

‘DISCUSSION DRAFT

Gila Project: Interim written progress report for Sub-Task 1: Develop Preliminary Method of Finance

NOTE: All of the work below should be considered preliminary. Much of what follows includes a “layman’s” reading of federal and state statutes that would need to be verified by professional legal counsel.

Summary of Entire Task: Construct and present to the ISC a plan of finance whereby the ISC can most cost-effectively issue debt today to finance near-term efforts to identify and evaluate a potential “New Mexico Unit” as defined by the Colorado River Basin Project Act (the “Act”). Such debt would be repaid using revenues to be distributed to the ISC beginning in 2012 pursuant to the Act.

Sub-Task 1: Develop Preliminary Method of Finance.

I.A. Determine authority under state law for ISC to issue debt for contemplated purposes and to repay the debt from future distributions from the New Mexico Unit Fund (the “Fund”).

Summary: State statutes appear to give the ISC all the authority it needs to sell the revenue bonds necessary to finance any work done associated with the New Mexico Unit, to carry out that work and to pledge revenue distributed to the New Mexico Unit Fund. Also, the ISC has four options for the sale of these bonds: 1) sale to a private investor or investors through a public sale; 2) sale to as private investor or investors in a public sale 3) sale to the New Mexico finance authority in a private sale 4) sale to the state investment office in a private sale. I will elaborate more on the relative benefits of each method of sale under Sub-Task 2, to be completed next week.

- Article 72-14-13 NMSA 1978 authorizes the ISC to issue “water conservation revenue bonds” with the approval of the state board of finance for the purpose of paying the “costs of works” involved in conserving and distributing water. The terms “works” and “cost of works” are very broadly defined in 72-14-9 and would include any required planning or surveys and would include the payment of financing costs, including fees and interest.
- Article 72-14-11 NMSA 1978 authorizes the Interstate Stream Commission to conduct any project, “...the cost of which is to be paid wholly by means of or with the proceeds of revenue bonds authorized, or in connection with a grant to aid in financing such project from the United States or any instrumentality or agency thereof, or with other funds provided under the authority of Sections 72-14-9 through 72-14-28 NMSA 1978.
- Article 72-14-13.C NMSA 1978 states explicitly that the ISC bonds issued under this statute may be issued and sold from time to time at a public or private sale to

any purchaser, including the New Mexico finance authority, and in such amounts as may be determined by the ISC. Also, the state investment officer is authorized to invest the permanent funds of the state in bonds issued under this statute.

I.B. Verify that distributions from the New Mexico Unit Fund (the “Unit Fund”) may be spent for the purposes contemplated, including the payment of interest on debt issued by ISC.

Summary: The Arizona Water Settlements Act explicitly authorizes the ISC to utilize monies in the Unit Fund to cover project costs, including costs associated with planning and environmental compliance activities. The Arizona Water Settlements Act, neither specifically authorizes, nor prohibits the issuance of debt and payment of interest on funds used to pay project costs. Informal discussions with experienced bond counsel yielded the view that the issuance of debt payment of interest to finance capital project costs is allowed, unless specifically prohibited. A formal bond counsel opinion on this point would be given as part of the bond issuance process.

- Subsection (i) of Section 212 of the Arizona Water Settlements Act states that amounts made available from the Colorado Basin Project Fund for the New Mexico Unit shall be placed in the New Mexico Unit Fund, a State of New Mexico Fund established and administered by the New Mexico Interstate Stream Commission. This subsection states in part that... “(w)ithdrawals from the New Mexico Unit Fund shall be for the purpose of paying costs of the New Mexico Unit other water utilization alternatives....., including costs associated with planning and environmental compliance activities and environmental mitigation and restoration.”

I.C. Evaluate the enforceability under federal law and financial strength of the pledge of the future distributions to the New Mexico Unit Fund (the “Fund”).

Summary: The federal statutory authorization for future distributions from the Lower Colorado River Basin Development Fund (the “Development Fund”) to the New Mexico Unit Fund (the “Unit Fund”) is clear. However, it will take more research to determine the strength and reliability of that pledge and, therefore, the likely credit rating on bonds backed by the distributions. The security of the pledge for any bond issues would be traceable back to security of payments made from the Development Fund to the Unit Fund. Money in the Development Fund is a complicated combination of federal appropriations to the Development Fund for project construction and revenues generated from the operation of these projects by the Central Arizona Irrigation District (the “District”) and others.

