



Rating Update: MOODY'S AFFIRMS Aa3 RATING ON CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK ENERGY EFFICIENCY MASTER TRUST REVENUE BONDS SERIES 2003A & 2005A; OUTLOOK REMAINS STABLE

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APPROXIMATELY \$19.9 MILLION OF OUTSTANDING DEBT AFFECTED

CALIFORNIA INFRASTRUCTURE & ECONOMIC DEVELOPMENT BANK
State Revolving Funds
CA

Opinion

NEW YORK, February 01, 2012 --Moody's Investors Service has affirmed the Aa3 rating on approximately \$19,935,000 of California Infrastructure and Economic Development Bank (I-Bank), Energy Efficiency Master Trust Revenue Bonds, Series 2003A and 2005A. The outlook remains stable.

RATING RATIONALE

The rating is primarily based on the sizeable reserves securing the bonds and sufficient projected debt service coverage levels (minimum of 1.10x). The principal sources of security for the bonds are loan repayments derived from energy cost savings and other legally available sources of the pledged loan recipients, investment earnings, and the reserves.

STRENGTHS

- * Sizeable series-level reserves invested in Royal Bank of Canada (rated Aa1/P-1) guaranteed investment contracts (GICs), as well as an additional program-level Master Reserve account
- * Sufficient projected debt service coverage levels which are required to meet at least 1.10x coverage throughout the life of the deal prior to any release of funds from the program, as pursuant to Secured Loan Agreements
- * If necessary, management's willingness and ability to substitute a nonperforming pledged loan with a performing unpledged loan in order to meet debt service payments as well as the bonds' 1.10x debt service coverage sufficiency, as mentioned above
- * Loan repayments are due over two months in advance of bond debt service, providing sufficient time for any delayed payments to be addressed
- * 2003A bonds will mature in 2014, and the 2005A bonds will mature in 2019

CHALLENGES

- * The contingent nature of the underlying loan pledges and certain borrower profiles weaken the loan portfolio's overall credit quality
- * Weak loan portfolio diversity, specifically a high concentration among the top 5 largest borrowers and a low proportion of borrowers that comprise less than 1% of the total loan portfolio

DETAILED CREDIT DISCUSSION

CHARACTERISTICS OF LOAN PORTFOLIO SECURITY

Pledged loans are unsecured obligations between the borrower and the California Energy Commission (CEC). Repayments are primarily derived from the funded project's energy cost savings as calculated in a manner prescribed by the CEC. Prior to pledging a loan's repayments to secure a series of bonds, the borrowers' energy cost savings had been previously deemed sufficient in order to meet its loan obligations. Changes in energy use and rate reductions and changes to the borrower's equipment/facility which occur after issuance of the loan will not affect the CEC's initial finding of energy cost savings. There is no assurance, however, that the performance of the project will not deteriorate, that energy rates will not decline to a point at which energy savings are no longer realized, or that other factors may not result in a loss of energy savings. In the event annual energy cost savings resulting from the project fail to equal or exceed the amount of loan repayments due, the loan agreement may be renegotiated.

At the sole discretion of the borrower, and to the extent there are any available, the borrower may choose to use other legally available funds to fulfill loan repayments in the event of insufficient energy cost savings. The borrower loan agreements do not define what funds could be legally available, but specific language prohibits the borrower from levying taxes to ensure repayment.

It is possible that the validity or enforceability of any or all of the pledged loans could be challenged on the basis that they represent a debt contingent on energy savings of the borrowing public entity without a vote of the electorate, as is often required for municipal entities in the State of California entering into debt obligations. However, a 1984 opinion written by the California Attorney General concluded that the borrowing of funds to implement an energy conservation project did not require electorate consent because the energy loans constituted a contingent liability payable solely from the savings in energy costs and because the governing body was not empowered to levy taxes for the purpose of making loan repayments.

In the event that a pledged loan does not perform as expected, including becoming seriously delinquent or defaulting, it may be substituted at management's discretion with a seasoned, current loan from the CEC's unpledged loan portfolio. Management has indicated a strong willingness and ability to take action if necessary, although it has never been required to do so. The June 30, 2011 audit reported non-current assets of \$41.8 million comprised of non-pledged loan receivables, though the amount of bondholder security provided by substitution of nonperforming loans could be diminished if the program leverages its (currently) unpledged loan portfolio with additional debt.

