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CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-BANK)

STAFF REPORT

REQUEST

Staff is requesting the Board provide direction to proceed with confirming the benefits of refunding one or more series of bonds issued to provide cost savings affording additional funding for the I-Bank's own Infrastructure State Revolving Fund (ISRF) Program (ISRF Program Bonds) and commencing the refunding process. Based on initial informal discussions with financial and capital market advisors, a refunding of ISRF Program Bonds can be expected to achieve cost savings, and increase administrative efficiency by modernizing and restructuring the bond documents. Once staff confirms the anticipated benefits of a refunding, staff requests the Board give authorization to staff to assemble the bond team, procure professional services for a bond refunding transaction and commence the transaction. Staff would return to the Board at a later date for final approval for the issuance of refunding bonds for one or more series of ISRF Program Bonds.

BACKGROUND

Staff is requesting the specific direction from the Board, in part, because the Debt Management Policy presented by staff during the December 2012 Board meeting has not yet been approved by the Board. Such a policy would likely have provided staff with all the guidance necessary to commence the bond refunding process. However, the Board opted to defer consideration of the policy to allow more time to review the substantial new policy.

Since 2004, the I-Bank has issued three series of ISRF Program Bonds as summarized in the table below. The bond proceeds of each series were used to provide additional funding for loans to qualified borrowers under the ISRF Program. Each series of ISRF Program Bonds were issued on a fixed-rate, tax-exempt basis and are currently rated 'AA+,' ''Aa2,' and 'AA+' by Fitch Ratings, Moody's Investors Service, and Standard and Poor's, respectively.

ISRF Program Bonds	Issue Date	Original Principal Amount	Outstanding Principal Amount as of 10/2/2012
2004 Series Bonds	3/18/2004	$51,370,000	$40,525,000
2005 Series Bonds	12/14/2005	52,800,000	41,360,000
2008 Series Bonds	9/24/2008	48,375,000	40,095,000
Total		**$152,545,000**	**$121,980,000**

The existing ISRF Program Bonds are secured by borrower repayments of ISRF Program loans[1] (Loans). The current bond structure is a complex one involving a master/series indenture structure (Master Indenture and Series Indentures). Upon the execution of loan documents, each Loan is initially pledged to secure the Master Indenture. Each time a new series of ISRF Program Bonds is issued, a new Series Indenture is entered into. Upon the issuance of a series

[1] "Loan" generically means loan, installment sale or lease.

bonds, specific Loans are released from the Master Indenture and pledged to the new Series Indenture. The ISRF Program Bonds have a cross-collateralization provision which allows excess Loan repayments pledged to secure a given series of bonds, as well as Loan repayments pledged to the Master Indenture, can be used for making payments on any series bond, if needed.

Approximately 100 Loans have been approved by the Board totaling nearly $450 million.[2] The following chart reflects the aggregate number and dollar amount of Series and Master Pledged Loans:

ISRF Program Bonds	Series Bonds Outstanding Principal Amount as of 10/2/2012	Amount of Pledged Obligations as of 9/30/2012	# of Pledged Obligations As of 9/30/2012
2004 Series Bonds	$ 40,525,000	$61,125,000	19
2005 Series Bonds	41,360,000	59,952,000	17
2008 Series Bonds	40,095,000	73,196,000	22
Master Indenture		97,494,000	27
Total	**$121,980,000**	**$291,767,000**	**85**

Payments on all outstanding ISRF Program Bonds have been made as agreed and the I-Bank is in compliance with all bond covenants. All three rating agencies indicate the ISRF Program Bond credit ratings listed above are stable, and cite strong, proactive ongoing annual surveillance by program staff in the annual credit ratings reviews.

ESTIMATED SAVINGS

The ISRF Program Bonds have a standard ten year at par call option. This means that the after the first ten years, the I-Bank can redeem all or a portion of the bonds by making prepayments directly to bondholders (i.e., call outstanding bonds) in the amount of the remaining balance owed on the bonds. Doing a refunding after a ten year call period is referred to as a current refunding (Current Refunding). However, if there are sufficient reasons to do so, an issuer may affect a defeasance of the bonds during that first ten year period, through a structure referred to as an advanced refunding (Advanced Refunding). In an Advanced Refunding, the amounts necessary to pay off the bonds are irrevocably deposited in an escrow account and held until the bonds are eligible for redemption at the first call date.

Due to historically low interest rates, staff see an opportunity to capture savings that may not materialize if the I-Bank waited to effect a Current Refunding, with the earliest opportunity being in 2014 for the 2004 and 2005 Series Bonds and as late as 2018 for the 2008 Series Bonds.

To take full advantage of the opportunity to switch to an open indenture structure (explained below) for the ISRF Program Bonds, staff anticipates it likely will involve refunding all three series of ISRF Program Bonds, even if there are no savings involved in refunding the 2008

[2] Not all loans that were approved by the Board were subsequently closed and/or funded for a variety of reasons. Two loans have been fully paid.

