

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK

UTILIZATION OF CERTAIN MONEY WITHIN THE CALIFORNIA INFRASTRUCTURE GUARANTEE TRUST FUND

STAFF REPORT

I. INTRODUCTION

IBank seeks the release of money that has been sitting idle for over 15 years because of a 2003 commitment to guarantee bonds the Imperial Irrigation District (“IID”) never issued. Freeing this money will allow IBank to expand its financing opportunities for critical projects for local governments and other eligible borrowers.

In 2003, the IBank Board of Directors (the “**Board**”) adopted a resolution committing up to \$20 Million to guarantee bonds IID expressed an intent to issue for a water project. The commitment initially was set to expire at the end of 2009. A subsequent resolution extended the expiration date by one year. Then, before the commitment could expire on December 31, 2010, Senate Bill 856 was adopted. Section 69 of that Bill required IBank to hold the original commitment amount and all accumulated interest (a sum totaling \$24,247,108.79) for IID’s benefit in perpetuity. IBank may use this money only to guarantee IID’s eventual bonds, bonds that have not been issued in over 15 years, and which might never be issued.

IBank’s \$24,247,108.79 will remain tied-up until either IID finally issues its bonds or the Legislature adopts new legislation releasing IBank’s money back to IBank. However, that sum has accumulated interest over the years and that interest is not part of the money the Legislature committed to IID. IBank requests the Board’s approval to remove the accreted interest from the IID commitment and instead apply it to IBank’s existing ISRF Bond Reserve Fund, freeing-up an equivalent amount of IBank equity to be used for ISRF projects, or for any other purpose permitted under the Bergeson-Peace Infrastructure and Economic Development Bank Act (the “**Act**”).

II. BACKGROUND:

A. The Act Enables IBank to Insure its Bonds and to Guarantee Third Parties’ Bonds.

The Act establishes three funds: (1) the California Infrastructure Guarantee Trust Fund (Government Code (“**GC**”) Sections 63060-63067) (the “**Guarantee Fund**”); (2) the California Infrastructure and Economic Development Bank Fund (GC

Sections 63050-63056) (the “**IBank Fund**¹”); and (3) the California Small Business Expansion Fund (GC Sections 63089.5-63089.62) (the “**Expansion Fund**²”).

The Guarantee Fund is the subject of this Staff Report. The Guarantee Fund creates a mechanism for IBank to insure its various debt obligations and to issue guarantees on behalf of the State and local governments. GC Section 63060(a) provides, in relevant part, that the Guarantee Fund was created “... for the purpose of insuring all or a portion of the accounts and subaccounts within the [IBank Fund], any contracts or obligations of the bank or a sponsor³, and all or part of any series of bonds issued by the bank, or a special purpose trust, or by a sponsor pursuant to this division, and for the purpose of defraying the administrative expenses incurred by the bank in operating the programs of loan and bond guarantee.” (GC Section 63060(a).)

Although each Fund has an independent existence and was created for a separate purpose, the statutory scheme does allow for some overlap between the IBank Fund and the Guarantee Fund. For instance, IBank’s Executive Director may transfer money between the IBank Fund and the Guarantee Fund “... when appropriate to accomplish the financing objectives of [the Act].” (GC Section 63050(e).)

B. IBank Issues a Commitment to Guarantee Future IID Bonds.

On May 13, 2003, IID applied to IBank for a preliminary loan guarantee commitment. IID’s application requested that IBank guarantee IID’s planned \$150 Million bond financing. IID intended its planned bond issue to finance certain water conservation projects necessary to ensure the continued receipt of the maximum possible amount of Colorado River water.

On May 28, 2003, the Board adopted Resolution 03-16 approving Criteria, Priorities and Guidelines for a proposed IID loan guarantee. Resolution 03-16 authorized IBank’s Executive Director to transfer \$20 Million from the IBank Fund to the Guarantee Fund. Soon thereafter IBank completed the \$20 Million transfer.

On June 27, 2003, the Board adopted Resolution 03-18, approving a \$20 Million preliminary loan guarantee commitment in favor of IID (the “**Preliminary Guarantee Commitment**”). The Preliminary Guarantee Commitment was set to expire by its own terms on the earlier of: (1) December 31, 2003, unless IID had entered into a series of agreements related to the allocation and transfer of Colorado River water

¹ The purpose of the IBank Fund is to implement the objectives and provisions of the Act. (GC Section 63050(a).)

² The Expansion Fund’s purpose is to fund small business loans and guarantees and to pay the administrative costs of IBank’s Small Business Finance Center. (GC Section 63089.5(b).)

