

**CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK
(I-Bank)
INFRASTRUCTURE STATE REVOLVING FUND PROGRAM (ISRF)**

STAFF REPORT

ISSUE:

Staff is requesting the I-Bank Board's approval to amend and restate the existing Criteria, Priorities and Guidelines (Existing Criteria) for the Infrastructure State Revolving Fund Program (ISRF Program) to address numerous issues which have limited I-Bank's ability to fulfill some of its mandates under the Bergeson-Peace Infrastructure and Economic Development Act (I-Bank Act) to finance projects needed to implement economic development and job creation in the State of California (State). Since the inception of the I-Bank, demand for infrastructure financing in California has continued to increase. The proposed Amended and Restated Criteria, Priorities and Guidelines (Proposed Criteria), attached hereto as Attachment A, are intended to provide a streamlined and transparent process to select infrastructure and economic expansion projects for I-Bank financial assistance.

According to the California Infrastructure Report Card (CIRC), California's infrastructure investment is facing serious challenges keeping up with the state's growing population demands and is continuing to delay much-needed infrastructure projects vital to the fueling of the State's economic engine. California in some respects is a microcosm of our nation. We are a culturally diverse and rapidly growing state. As such, our infrastructure is beginning to show its age. Case studies show that robust statewide infrastructure investment means a healthier economy, improved job base, and higher quality of life for residents.

Per the CIRC, the State needs an estimated \$765 billion investment in infrastructure over the next ten years or an annual investment exceeding \$75 billion. However, funding limitations continue to severely restrict the ability of local governments to implement the infrastructure improvements that are absolutely critical to the State's economic wellbeing. The magnitude of the demand, throughout the State, for readily available, low-cost financing for unmet infrastructure needs today underscores the necessity for amending the Existing Criteria in a manner aimed at both strengthening the ISRF Program and increasing the availability of financing for both infrastructure and economic expansion projects.

The Proposed Criteria is guided by the desire to reach more borrowers and finance more projects thereby furthering the intent of the Legislature of the State (Legislature) to promote the economic health of the State. For example, in the I-Bank Act, the Legislature declare that the "economic revitalization, future development and a healthy climate for jobs in California will depend upon a well-conceived system of public improvements that are essential to the economic well-being of the citizens of the State

and are necessary to maintain, as well as create, employment within the State for business.” Thus, the I-Bank was charged with the creation of a mechanism to finance projects needed for public improvements, to facilitate the implementation of economic development, job creation and growth management strategies, and to provide a secure and stable funding source in order to meet the critical economic, social and environmental needs of the State.

However, as indicated by the fact that only 5 loans were made under ISRF Program in the last 3 years, the ISRF Program is falling short of its mandate under the I-Bank Act. The staff, in consultation with over 80 stakeholders, including, without limitation, 21 municipalities, 30 financial and advisory institutions, 3 pension funds, 2 unions and more than 25 other interested I-Bank stakeholders, has identified the Existing Criteria as a significant obstacle to fulfilling the purposes and meeting the goals of the I-Bank Act.

BACKGROUND:

Since its inception, the I-Bank was charged with facilitating the implementation of infrastructure and economic expansion improvements necessary to promote economic growth throughout the State. In order to provide it with adequate tools for accomplishing such a formidable goal, the I-Bank was given broad statutory authority to issue bonds, make loans, provide guarantees and to leverage State, federal, local, and private funds to target public investment for the economic health and vitality of California communities. As we proceed in the second decade of the 21st century local governments are still calling for the State to take action and be in the forefront in meeting the infrastructure and economic expansion needs of a growing population and a rapidly changing economy.

With 38 million residents, California is the most populated state in the country and its economy ranks as the world’s eighth largest economy. This trend is expected to continue into the foreseeable future. Over the next 20 years, California is expected to grow at a rapid pace. The State Treasurer’s Office (STO) points out in the October 2011 State of California Debt Affordability Report that “Most of our current system of roads, schools, levees, water delivery and the like was designed and built more than three decades ago to accommodate the 25 million people then expected to live in California by the mid-1970’s. We’re now at around 39 million and projected to reach 60 million by 2050.” The STO called on the State policymakers to “devise a strategic infrastructure financing plan that reduces reliance on the State General Fund”. The Proposed Criteria is that strategic infrastructure financing plan that will position the I-Bank to assist in reducing reliance on the State General Fund.

In 2013, local communities throughout the State continue to face significant financial challenges in addressing, in a meaningful and timely manner, the badly needed repairs and retrofits of their crumbling and grossly inadequate infrastructure facilities. These are the very same facilities that are necessary to achieve and sustain economic vitality. The ISRF Program was established by the I-Bank to help meet these challenges.

