incurred by Morgan Stanley were more than anyone anticipated due to the complexity of issuing the bonds while the lawsuit was pending. Once the bonds went to market, Morgan Stanley and UBS split the book of business evenly with each firm responsible for selling (and earning commissions) on 50% of the bonds. It was expected that UBS would take the lead as underwriter on the next issuance of bonds as part of the original agreement between UBS and Morgan Stanley. If we were to seek a co-underwriter, a reasonable expectation would be that they take the lead on the next issuance but that they would do so in partnership with Morgan Stanley and evenly split the bonds to be sold.

Some of the factors to consider in determining whether to use one underwriter or two include:

- Morgan Stanley has a long working relationship with the district and performed admirably on the last issuance in a very complicated transaction. Their firm could move quickly and easily when the district was ready to issue the next series.

- If the Board felt that it was best to secure a new co-underwriter, staff would initiate that process by following the same procedures as before. It is expected that process would take about 3 months and would include the involvement of the Audit & Finance Committee to interview new firms to be co-underwriters with Morgan Stanley. A recommendation from the Audit & Finance Committee would then be forwarded to the Board.

- The interests of the district would be well served by either of these options. It is an unusual situation to interview firms to come into a transaction as a co-underwriter when the lead underwriter has already been chosen, but we are reasonably confident that firms would show interest in this competitive market.

- Lastly, if staff were directed to solicit a co-underwriter, the estimated timeframe would in no way impact a future issuance based on the current program spending plan. Planning for a third issuance will likely commence in calendar year 2009 as available proceeds from the Series A and B issuance are anticipated to carry the district through calendar year 2010.

This discussion has been agendized for the August 25, 2008 meeting of the Audit/Finance Committee.

C: John Shupe
Hector Quinonez
Charles Allen
Mike Brandy