- Section 403(f) of the Colorado River Basin Project Act as amended by Section 107 of the Arizona Water Settlements Act clearly authorizes payments from the Lower Colorado River Basin Development Fund (the “Development Fund”) to the New Mexico Unit Fund (the “Unit Fund”) in an amount totaling \$66 million, adjusted

for construction costs, paid in ten equal installments beginning in 2012. The distributions from the Development Fund to the Unit Fund are to be made annually “without further appropriation” and are to be credited against what the Central Arizona Water Conservation District (the “District”) would otherwise owe the Federal Government as repayment for construction of the Central Arizona Project and other projects. The authorization is clear and it is also clear that no additional appropriation is required for the distribution from the Development Fund to the Unit Fund to take place.

- However, rather than being a straight pledge of federal revenue ultimately backing the ISC Bonds, the pledge would be of the willingness and/or ability of the District, the federal government and others to make payments into the Development Fund, from which the annual allocations are then credited to the Unit Fund. The Development Fund contains a variety of funds including appropriations for construction of the Central Arizona Project and other projects. Upon the completion of these projects, the revenues earned by such projects from the distribution of water, generation of electricity, etc., are also deposited into the Development Fund.
- Also, although Section 403(f) of the Colorado River Basin Project Act, as amended, states that distributions from the Project Fund to the Unit Fund can be made without further appropriation, additional federal appropriation language may be required before revenues from the Development Fund can be used for the New Mexico Unit. Section 403(e) of the Act states: “Revenues credited to the development fund shall not be available for construction of the works comprised within any unit of the project herein or hereafter authorized except upon appropriation by the Congress.” More legal research is needed to determine the implications of this section

**Second Progress Report
Gila Project
Method of Finance
March 16, 2007**

Preliminary Financing Plan: Draft for Discussion Purposes Only

Project Summary: The item to be financed is preliminary planning and design to commence in 2007, for a project, known as the New Mexico Unit, which must be through the planning and design and be ready to proceed by 2014. Federal funds do not become available to the ISC for this project planning until 2012. If the project is not ready to proceed in 2014 New Mexico loses federal project funding and 14,000 acre feet of water rights. Since two years is not sufficient time to complete the planning process the ISC wishes to issue bonds in 2007 to finance the initial stages of the planning and pay the bonds off with the initial distribution from the Colorado River Basin Development Fund in 2012. Preliminary discussions indicate the need for approximately \$1 million per year for the period 2007 – 2012, or about \$6 million total (Note for discussion: The timing of the 2012 payment might be such that only \$ 5 million in borrowed funds would be needed).

Preliminary Financing Plan: Based on preliminary discussions with staff of the NMFA and private sector financial experts, the most cost-effective method of raising the \$6 million in project funds would be through the issuance by ISC of zero-coupon (or capital appreciation) bonds in an amount equal to \$6 million, plus enough additional bonds to cover required reserve funds and the legal and marketing costs of the bond issuance.

By definition, zero coupon bonds do not pay interest prior to maturity. The purchaser of the bonds receives one payment at maturity. That payment includes original principal plus interest, which is accrued and compounded semi-annually at the interest rate fixed at issuance. Therefore, the ISC bonds would be sold in 2007 with no payments due until the distributions start in 2012

For this initial illustration of marketing alternatives, this example assumes a single 2007 bond issue to raise the entire amount. If the ISC is not sure of the amount needed during the five year period, multiple bond issues could be sold during the period 2001 - 2012. The decision as to number of issues also relates to the balancing of the costs of each additional transaction, the interest costs on borrowed funds and the interest earned on bond proceeds that are invested pending their use. All these cost variables change with the type of sale, as well as whether the bonds are structured to be federally tax-exempt because of the investment restrictions on proceeds of tax-exempt bond issues. Future analyses will include more detailed discussions of these costs, as more data becomes available on the actual costs of each marketing alternative.