The ISRF Program is a revolving loan¹ program that provides low-cost financing to local governmental entities (Borrowers) for public infrastructure projects. By pooling funds for project lending through the issuance of program bonds (ISRF Program Bonds) in the public bond market, the I-Bank embarked upon the leveraging of the ISRF Program in order to provide a greater access to capital needed to fund a larger number of capital-intensive projects sooner than would otherwise be available should the I-Bank rely solely on appropriations from the Legislature.

However, in the entirety of the fiscal year ending June 30, 2011, **only one loan was made by I-Bank under the ISRF Program. While fiscal year 2011-12 saw the number of loans rise to three, I-Bank repeated its one loan year in fiscal 2012-2013. This means that over the last three fiscal years, the ISRF Program approved a total of five (5) loans.** Based on such performance, it has become exceedingly clear that the ISRF Program is falling well short of meeting one of the key mandates of the I-Bank Act.

ANALYSIS:

Since assuming office, the I-Bank's Executive Director, along with other I-Bank staff (the Staff), has met with local government officials, governmental agencies, private organizations and other professionals involved with infrastructure development and finance to gauge the effectiveness of the ISRF Program in achieving its stated goals. The common denominator in all the feedback received by the Staff was centered on the difficulties experienced by prospective credit-worthy Borrowers in attempting to meet the overly rigid standards and requirements of the Existing Criteria.

By the same token, exchanges between the Staff and financial advisors, underwriters and other experts in the capital markets have led the Staff to conclude that revision of the Existing Criteria would likely be viewed very favorably with the rating agencies that rate the I-Bank's ISRF Program Bonds. As indicated by the I-Bank's Executive Director during the September Board meeting, the Staff is diligently working on structuring the issuance of new ISRF Program Bonds to refinance existing program bonds with two goals in mind. The first is to achieve cost savings and the second is to issue additional ISRF Program Bonds so that larger amounts would be available to the I-Bank and thus that would enable the ISRF Program to make larger loans to help address the need of capital-intensive infrastructure projects.

The Staff currently expect to bring the proposed refinancing and restructuring of the ISRF Program Bonds to the Board, for final approval, during the November Board meeting. Given that ISRF criteria play a significant role in the rating on ISRF Program bonds, there is an immediate need to address the limitations of the Existing Criteria. The anticipated restructuring of the ISRF Program Bonds, as part of the upcoming refunding transaction, will allow for a more streamlined approach for going to capital

¹ "Loan" is generically used to refer to various forms of limited obligation financings.

markets for additional ISRF Program Bonds. This would take place if and when the demand for ISRF loans reaches a point where issuing an additional series of ISRF Program Bonds is deemed by the Board to be prudent and appropriate.

The Staff have identified 12 major areas, in the Existing Criteria, where the revisions contemplated under the Proposed Criteria are expected to both enhance the quality and prudent administration of the ISRF Program and to assist in providing more readily available financing for creditworthy Borrowers. If adopted by the Board, the Proposed Criteria would make the following substantive amendments to the Existing Criteria:

1. **The Proposed Criteria eliminates the pre-application step in the ISRF Application Process.** When first established, the pre-application step was envisioned as a relatively short and an easy to complete first step in the loan application process. Those pre-applications that provided enough information to indicate that eligibility criteria were likely to be met and approved. Applicants with approved pre-applications would be invited to submit a full financing application.

However, ISRF Staff also hold one or more pre-financing meetings. During such meetings, ISRF applicants discuss the proposed project and its expected impact on the applicant's community, including job creation and retention, community economic need, the unemployment rate, poverty rate and other indicators of need, the extent to which I-Bank's loan leveraged funds from other sources, the ability of the applicant to initiate the project in a timely manner, the amount and maturity of the loan, the financials of the applicant, the sources of repayment and available collateral, and other factors that may be unique to the project. Upon conclusion of such meetings, the applicant would be encouraged to submit a pre-application. However, rather than a quick and easy process to get a rough determination on eligibility, the pre-application process devolved into an increasingly complex one that would often take several months sometimes up to 50 weeks, for the staff to review and reach a decision on an application. The preliminary application only added time to the process. After such a grueling process, potential borrowers would then be asked to submit an actual financing application. The Staff believes that such redundant requirements and the time it took potential borrowers to maneuver through the multi-step application may have served to discourage potential borrowers from participating in the ISRF Program and may have even led some to seek financing from other sources.

Since the pre-meetings actually fulfill the original intended purpose of the pre-applications, the elimination of the pre-application step in the financing process would streamline the process and decrease the overall financing time for potential borrowers .

2. **The Proposed Criteria amends the minimum and maximum loan amounts.** The current range for loan amount is between \$250,000 to \$10 million. The proposed range for the loan amount is between \$50,000 to \$25 million. Larger loans may be approved by I-Bank if supported by strong sources of repayment, strong collateral, strong creditworthy borrowers, or other factors. Stakeholders have

identified a need for a wider range in size of loans mainly due to the increased costs of major projects as well as the need of smaller borrowers for smaller amounts to finance more modest projects.