³ Government Code Section 63010(u) defines a “sponsor” as “... any subdivision of the state or local government, including departments, agencies, commissions, cities, counties, nonprofit corporations formed on behalf of a sponsor, special districts, assessment districts, and joint powers authorities within the state or any combination of these subdivisions that makes an application to the bank for financial assistance in connection with a project in a manner prescribed by the bank.”

with the San Diego County Water Agency and other Southern California water agencies, and (2) December 31, 2009.

IID entered into the necessary agreements to extend the Preliminary Guarantee Commitment past December 31, 2003. However, by December 2009, IID still had not issued its bonds and IBank and IID still had not entered into a guarantee agreement. Instead of allowing the Preliminary Loan Commitment to expire, the Board adopted Resolution 09-48 on December 15, 2009, modifying certain terms of the Preliminary Guarantee Commitment and extending its expiration date to December 31, 2010.

C. SB 856 Extends IBank's Preliminary Guarantee Commitment in Perpetuity.

Despite IBank's previous accommodation of IID and ongoing patience with the delay in issuing the IID Bonds, as 2010 neared its end IID was no closer to actually issuing bonds and IBank's Preliminary Guarantee Commitment would soon expire. In October 2010, Senate Bill 856 was signed into law. Section 69 of SB 856 ("**SB 856/69**") provided that the \$20 Million transferred to the Guarantee Fund in connection with Resolution 03-18, together with accrued interest as of January 1, 2010, was to be "... deposited in a guarantee reserve account within the [Guarantee Fund], which is hereby established as the IID Infrastructure Guarantee Trust Account." As of January 1, 2010, the balance of the IID Infrastructure Guarantee Trust Account (hereinafter, the "**IID Guarantee Account**") was \$24,247,108.79 (the "**IID Guarantee Balance**").

SB 856/69 designated the money in the IID Guarantee Account as of January 1, 2010 as the "reserve account requirement" under GC Section 63064. As discussed in more detail in Section III, below, this designation effectively required that the amount in the IID Guarantee Account as of January 1, 2010 remain set aside in perpetuity for the benefit of guaranteeing IID's potential future bonds.

SB 856/69 provided that IID may issue bonds to finance certain water delivery system efficiency improvements designed to ensure a full allocation of Colorado River water (the "**IID Bonds**") in a par amount of up to \$150 Million (in 2003 dollars, adjusted to present value by the construction cost index). SB 856/69 further required that IBank issue a guarantee for the IID Bonds backed by the IID Guarantee Account.

The net result of SB 856/69 was to trap the IID Guarantee Balance in the IID Guarantee Account until either IID finally issued the IID Bonds, or the Legislature somehow modified SB 856/69.

Although the IID Guarantee Balance must sit idle awaiting IID's potential future action, SB 856/69 did not seal to the same fate the \$1,088,355.39 in interest that has accumulated since January 1, 2010 (the "**Accumulated Interest**"). The Act and SB 856/69 would permit IBank to use this accumulated interest (in a manner consistent with the Act) for IBank's other programs.

III. ANALYSIS:

A. The Act Permits IBank's Use of the Accumulated Interest to Guarantee, or as a Credit Enhancement for, IBank's ISRF Bonds; the IID Guarantee Balance Must Remain Set-Aside for IID's Potential Future Bonds.

A primary purpose of the Guarantee Fund is to back IBank's debt. GC Section 63060(a) provides "... all money in the [Guarantee Fund] is hereby continuously appropriated to the bank without regard to fiscal years for the purpose of insuring all or a portion of the accounts and subaccounts within the infrastructure bank fund, any contracts or obligations of the bank or a sponsor, and all or part of any series of bonds issued by the bank ...". GC Section 63060(a) goes on to state "The [Guarantee Fund] is authorized to guarantee all or a part of any of the accounts and subaccounts within the infrastructure bank fund, any contracts or obligations of the bank ..., and all or part of any series of bonds issued by the bank ... and to authorize payment on any guarantee or enhancement of the [Guarantee Fund]."

The Act is clear that IBank may use money in the Guarantee Fund to insure/guarantee IBank's Bonds. IBank issued three series of its Infrastructure State Revolving Fund Revenue Bonds, one in 2014, one in 2015, and one in 2016 (collectively, the "**ISRF Bonds**"). Repayment to the ISRF Bondholders is secured by a reserve fund (the "**ISRF Bond Reserve**"), which acts as a payment guarantee for the ISRF Bondholders. If for any reason IBank is unable to pay when due debt service on the ISRF Bonds, the ISRF Bondholders will instead be paid out of the ISRF Bond Reserve.