A preliminary presentation of the alternatives is included in Table 1, which is included as a separate attachment. (Note: The figures in Table 1 are very rough estimates and should

be used for preliminary discussion purposes only. The estimates will be refined as the analysis progresses.)

Bond Marketing Alternatives

Introduction

State statutes appear to give the ISC all the authority it needs to sell the revenue bonds necessary to finance any work done associated with the New Mexico Unit and authorizes the four marketing options outline in Table 1:

- Article 72-14-13 NMSA 1978 authorizes the ISC to issue “water conservation revenue bonds” with the approval of the state board of finance for the purpose of paying the “costs of works” involved in conserving and distributing water. The terms “works” and “cost of works” are very broadly defined in 72-14-9 and would include any required planning or surveys and would include the payment of financing costs, including fees and interest.
- Article 72-14-13.C NMSA 1978 states explicitly that the ISC bonds issued under this statute may be issued and sold from time to time at a public or private sale to any purchaser, including the New Mexico finance authority, and in such amounts as may be determined by the ISC. Also, the state investment officer is authorized to invest the permanent funds of the state in bonds issued under this statute.

For the purpose of comparing the marketing alternatives, it is assumed that a single bond issue would be sold by the ISC in 2007 and would mature in 2012.

The amount of accrued interest due at the end of five years would depend on the interest rate on the bonds and the size of the bond issue, which in turn depends on the amount borrowed in addition to the \$6 million to pay the costs of the transaction. Initial estimates place the amount of principal and interest required to be repaid in 2012 at between \$7.3 million and \$7.9 million, depending on method of sale and purchaser of the bonds.

Sale to NMFA

Preliminary estimates, based on the best information available today, indicate that the sale of the ISC bonds to the NMFA would be the most cost effective. The NMFA will offer the lowest interest rate, 3.9% today, and would pay all the ISC’s legal and financial advisory costs of structuring the bond issue and placing it with the NMFA.

- The NMFA offers all its borrowers insured AAA tax-exempt rates, regardless of their creditworthiness.
- The NMFA also pays up to \$200,000 in borrowing costs, including the costs of structuring bond issues that they purchase.

Total bonds sold would equal \$6 million, with no issuance costs included. About \$1.28 million in interest would accrue over the five years the bonds are outstanding and be paid along with the repayment of the \$6 million in bond principal.

Public Sale

The ISC could issue the tax-exempt bonds in a public sale to private investors and, because of the strong revenue pledge backing the bonds, get close to the same rate as that offered by NMFA.

However, structuring and marketing the bond issue would cost about \$161,000 in consultant fees. Further, this does not include the cost in ISC board and staff time required to hire and supervise the required consultants, and to coordinate the public bond issuance process.

Almost \$6.2 million in bonds would be sold, with the addition of the \$161,000 in issuance costs to the project amount. The financing of these issuance costs and a slightly higher interest rate would increase the interest paid to about \$1.35 million.

Private Sale/Placement

The ISC can cut issuance costs almost in half, to an estimated \$85,000 by issuing the bonds in a private sale to a private investor. Legal costs are less because federal law requires far less legal disclosure since the bond issue is being sold privately and not as a publicly traded security. Also, the purchaser would perform his/her own credit analysis rather than relying on a credit rating and the bonds would not require the marketing by bond underwriters that is involved in a public sale.

However, what is saved in bond issuance costs by selling the bonds privately, would likely be more than offset by a higher interest rate on the bonds. Total bonds sold would equal about \$6.1 million, with issuance costs. About \$1.52 million in interest would accrue over the five years the bonds are outstanding.

Purchase of the Bonds as Investments by the State Investment Office

Looking at only the transactions cost of the bond issue, the sale of the bonds to the SIO would probably be the next lowest-cost alternative to a sale to the NMFA. The bond sale would require only an estimated \$55,000, due in large part to the fact that this sale of bonds would be from one state agency to another. However, the rate required by the SIO would likely be much higher than that required by the NMFA and the other tax-exempt bond sale alternatives.

The SIO, in purchasing an investment, has the fiduciary responsibility to seek the highest yield possible. Since the SIO is not subject to federal income taxes, it has no incentive to accept lower interest earnings because the earnings are exempt from federal taxation.