3. **The Proposed Criteria amends the process for determining the interest rate subsidy for an ISRF Loan.** Under the Proposed Criteria, the ISRF Program would continue to offer low fixed interest rates to eligible Borrowers that are based on the Thompson's Municipal Market Data Index for an "A" rated tax-exempt security with a weighted average life similar to the I-Bank loan. However, the subsidy provided would not be an across-the-board subsidy offered under a one-size-fits-all financing theory. Rather, under the Proposed Criteria, the size of the interest rate subsidy offered would be driven by various considerations that are considered as part of the credit underwriting process.
4. **The Proposed Criteria amends the process for determining the minimum coverage ratio requirement.** Under the Proposed Criteria, the minimum debt service coverage ratio as a requirement applicable to all borrowers is eliminated. By, once again steering away from a one-size-fits-all approach, the Proposed Criteria would provide that the appropriate minimum debt service coverage ratio would be determined on the basis of the credit and underwriting analysis which would take into account various credit-related factors, including, without limitation, the strength of the sources of repayment and available collateral.
5. **The Proposed Criteria eliminates the point system for the selection and prioritization of projects.** Historically, the point system was highly subjective and difficulties in its implementation arose whenever empirical data to support the awarding of points was not readily available. In addition, the point system is not flexible enough to take into account the multiple goals of the I-Bank as expressed by the Legislature in the I-Bank Act.
6. **The Proposed Criteria adds Economic Expansion Projects as eligible projects.** Under the Proposed Criteria, Economic Expansion Projects which facilitate the environmental, economic and social goals in the I-Bank Act and are reflected in the State Environmental Goals and Policy Report would be deemed eligible for I-Bank financial assistance. Economic Expansion Projects, include without limitation, research, cultural, educational, industrial, utility, commercial, recreational and social welfare facilities. At present, the I-Bank does have effective tools to further the economic expansion and job creation goals of the I-Bank Act. By contrast, the addition of Economic Expansion Projects, as eligible projects, would serve as a vehicle to leverage state, federal, local, and private funds to target public investment for the economic health and vitality of California communities. Under the Proposed Criteria, and consistent with the provisions of the I-Bank Act, the borrower for an Economic Expansion Project would be any person, company, corporation, association, state or municipal governmental entity, partnership, firm, or other entity or group of entities; provided that such a borrower is organized as a not for profit entity and it is engaged in business or operations within the State.

7. **The Proposed Criteria eliminates the distinction between Tier 1 and Tier 2 Borrowers.** This distinction was rarely, if ever applied to borrowers under the ISRF Program. Thus, its inclusion as part of the Existing Criteria only served to further complicate the application process.
8. **The Proposed Criteria eliminates the automatic exclusion of borrowers who have rated debt from the ISRF Program.** Under the Proposed Criteria, this amendment is expected to enhance the quality of the borrowers/ISRF loans that serve to secure the ISRF Program Bonds. As such, this revision is intended to both support and work toward the goal of raising the credit rating on ISRF Program Bonds. This in turn would lower the I-Bank's borrowing costs and thus facilitate the I-Bank's ability to continue to provide interest rate subsidies for loans made under the ISRF Program.
9. **The Proposed Criteria eliminates the automatic exclusion of refinancing of existing indebtedness.** Under the Proposed Criteria, potential Borrowers who wish to refinance eligible projects in order to achieve costs savings, may be considered for financial assistance under the ISRF Program if the potential borrower intends to utilize the cost savings to facilitate the development of another infrastructure or economic expansion project.
10. **The Proposed Criteria is amended to provide that an amendment fee will be imposed in proportion to the amount of work involved to effect the requested amendment.** Under the Existing Criteria, an amendment fee is not charged for amendments to existing loan documents. Under the Proposed Criteria, the I-Bank may elect to charge an amendment fee where such a fee would enable the I-Bank to recover significant costs associated with an amendment. This is most likely to occur with respect to complex amendments.
11. **The Proposed Criteria eliminates the selection process for loans secured by tax increment revenues that had been offered in connection with redevelopment agencies.** Given the dissolution of redevelopment agencies in the State of California, the continued inclusion of criteria for the selection of tax-increment secured loans no longer made sense. In the event that the State enacts new laws that permit entities to pledge tax increment revenues to secure loans, the Proposed Criteria would be amended to accommodate such new laws.
12. **The Proposed Criteria adds more transparency to the credit underwriting process.** The Proposed Criteria provides more details as to the specific elements of the credit and underwriting analyses conducted as part of the financing evaluation process under the ISRF Program. .

RECOMMENDATION

The Staff recommends that the Board approve Resolution 13-17 adopting the Amended and Restated Criteria, Priorities and Guidelines for the selection of projects for financing under the Infrastructure State Revolving Fund Program.