Series Bonds. Thus, staff is asking the Board for approval to commence with an Advanced Refunding of all three series of ISRF Program Bonds in the year 2013. Based on current interest rates, the chart below provides estimated savings analysis[3] that could be achieved with a 2013 Advanced Refunding:

ISRF Program Bonds	Outstanding Principal Amount	Estimated Dollar Amount of Debt Service Savings	% of Net Present Value Savings
Series 2004 Bonds	$40,525,000	$ 5,226,000	12.90%
Series 2005 Bonds	41,360,000	5,397,000	13.05%
Sub-Total	**$81,885,000**	**$10,623,000**	**12.97%**
Series 2008 Bonds	40,095,000	-347,000	-.87%
Total	**$121,980,000**	**$10,276,000**	**8.36%**

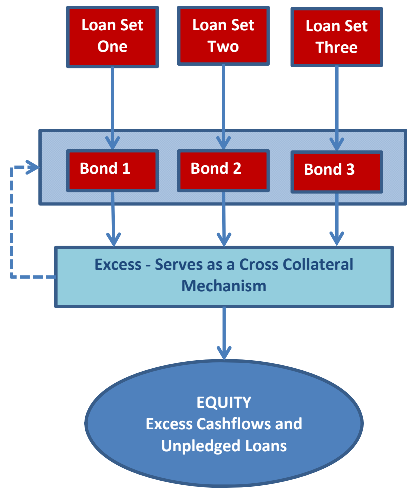
ADDITIONAL REFUNDING BENEFITS

The ISRF Program, created in 1999-2000, and initially capitalized with a net state General Fund appropriation of approximately $162 million, was designed to be a "leveraged revolving loan program," such that program loans would be funded with the initial cash appropriation, and subsequently funded from interest earnings on cash and investments, Loan principal and interest repayments and the proceeds of bonds issued by the I-Bank. The ISRF Program leveraged loan structure anticipated a leveraging of the initial cash appropriation of approximately 3:1 (three bond dollars for every one cash dollar). With the ISRF Program Bonds, the ISRF Program is currently leveraged about 1:1. Thus, there is additional room for the issuance of additional bonds to further leverage the program at a later date as demand and cash flow dictates.

At the time of the initial bond issuance, a closed indenture (Closed Indenture) model for program bonds, such as the ISRF Program Bonds, was the standard structure used nationwide. In a closed indenture model, each series of bonds is secured by borrower repayments from a separate pool of specifically identified and pledged loans. The flowchart below provides a diagram depicting a high level description of a Closed Indenture:

[3] Unsolicited refunding analysis was provided to staff by several bond underwriting firms.

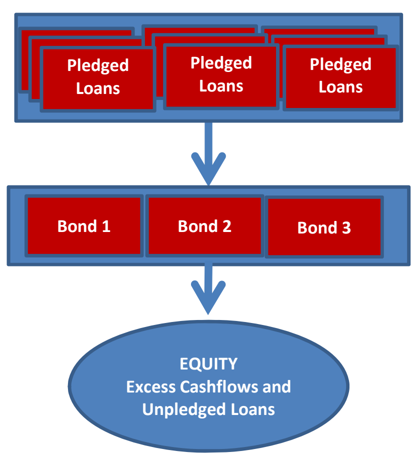
Closed Indenture



Administration of a program utilizing a closed indenture model requires a high level of monitoring and maintenance of individual loans (also referred to as assets) to ensure compliance with the bond coverage and other covenants for each series of bonds.

During the past decade, a new model, the open indenture (Open Indenture) model was developed and has been successfully used across the nation to leverage state revolving funds (SRF). An Open Indenture model allows for the establishment of a common group of "assets" pledged to all series of bonds on a parity (roughly equal) basis.

Open Indenture



Because an Open Indenture structure would allow all program bonds to be supported by a common pool of assets/loans, the need for tracking separate loans pledged to separate series and covenants specific to each series is eliminated. Thus, it is anticipated that an Open Indenture structure specifically designed for the ISRF Program Bonds would allow the I-Bank to: (i) ease cash flow administration; (ii) increase credit capacity for future leveraging allowing for more efficient debt service coverage as program demand increases; and, (iii) increase flexibility for additional bond issuances and program changes, all of which would help the I-Bank to maintain sound bond debt service coverage ratios and preserve or potentially strengthen the credit ratings of the ISRF Program Bonds.

ASSEMBLING A BOND FINANCING TEAM

If the Board directs staff to proceed with confirming the benefits of refunding one or more series of bonds issued to provide cost savings affording additional funding for the I-Bank's own Infrastructure State Revolving Fund (ISRF) Program (ISRF Program Bonds) and commence the refunding process, staff will assemble and engage a team of specialized professionals (Bond Financing Team) that will include, but is not limited to financial advisor, bond counsel/tax counsel, disclosure counsel, bond trustee, escrow agent, and verification agent, and may include a credit enhancement provider.

The State Treasurer's Office (STO), in its capacity as the I-Bank's agent for sale in a public offering of I-Bank bonds, would be responsible for selecting one or more underwriting firms for a refunding of ISRF Program Bonds, which firm or firms are also a member or members of the Bond Financing Team.

Among other things, the Bond Financing Team will assist the I-Bank with structuring the transaction, developing and conducting rating agency presentations, marketing and pricing the bonds as well as developing and preparing bond refunding documents to be presented to the I-Bank Board for approval at a future Board meeting.

STAFF RECOMMENDATION

Staff recommends the Board direct staff to proceed with confirming the anticipated benefits of refunding one or more series of ISRF Program Bonds to achieve cost savings, and to potentially modernize and restructure the bond documents to facilitate more efficient bond administration. Staff also recommends that if staff determines it is feasible to refund one or more series of ISRF Program Bonds, that the Board direct staff to assemble a Bond Financing Team and procure other professional services for a bond refunding transaction and commence the transaction. Staff would then return to the Board at a later date for final approval for the issuance of refunding bonds for one or more series of ISRF Program Bonds.