The SIO would likely require a “taxable” rate with a realistic risk premium. For purposes of this comparison the rate is expected to be 1 percentage point above the interest rate on U.S. Treasury securities, or about 5.4%. (Note: The SIO is authorized by law to accept

lower "differential" interest rates in certain limited cases. We have not explored that possibility, but will do so as this financing progresses.).

The \$55,000 in issuance costs would mean a total bond issue of \$6,055,000. The 5.4% interest rate would result in the accrual of about \$1.85 million in interest over the five years the bonds are outstanding, highest among the alternatives.

Some of the difference in the rate offered by the SIO and the tax-exempt alternatives could be made up in investment earnings on the proceeds, because of the restrictions placed on the investment of the proceeds of tax-exempt bonds. However, there is also a good possibility that the NMFA, as they have done in the past, would offer a tax-exempt equivalent rate, but purchase the securities as "taxable" securities, avoiding investment restrictions.

- that the also issue the tax-exempt securities

Pledged Revenue: Ten annual distributions of \$6.6 million (adjusted for increases in construction costs between 2005 and 2012) beginning in 2012 from the Lower Colorado River Basin Development Fund to the New Mexico Unit Fund.

- Currently income to the Development Fund from the District is projected to be about \$50 million annually, with a balance available in 2012 of about \$500 million from which to make an estimated \$9 million distribution (\$6.6 million, adjusted for construction cost inflation) distribution to the Unit Fund and, therefore, to make the \$6.2 million debt service payment.

- Section 403(f) of the Colorado River Basin Project Act as amended by Section 107 of the Arizona Water Settlements Act clearly authorizes payments from the Lower Colorado River Basin Development Fund (the “Development Fund”) to the New Mexico Unit Fund (the “Unit Fund”) in an amount totaling \$66 million, adjusted for construction costs, paid in ten equal installments beginning in 2012. The distributions from the Development Fund to the Unit Fund are to be made annually “without further appropriation” and are to be credited against what the Central Arizona Water Conservation District (the “District”) would otherwise owe the Federal Government as repayment for construction of the Central Arizona Project and other projects. The authorization is clear and it is also clear that no additional appropriation is required for the distribution from the Development Fund to the Unit Fund to take place.
 - However, rather than being a straight pledge of federal revenue ultimately backing the ISC Bonds, the pledge would be of the willingness and/or ability of the District, the federal government and others to make payments into the Development Fund, from which the annual allocations are then credited to the Unit Fund.
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 - The Development Fund contains a variety of funds including appropriations for construction of the Central Arizona Project and other projects. Upon the completion of these projects, the revenues earned by such projects from the distribution of water, generation of electricity, etc., are also deposited into the Development Fund.
- Debt service would be payable from

I.A. Authority under state law for ISC to issue debt for contemplated purposes and to repay the debt from future distributions from the New Mexico Unit Fund (the “Fund”).

I.B. Pledged Revenue: Annual distributions to the New Mexico Unit Fund (the “Unit Fund”) created pursuant to the Arizona Water Settlements Act made from the balance in the Colorado Basin Project Fund

Summary: The Arizona Water Settlements Act explicitly authorizes the ISC to utilize monies in the Unit Fund to cover project costs, including costs associated with planning and environmental compliance activities. The Arizona Water Settlements Act, neither specifically authorizes, nor prohibits the issuance of debt and payment of interest on funds used to pay project costs. Informal discussions with experienced bond counsel yielded the view that the issuance of debt payment of interest to finance capital project costs is allowed, unless specifically prohibited. A formal bond counsel opinion on this point would be given as part of the bond issuance process.

- Subsection (i) of Section 212 of the Arizona Water Settlements Act states that amounts made available from the Colorado Basin Project Fund for the New Mexico Unit shall be placed in the New Mexico Unit Fund, a State of New Mexico Fund established and administered by the New Mexico Interstate Stream Commission. This subsection states in part that... “(w)ithdrawals from the New Mexico Unit Fund shall be for the purpose of paying costs of the New Mexico Unit other water utilization alternatives....., including costs associated with planning and environmental compliance activities and environmental mitigation and restoration.”