The ISRF Bond Reserve is required to be maintained at the least of (1) 10% of the initial offering price of the ISRF Bonds, (2) maximum annual debt service for the ISRF Bonds, or (3) 125% of the average annual debt service on the ISRF Bonds. The ISRF Bond Reserve is to be maintained at this "lesser of three test" level until all outstanding ISRF Bonds are repaid.

Because the ISRF Bond Reserve acts as a form of guarantee for IBank's payment of the ISRF Bond debt service, the Act permits using Guarantee Fund moneys for the ISRF Bond Reserve (unless money in the Guarantee Fund is otherwise committed). The IID Guarantee Balance is already committed to guaranteeing the IID Bonds, and so could not be used to fund the ISRF Bond Reserve. SB 856/69 deemed the IID Guarantee Balance to be the "reserve account requirement," as that term is used in GC Section 63064(a). GC 63064(a) states "The Legislature may establish, and from time to time increase, for the guarantee reserve account a requirement that shall be known as the 'reserve account requirement.'" GC Section 63063(a) provides that IBank "... shall take all reasonable steps to ensure that the guarantee reserve account is continuously maintained at not less than the reserve account requirement ...". GC 63063(b) states that IBank "... shall not cause sums to be withdrawn from, the guarantee reserve account in amounts that would reduce the moneys therein to less than the reserve account requirement, except as necessary to satisfy liabilities

arising under contracts of guarantee.” SB 856/69’s designation of the IID Account Balance as the reserve account requirement, and setting aside the IID Account Balance for the eventual guarantee of the IID Bonds, prevents IBank from utilizing that money for any purpose other than guaranteeing the potential IID Bonds.

On the other hand, neither the Act nor any provision of SB 856/69 prohibits IBank from utilizing the Accumulated Interest to guarantee the ISRF Bonds.

IBank previously funded the ISRF Bond Reserve with its own equity; IBank did not use any ISRF Bond proceeds to fund the ISRF Bond Reserve. IBank could have used Accumulated Interest to fund partially the ISRF Bond Reserve, but it did not. Now, IBank seeks to apply the Accumulated Interest to the ISRF Bond Reserve and release an equivalent sum of IBank’s equity from the ISRF Bond Reserve back to IBank. IBank intends to deposit its initial freed equity into the Treasurer’s Surplus Money Investment Fund.

B. SB 856/69 does not Prohibit IBank from Using the Accumulated Interest to Guarantee, or as a Credit Enhancement for, IBank’s ISRF Bonds.

Nothing in SB 856/69 prohibits IBank from using the Accumulated Interest. SB 856/69 only commits the IID Guarantee Balance to the potential future IID Bond issue and sets the IID Guarantee Balance as the “reserve account requirement” under GC Section 63064(a). SB 856/69 does not place any limits on, or even mention, the use of Accumulated Interest. A copy of SB 856/69 is attached hereto as Exhibit A.

C. IBank Intends to File a Validation Action, and has Provided a Copy of this Staff Report to IID, to Ensure IBank’s Use of the Accumulated Interest is Legally Binding and Free from any Challenge or Protest.

Code of Civil Procedure Section 860 permits an agency to bring an action in the Superior Court of the County the agency is located in to determine the validity of a matter, if the agency is authorized to do so by law (a “**Validation Action**”). GC Section 17700 provides that the State or any agency, department, etc., of the State may bring an action to determine the validity of its contracts and obligations. IBank seeks to obligate the Accumulated Interest to secure the ISRF Bonds. Therefore, IBank is entitled to, and intends to, file a Validation Action in the Sacramento County Superior Court seeking a determination that its intended pledge of the Accumulated Interest to the ISRF Bond Reserve is proper.

Specifically, IBank intends to validate its plan to transfer the Accumulated Interest from the Guarantee Fund to the account holding the ISRF Bond Reserve. This account is within the IBank Fund. GC Section 63050(e) permits IBank to transfer money between the IBank Fund and the Guarantee Fund. Therefore, GC 63050(e) permits IBank to transfer the Accumulated Interest (currently residing in the Guarantee Fund) to the account holding the ISRF Bond Reserve (residing in the IBank Fund).

