MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns a Aaa rating to California Infrastructure and Economic Development Bank Clean Water State Revolving Fund Refunding Revenue Series 2012 Bonds; Outlook is stable

Global Credit Research - 10 Oct 2012

$69.3 million of debt affected

CALIFORNIA INFRASTRUCTURE & ECONOMIC DEVELOPMENT BANK
State Revolving Funds
CA

Moody's Rating

ISSUE		RATING
Clean Water State Revolving Fund Refunding Revenue Bonds, Series 2012		Aaa
Sale Amount	$69,295,000	
Expected Sale Date	10/15/12	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

Opinion

NEW YORK, October 10, 2012 --Moody's Investors Service has assigned a Aaa rating to $69.3 million of California Infrastructure and Economic Development Bank (I-Bank) Clean Water State Revolving Fund Refunding Revenue Series 2012 Bonds. The outlook is stable.

RATING RATIONALE

The rating is primarily based on cash flow projections which demonstrate the program's ability to withstand a default on 42% of the pledged loan portfolio over the life of the bonds. Assuming no pledged loan defaults, the minimum debt service coverage is strong - 1.73x in the year 2014. Additionally, the Series 2012 Bonds will be issued under a new Master Indenture which offers the obligor, State Water Resources Control Board (SWRCB or the Board), with more flexibility and provides bondholders with a solid legal framework.

The refunding is estimated to generate approximately $10 million in present value savings for the Board.

Credit Strengths:

* High default tolerance of 42%.

* Strong minimum debt service coverage of 1.73x.

* Strong (Aa-range) credit quality of pledged loan portfolio

* In the unlikely event that a pledged loan does not perform as expected, management is willing and able to substitute it with a performing loan from the Board's balance sheet.

* The Master Indenture offers the Board with more flexibility and provides bondholders with a solid legal framework.

Credit Challenges:

* There is high concentration and limited diversity among 16 unique borrowers that comprise the pledged loan portfolio, but this risk is mostly mitigated by the credit strengths mentioned above.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The proceeds of the Series 2012 Bonds will be used to refund all of the outstanding Series 2002 Bonds, and to pay costs of issuance of the Series 2012 Bonds. A portion of the proceeds of the Series 2012 Bonds, together with amounts on deposit in certain funds with respect to the Series 2002 Bonds, will be deposited in the Series 2002 Escrow Fund established pursuant to Escrow Instructions from the I-Bank to the Treasurer of the State of California, as escrow agent.

LEGAL SECURITY: The Series 2012 Bonds are special limited obligations of the I-Bank, generally payable from and secured by the pledged revenues derived from the pledged loans, investment earnings on deposit, and any other amounts that the Board may elect to apply, including any amounts transferred from the Restricted Assets Fund.

SERIES 2012 BONDS EXHIBIT ROBUST DEFAULT TOLERANCE

The 2012 Bonds are secured by 24 pledged loans from 16 unique borrowers; the repayments of which are derived from clean water, sewer, and related revenues. Pledged loan principal is $394.8 million, and of that, $143.1 million is maturing prior to the maturity of the bonds. Cash flow projections demonstrate that the minimum debt service coverage throughout the life of the bonds is 1.73x in the year 2014. Thereafter, the debt service coverage reaches a maximum of 3.41x in the bond's final year of payment.

A default tolerance cash flow scenario, which measures the maximum level of pledged loan defaults over the life of the bonds without disrupting debt service obligations, is a key credit factor of the rating on the bonds. The Program's default tolerance scenario demonstrated a robust level of 42% pledged loan defaults, assuming that this proportion of the pledged loan portfolio defaulted immediately and the Board did not benefit from any recovery.

The Series 2012 Bonds utilize a cash flow model, and therefore do not maintain a debt service reserve as did the Series 2002 Bonds that are being refunded.

PLEDGED LOAN PORTFOLIO FEATURES

The pledged loan portfolio exhibits limited diversity characteristics. It is small (16 unique borrowers), the top 5 borrowers comprise a significant amount of the pool (66%), and there are no borrowers comprising less than 1% of the loan portfolio. High levels of concentration is a credit negative because the SRF is more susceptible to the nonperformance of one borrower. However, the SRF exhibits several features that mitigate this risk. First, the weighted average pool rating is strong (Aa-range), and therefore we assess this pool more favorably than one of similar unfavorable diversity attributes but of lower credit quality. The strong weighted average pool rating is driven by 59% of the portfolio being rated A1 or above. In particular, the largest borrower, Orange County Water District (comprising about 28% of the pool) is rated Aa1 (stable outlook). Secondly, as discussed above, the pool exhibits a robust default tolerance level that provides bondholders with superior credit protection from nonperformance of pledged loans. Lastly, the Board has the willingness and ability to substitute nonperforming pledged loans, if any, from its large inventory of performing loans.

2012 MASTER INDENTURE EXHIBITS SOLID LEGAL FRAMEWORK

The 2012 master indenture exhibits key provisions that offer the Board flexibility and provide bondholders with a solid legal framework.

The master indenture permits the substitution of pledged loans at the Board's discretion, and management communicated its willingness and ability to substitute a nonperforming or distressed pledged loan with one(s) from the unpledged portfolio if appropriate. As of June 30, 2012, the Board maintained $3.1 billion of loans (of which $2.8 billion were amortizing, and $394 million are pledged to the 2012 Bonds). We view this as a very strong feature of the legal framework because, although unlikely, it mitigates the risks associated with the nonperformance of a pledged borrower. The strength of this feature however could deteriorate if the amount of unpledged loans available for substitution is materially reduced.

The 2012 indenture utilizes an open structure - meaning additional parity revenue bonds may be issued under the indenture in the future provided that the additional bonds test is satisfied. With this feature, all bonds issued under the indenture can be cross-collateralized with program-level assets, as opposed to having a series-specific flow of funds as was the case in the 2002 indenture. The 2012 indenture maintains a closed-loop structure which retains pledged assets unless released per the Coverage Test at the Board's discretion. The Coverage Test must demonstrate that program assets are not less than 105% of debt service for each bond year, and that the debt service reserve, if any, is fully funded as per the minimum requirement. (The 2012 Bonds are not required to maintain a reserve). If these two conditions are met, pledged assets may be released from the lien of the indenture and transferred to the Clean Water SRF (outside of the indenture) free and clear. Furthermore, the legal framework establishes the opportunity to potentially cross-collateralize with the Drinking Water SRF, which is administered by California's Department of Public Health, in the future. There are no drinking water loans in the program at this time.

OUTLOOK

The outlook on the bonds is stable to reflect sufficient additional resources and ability to mitigate the risks associated with nonperforming loans, including: high default tolerance, strong credit quality of the loan portfolio, and the ability to substitute loans under the Master Indenture.

What could change the rating up:

* Not applicable

What could change the rating down:

* Material deterioration of the loan portfolio credit quality

* Significant decline in minimum debt service coverage or default tolerance

KEY INDICATORS

* Bond program type - Cash flow

* Default tolerance - 42%

* Minimum debt service coverage - 1.73x

* Pool weighted average rating range - Aa

* Unique borrowers - 16

* Borrowers with less than 1% of the total portfolio - 0%

* Top 5 borrowers - 66%

1.Orange County Water District (Aa1) - 28%

2.City of Hayward (NR) - 12%

3.Yucaipa Valley Water District (A1) - 10%

4.City of Chico (NR) - 10%

5.Inland Empire Utilities Agency (Aa2) - 7%

The principal methodology used in this rating was U.S. State Revolving Fund Debt published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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