I.C. Evaluate the enforceability under federal law and financial strength of the pledge of the future distributions to the New Mexico Unit Fund (the "Fund").

Summary: The federal statutory authorization for future distributions from the Lower Colorado River Basin Development Fund (the "Development Fund") to the New Mexico Unit Fund (the "Unit Fund") is clear. The security of the pledge for any bond issues would be traceable back to security of payments made from the Development Fund to the Unit Fund. Money in the Development Fund is a complicated combination of federal appropriations to the Development Fund for project construction and revenues generated from the operation of these projects by the Central Arizona Irrigation District (the "District") and others.

- Section 403(f) of the Colorado River Basin Project Act as amended by Section 107 of the Arizona Water Settlements Act clearly authorizes payments from the Lower Colorado River Basin Development Fund (the "Development Fund") to the New Mexico Unit Fund (the "Unit Fund") in an amount totaling \$66 million, adjusted for construction costs, paid in ten equal installments beginning in 2012. The distributions from the Development Fund to the Unit Fund are to be made annually "without further appropriation" and are to be credited against what the Central Arizona Water Conservation District (the "District") would otherwise owe the Federal Government as repayment for construction of the Central Arizona Project and other projects. The authorization is clear and it is also clear that no additional appropriation is required for the distribution from the Development Fund to the Unit Fund to take place.
- However, rather than being a straight pledge of federal revenue ultimately backing the ISC Bonds, the pledge would be of the willingness and/or ability of the District, the federal government and others to make payments into the Development Fund, from which the annual allocations are then credited to the Unit Fund. The Development Fund contains a variety of funds including appropriations for construction of the Central Arizona Project and other projects. Upon the completion of these projects, the revenues earned by such projects from the distribution of water, generation of electricity, etc., are also deposited into the Development Fund.
- Also, although Section 403(f) of the Colorado River Basin Project Act, as amended, states that distributions from the Project Fund to the Unit Fund can be made without further appropriation, additional federal appropriation language may be required

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Method of Finance
March 16, 2007**

Preliminary Draft: For Discussion Purposes Only

Project Summary: The item to be financed is preliminary environmental assessments and other planning efforts for a project, known as the New Mexico Unit. The project must be through the planning and design and be ready to proceed by 2014. Funds allocated from the Colorado River Basin Development Fund (the "Development Fund") for these purposes do not become available to the ISC until 2012. For discussion purposes the distributions from the Development Fund are estimated to be approximately \$8 million - \$9 million per year for ten years (\$6.6 million plus indexing for construction cost increases). If the project is not ready to proceed in 2014, New Mexico loses additional allocations from the Development Fund and an additional 14,000 acre feet of water rights. Since two years is not sufficient time to complete the environmental assessment and planning process, the ISC plans to issue bonds in 2007 to finance the initial stages of the process and pay the bonds off with the initial distribution(s) from the Development Fund. Preliminary discussions indicate the need for approximately \$1 million per year for the period 2007 – 2012, or about \$6 million total (Note for discussion: The timing of the 2012 payment might be such that only \$ 5 million in borrowed funds would be needed. Also, if we want to be conservative we could have the bonds mature in 2013, so that two distributions from the Fund would have been made).

Preliminary Financing Plan: Initial investigation indicates that the most cost-effective method of raising the \$6 million in project funds would be through the issuance by ISC of zero-coupon bonds in an amount equal to \$6 million. plus enough additional bonds to cover required reserve funds and the legal and marketing costs of the bond issuance.

By definition, zero coupon bonds do not pay interest prior to maturity. The purchaser of the bonds receives one payment at maturity. That payment includes original principal plus accrued interest, which is compounded semi-annually at the interest rate fixed at issuance. Therefore, the ISC bonds would be sold in 2007 with no payments due until the distributions start in 2012

This initial comparison of financing alternatives assumes a single 2007 bond issue to raise the entire \$6 million in project funds. If the ISC is not sure of the amount needed during the five year period, multiple bond issues could be sold during the period 2001 - 2012. The decision as to number of issues also relates to the balancing of the costs of each additional transaction, the interest costs on borrowed funds and the interest earned on bond proceeds that are invested pending their use. All these cost variables change with the type of sale, as well as whether the bonds are issued as federally tax-exempt because of the investment restrictions on proceeds of tax-exempt bond issues. Future analyses will include more detailed discussions of these costs, as more details of the financing are determined.