However, GC Section 63065(c) appears to conflict with GC Section 63050(e). GC Section 63065(c) provides that money in the Guarantee Fund "... may not be transferred to any other fund except for payment on any guarantee or enhancement ...". This portion of the Act indicates the Accumulated Interest could not be transferred directly into the account holding the ISRF Bond Reserve. GC Section 63065(c) does allow for the pledge of money in the Guarantee Fund and the subsequent payment of Guarantee Fund money to the pledgee in the event of a default.

IBank believes that GC Section 63050(e) is the more specific statute and should govern over GC Section 63065(c). IBank intends to solidify its belief through its planned validation action. However, if a court were to determine for some reason that GC Section 63065(c) governed over GC 63050(e), then IBank intends to leave the Accumulated Interest within the Guarantee Fund, obtain a credit enhancement in an amount approximately equal to the Accumulated Interest, pledge the Accumulated Interest as security for the credit enhancement, then use the credit enhancement to replace an equivalent sum of money in the ISRF Bond Reserve. Doing so is permitted under the ISRF Bond Indenture and is consistent with the restrictions of GC Section 63065(c).

Further, IBank has given IID the opportunity to comment on IBank's planned use of the Accumulated Interest. IBank sent IID a copy of this Staff Report and invited IID to attend the Board meeting to discuss any concerns it may have.

IV. CONCLUSION AND STAFF RECOMMENDATION

The Accumulated Interest is sitting idle in an account, benefitting no one. Instead of allowing the Accumulated Interest to remain trapped, IBank proposes releasing the money and using it to guarantee the ISRF Bonds. This will, in turn, free money previously guaranteeing the ISRF Bonds to be used to finance projects for municipalities, schools, and other eligible IBank borrowers, or for any other purpose permitted under the Act. Accordingly, IBank recommends approval of Resolution 18-17, which will authorize IBank's Executive Director or Chief Deputy Executive Director to take all necessary action, including causing a Validation Action to be filed on IBank's behalf, to pledge and/or transfer to the ISRF Bond Reserve (1) the Accumulated Interest, and (2) all future interest that accumulates in the IID Guarantee Account.

Submitted By: Teveia Barnes, Executive Director
 William Pahland, General Counsel

November 9, 2018

SENATE BILL 856, SECTION 69

SEC. 69.

(a) For the purpose of this section, the following words and terms shall have the following meanings:

(1) "Bank" means the California Infrastructure and Economic Development Bank.

(2) "IID" means the Imperial Irrigation District.

(3) "IID Infrastructure Guarantee Trust Account" means the account within the California Infrastructure Guarantee Trust Fund established by this section.

(4) "Infrastructure Bank IID Guaranteed Project Bonds" means obligations of IID issued in a principal amount providing net project proceeds of up to one hundred fifty million dollars (\$150,000,000) in 2003 dollars as adjusted to their present value by the construction cost index, comprising the net of costs of issuance and the funding of a reserve account in the maximum amount provided by federal law with respect to tax exempt obligations, the net project proceeds of which are for the purpose of completing Transfer Agreement Project Improvements.

(5) "SDCWA" means the San Diego County Water Authority.

(6) "Shortfall" means, to the extent the number is negative, revenues received by IID pursuant to the transfer agreement, less the operation and maintenance costs, administrative costs, other noncapital costs related to the Transfer Agreement Project Improvements, and debt service on the Infrastructure Bank IID Guaranteed Project Bonds, not to exceed the amount due as debt service on the Infrastructure Bank IID Guaranteed Project Bonds on any payment date for those bonds and subject to offset as set forth in this section.

(7) "Transfer agreement" means that Agreement for Transfer of Conserved Water by and between IID and SDCWA dated April 29, 1998, as amended as of October 10, 2003.

(8) "Transfer Agreement Project Improvements" means projects or programs undertaken by IID for the purposes of the development of "conserved water" as that term is used in, and for the purposes of, the Quantification Settlement Agreement that was executed on October 10, 2003, that are financed with proceeds of the Infrastructure Bank IID Guaranteed Project Bonds.

(9) "Triggering event" means any of the following:

(A) Termination of the transfer agreement on or before October 3, 2048, for reasons other than set forth in subparagraph (B) or (C).

(B) A default under the transfer agreement by SDCWA resulting in a reduction in revenues payable to IID, provided that IID has assigned to the bank that portion of its payment rights under the transfer agreement sufficient for the bank to be made whole in the event recovery is obtained from the SDCWA.

(C) A court or administrative body order or other action that results in a reduction or elimination of revenues under the transfer agreement.