Additionally, loan repayments are due over two months before bond debt service is payable, providing ample time for any delayed payments to be addressed.

SIZEABLE DEBT SERVICE RESERVES PROVIDE SUFFICIENT SECURITY TO BONDHOLDERS

As of June 30, 2011, debt service reserves were sized to approximately 60% and 26% of the total outstanding debt for the 2003A and 2005A series, respectively. Funds that reside within the reserves are invested in Royal Bank of Canada (RBC) (rated Aa1/P-1) guaranteed investment contracts (GICs) which provide fixed rates of return. Although the reinvestment rates are more profitable than other comparable instruments in today's low interest rate environment, any counterparty credit deterioration may reduce bondholder security through heightened counterparty risks such as the loss of invested funds due to bankruptcy. If RBC were to be downgraded, further review of the program may be necessary.

One bond series' program loans do not secure the payment of the other, except to the extent the repayments are made available through the Master Reserve pursuant to the Master Trust Agreement. Moneys transferred to the Master Reserve account will be available to pay debt service on any Master Trust bonds that experience debt service shortfalls or insufficient series-level reserve fund amounts. The Master Reserve is particularly important because it cross-collateralizes the program's multiple bond

series by temporarily trapping surplus funds at the bottom of the flow of funds prior to release.

SUFFICIENT DEBT SERVICE COVERAGE PROJECTIONS

Recent cash flow projections demonstrate 1.10x minimum debt service coverage levels for the 2003A and 2005A series, individually. The coverage is calculated from amounts in the surplus repayment account, loan repayments, and investment earnings (when applicable). Pursuant to the legal documents, funds may not be released from the program unless the minimum coverage requirement is met throughout the life of the bonds.

LOAN PORTFOLIO COMPOSITION CHARACTERISTICS; RECENT PERFORMANCE AND TRENDS

Of the borrowers that comprise the \$19.98 million loan portfolio, approximately 70% are rated (or have been assigned an internal credit assessment) in the A-range or above. Several factors, including the contingent nature of the pledge and the portfolio's composition of healthcare and not-for-profit borrowers, weaken the loan portfolio's overall credit quality. Furthermore, the portfolio does not exhibit any strong diversity characteristics. There is a high concentration among the top five borrowers and a low proportion of borrowers that comprise less than 1% of the total portfolio.

Beginning in July 2010, the California Department of Mental Health (pledged to Series 2005A) became delinquent on its loan repayments due to delayed appropriations. The \$104,505 payment was eventually received in April 2011 when the state budget had been resolved. CEC's management has expressed no credit concerns related to this borrower going forward. This is one of seven late payments the program has experienced since 2006. Furthermore, the program experienced two full prepayments of approximately \$760,000 within the past 12 months. Prepayments could diminish projected debt service coverage levels due to reduced interest payments. Borrowers do not experience a penalty for prepaying.

The 2003A bonds will mature in 2014, and the 2005A bonds will mature in 2019.

Outlook

The outlook is stable based on the strong levels of reserves and sufficient debt service coverage projections.

WHAT COULD CHANGE THE RATING UP

- * A significant improvement in the portfolio credit quality

WHAT COULD CHANGE THE RATING DOWN

- * Credit deterioration of the loan portfolio or of any investment provider
- * Debt service coverage levels which are insufficient to meet the 1.10x requirement
- * Leveraging the unpledged loan portfolio in a way that significantly reduces management's ability to substitute nonperforming pledged loans in the event of nonperformance

KEY STATISTICS

- * Unique borrowers: 16, 36, and 50 for the 2003A, 2005A and combined program, respectively
- * Composition of top 5 borrowers: 78%, 51%, and 47% for the 2003A, 2005A and combined program, respectively
- * Composition of borrowers with less than 1% of total portfolio: 1%, 8%, and 10% for the 2003A, 2005A and combined program, respectively

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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