A preliminary presentation of the alternatives is included in Table 1, which is included as a separate attachment. (Note: The figures in Table 1 are very rough estimates and should be used for preliminary discussion purposes only. The estimates will be refined as the analysis progresses.)

Bond Marketing Alternatives

Introduction

State statutes give the ISC the authority to sell the revenue bonds necessary to finance any work done associated with the New Mexico Unit and authorizes the four marketing options outline in Table 1:

- Article 72-14-13 NMSA 1978 authorizes the ISC to issue “water conservation revenue bonds” with the approval of the state board of finance for the purpose of paying the “costs of works” involved in conserving and distributing water. The terms “works” and “cost of works” are very broadly defined in 72-14-9 and would include any required planning or surveys and would include the payment of financing costs, including fees and interest.
- Article 72-14-13.C NMSA 1978 states explicitly that the ISC bonds issued under this statute may be issued and sold from time to time at a public or private sale to any purchaser, including the New Mexico finance authority, and in such amounts as may be determined by the ISC. Also, the state investment officer is authorized to invest the permanent funds of the state in bonds issued under this statute.

For the purpose of comparing the marketing alternatives, it is assumed that a single bond issue would be sold by the ISC in 2007 and would mature in 2012.

The amount of accrued interest due at the end of five years would depend on the interest rate on the bonds and the size of the bond issue, which in turn depends on the amount borrowed in addition to the \$6 million to pay the costs of the transaction. Initial estimates place the amount of principal and interest required to be repaid in 2012 at between \$7.3 million and \$7.9 million, depending on method of sale and purchaser of the bonds.

Sale to NMFA

Preliminary estimates, based on the best information available today, indicate that the sale of the ISC bonds to the NMFA would be the most cost effective. The NMFA will offer the lowest interest rate, 3.9% today, and would pay all the ISC’s legal and financial advisory costs of structuring the bond issue and placing it with the NMFA.

- The NMFA offers all its borrowers insured AAA tax-exempt rates, regardless of their creditworthiness.
- The NMFA also pays up to \$200,000 in borrowing costs, including the costs of structuring bond issues that they purchase.

Total bonds sold would equal \$6 million, with no issuance costs included. About \$1.28 million in interest would accrue over the five years the bonds are outstanding and be paid along with the repayment of the \$6 million in bond principal.

Initial discussions with the NMFA have been positive. However, before committing to buy the bonds, they would require clarification by their legal staff in two areas: 1) whether the project constitutes a “capital project” for purposes of their authorization to buy the ISC bonds, and 2) whether the authorization for expenditure of funds distributed from the Development Fund includes the payment of debt service on bonds issued to fund a project. The next step in moving forward with the NMFA would be to formally ask for these determinations.

Public Sale

The ISC could issue the tax-exempt bonds in a public sale to the private bond market and, because of the strong revenue pledge backing the bonds, get close to the same rate as that offered by NMFA.

However, structuring and marketing the bond issue would cost about \$161,000 in consultant fees. Further, this does not include the cost in ISC board and staff time required to hire and supervise the required consultants, and to coordinate the public bond issuance process.

Almost \$6.2 million in bonds would be sold, with the addition of the \$161,000 in issuance costs to the project amount. The financing of these issuance costs and a slightly higher interest rate would increase the interest paid to about \$1.35 million.

Private Sale/Placement

The ISC can cut issuance costs almost in half, to an estimated \$85,000 by issuing the bonds in a private sale to a private investor. Legal costs are less because federal law requires far less legal disclosure since the bond issue is being sold privately and not as a publicly traded security. Also, the purchaser would perform his/her own credit analysis rather than relying on a credit rating and the bonds would not require the marketing by bond underwriters that is involved in a public sale.