(b) The amount in the California Infrastructure Guarantee Trust Fund or any account in that fund on January 1, 2010, that is held for the benefit of the IID pursuant to Resolution No. 03-18, adopted by the California Infrastructure and Economic Development Bank on June 27, 2003, shall be deposited in a guarantee reserve account within the fund, which is hereby established as the IID Infrastructure Guarantee Trust Account. This amount shall also constitute the "reserve account requirement" for the account for the purposes of Section 63064 of the Government Code.

(c) The Infrastructure Bank IID Guaranteed Project Bonds shall be guaranteed by the bank, and the IID Infrastructure Guarantee Trust Account shall constitute the guarantee reserve account for the Infrastructure Bank IID Guaranteed Project Bonds as provided in Section 63063 of the Government Code. Moneys in the IID Infrastructure Guarantee Trust Account, including any amounts appropriated to this account, shall be paid for the benefit of the holders of the Infrastructure Bank IID Guaranteed Project Bonds in the amount of the shortfall upon the occurrence of all of the following: (1) a triggering event; (2) the exhaustion of the bond reserve account funded in the maximum amount provided by federal law with respect to tax exempt obligations by the Infrastructure Bank IID Guaranteed Project Bonds; and (3) funding by IID of debt service payments for 12 consecutive months. Moneys shall be transferred from the IID Infrastructure Guarantee Trust Account by the bank to the trustee for the Infrastructure Bond IID Guaranteed Project Bonds in an amount not to exceed the shortfall for the purpose of making principal or interest payments on the Infrastructure Bank IID Guaranteed Project Bonds.

(d) If a triggering event occurs and IID enters into a water transfer agreement with one or more parties, or a subsequent water transfer agreement with SDCWA, for all or any portion of the water that otherwise would have been transferred to SDCWA pursuant to the

transfer agreement, IID shall apply the net revenues received under the water transfer agreement or agreements as an offset against the shortfall.

(e) The Infrastructure Bank IID Guaranteed Project Bonds shall have maturities not to exceed 30 years from the date of issuance of each series of these obligations and bear a fixed rate of interest. The Infrastructure Bank IID Guaranteed Project Bonds shall be structured with level debt service unless the board of directors of the bank approves non-level debt service. The date or dates of issuance shall be as determined by IID.

(f) The guarantee by the bank of the Infrastructure Bank IID Guaranteed Project Bonds and any payment thereunder shall be without any rights of recourse, subrogation, reimbursement, contribution, or indemnity against IID, provided that IID shall reimburse any guarantee payments received in any IID fiscal year to the extent that transfer revenues in that fiscal year received under the transfer agreement, or under any subsequent water transfer agreements described in subdivision (d) exceed the amount required for IID to pay the operation and maintenance costs, administrative costs, and other noncapital costs related to the Transfer Agreement Project Improvements plus debt service on the Infrastructure Bank IID Guaranteed Project Bonds.

(g) The obligation of the bank and of the state to pay any guarantee benefit for the Infrastructure Bank IID Guaranteed Project Bonds shall be a limited obligation of the bank payable solely from amounts deposited in the IID Infrastructure Guarantee Trust Account pursuant to this section, or subsequently appropriated for deposit in the IID Infrastructure Guarantee Trust Account pursuant to subdivision (d) of Section 63064 of the Government Code. Upon the occurrence of a triggering event and satisfaction of the conditions precedent for funding described in subdivision (c), the executive director of the bank shall take the action as provided in Section 63064 of the Government Code. The guarantee of the Infrastructure Bank IID Guaranteed Project Bonds under this section shall not directly or indirectly or contingently obligate the state or any of its political subdivisions to levy or to pledge any form of taxation whatever for them or to make any appropriation for their payment. The contract of guarantee to be entered into by the bank shall contain on its face a statement to the following effect: "Neither the faith and credit nor the taxing power of the State of California is pledged to the payment of the principal of, or interest on, this contract of guarantee."

(h) The bank shall enter into a guarantee agreement with IID that is consistent with the terms of this section, as approved by the board of directors of the bank. Article 3 (commencing with Section 63040), Article 4 (commencing with Section 63042), and Article 5 (commencing with Section 63043) of Chapter 2 of Division 1 of Title 6.7 of the Government Code shall not apply to the guarantee by the bank of the Infrastructure Bank IID Guaranteed Project Bonds.

(i) Pursuant to Section 63066 of the Government Code, the bank may charge and collect an insurance guarantee premium upon the issuance of the guarantee of the Infrastructure Bank IID Guaranteed Project Bonds, not to exceed 1 percent of the principal amount thereof from the proceeds of the bonds, in an amount established by the board of directors of the bank.