However, what is saved in bond issuance costs by selling the bonds privately, could be more than offset by a higher interest rate on the bonds. Total bonds sold would equal about \$6.1 million, with issuance costs. About \$1.52 million in interest would accrue over the five years the bonds are outstanding.

Purchase of the Bonds as Investments by the State Investment Office

Looking at only the transactions cost of the bond issue, the sale of the bonds to the SIO would probably be the next lowest-cost alternative to a sale to the NMFA. The bond sale would require only an estimated \$55,000 in issuance costs, due in large part to the fact

that this sale of bonds would be from one state agency to another. However, the rate required by the SIO would likely be much higher than that required by the NMFA and the other tax-exempt bond sale alternatives.

The SIO, in purchasing an investment, has the fiduciary responsibility to seek the highest yield possible. Since the SIO is not subject to federal income taxes, it has no incentive to accept lower interest earnings because the earnings are exempt from federal taxation.

The SIO would likely require a "taxable" rate with a realistic risk premium. For purposes of this comparison the rate is expected to be 1 percentage point above the interest rate on U.S. Treasury securities, or about 5.4%. (Note: The SIO is authorized by law to accept lower "differential" interest rates in certain limited cases. We have not explored that possibility, but will do so as this financing progresses.).

The \$55,000 in issuance costs would mean a total bond issue of \$6,055,000. The 5.4% interest rate would result in the accrual of about \$1.85 million in interest over the five years the bonds are outstanding, highest among the alternatives.

Some of the difference in the rate offered by the SIO and the tax-exempt alternatives could be made up in investment earnings on the proceeds, because of the restrictions placed on the investment of the proceeds of tax-exempt bonds. However, there is also a good possibility that the NMFA, as they have done in the past, would offer a tax-exempt equivalent rate, but purchase the securities as "taxable" securities, avoiding investment restrictions.

Next Steps:

I will continue to refine these alternatives. I am getting more documentation from Randy Chandler on the details of the revenue distribution so that the NMFA, the SIO and any others that might be involved in the financing can get comfortable with the SIO's authority to issue bonds for this project and the security of the revenue to be pledged to the bonds. I will await a go-ahead from you before I give any documents to anyone for their review.

Table 1: Estimated Interest Rate and Costs of Bond Issuance: \$6 million Project Financed Over Five Years with Single Issue of Zero-Coupon Bonds.
(Potential Interest Earnings on Bond Proceeds Not Included)

	Sale of Bonds to NMFA ⁽¹⁾	Tax-Exempt Public Sale	Tax-Exempt Private Placement	Taxable SIO Investment ⁽²⁾
Costs of Bond Issuance				
Financial Advisor	\$0	\$25,000	\$25,000	\$25,000
Underwriter's Spread	\$0	\$45,000	\$30,000	\$0
Underwriter Counsel	\$0	\$25,000	\$0	\$0
Bond Counsel	\$0	\$30,000	\$30,000	\$30,000
Trustee	\$0	\$7,500	\$0	\$0
Rating	\$0	\$8,500	\$0	\$0
Bond Insurance	\$0	\$20,000	\$0	\$0
Total Costs of Bond Issuance	\$0	\$161,000	\$85,000	\$55,000
Net Proceeds Target	\$6,000,000	\$6,000,000	\$6,000,000	\$6,000,000
Total Bonds Sold	\$6,000,000	\$6,161,000	\$6,085,000	\$6,055,000
Interest Rate	3.9%	4.0%	4.5%	5.4%
Total Interest paid	\$1,278,193	\$1,349,225	\$1,516,403	\$1,848,484
Total Financing Costs: Issuance Costs plus Interest Paid	\$1,278,193	\$1,510,225	\$1,601,403	\$1,903,484

¹ All costs of bond issuance up to \$200,000 would be paid by NMFA from costs of issuance assistance fund. The bond interest rate offered by NMFA is assumed to be the insured AAA tax-exempt rate offered all tax-exempt borrowers from the Public Project Revolving Fund.

² For this comparison it is assumed that SIO would require a rate equal to the rate on U.S. Treasuries plus 100 basis points. The actual rate required by SIO to invest in these securities would be negotiated.

(Note: The figures in Table 1 are very rough estimates and should be used for preliminary discussion purposes only.)