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Chief Executive Officer

July 28, 2010

TO: Supervisor Gloria Molina, Chair
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: William T Fujioka
Chief Executive Officer

STATUS MEMORANDUM REGARDING AMERICAN RECOVERY AND REINVESTMENT ACT PROJECT FINANCING MECHANISMS

This is to provide your Board with a status update on the capital project financing mechanisms authorized under the American Recovery and Reinvestment Act (Recovery Act) and potential issues that may compromise the County's ability to realize the full financial benefits that were initially anticipated under these programs.

Currently, we are well-positioned to fully utilize the allocations of Qualified Energy Conservation Bonds (Energy Bonds) and Recovery Zone Economic Development Bonds that the County is authorized to issue under the Recovery Act. With respect to the Recovery Zone Facility Bonds (Facility Bonds), we are finalizing recommendations on feasible projects for your approval. Based on the project proposals we have received for the Facility Bonds, however, it appears that the full $271.5 million allocation made available to the County will not be utilized. We will be presenting project recommendations to your Board for the Energy Bonds and Facility Bonds programs on August 10, 2010.

The ability of state and local governments to issue Build America Bonds (BABs) in the future has been severely compromised by recent developments at the federal level. The deletion of a proposed extension of the issuance deadline for BABs from the recently enacted unemployment benefit extension caused a severe disruption in liquidity of the BABs market and has impaired the feasibility of future BABs issues. As a result, the County's ability to utilize BABs to the degree previously anticipated is now questionable.

The Chief Executive Office (CEO) is developing alternative financing plans, in close collaboration with the Treasurer's office, and will present recommendations for financing projects we were previously planning to finance with BABs to your Board, at the end of September, 2010.

Background

On February 17, 2009, President Obama signed the Recovery Act into law and enacted a $787 billion stimulus program, which included the BABs, an expansion of the Energy Bond program and Recovery Zone Bonds. The intent of the Recovery Act and these financing programs was to promote economic growth through the provision of unique financing incentives for state and local capital improvements. The BABs and Recovery Zone programs require the issuance of bonds by December 31, 2010.

Current Program Status

Qualified Energy Conservation Bonds

Qualified Energy Conservation Bonds are taxable bonds that can be issued by state or local governments to finance public capital improvements that will reduce energy consumption by 20 percent in governmental buildings or expand the use of renewable energy sources and other alternatives to fossil fuel technologies. The County is authorized to issue $39,018,000 in Energy Bonds. Legislation was approved in early 2010 that resulted in a direct federal subsidy of 70 percent of interest costs on the bonds. The bonds are not subject to an issuance deadline.

On January 26, 2010, your Board affirmed the County's intent to fully utilize its $39,018,000 Energy Bond allocation. Subsequent to your Board's approval, we have worked with the Chief Information Office (CIO) and Internal Services Department (ISD) to identify suitable locations for solar photovoltaic panel installations, based upon solar potential, system size (larger systems are more cost efficient due to economies of scale), and on-site electricity usage, which exceeds the electricity generated by the solar panel installation. Based on these criteria, the following projects will be recommended to your Board for financing under the Energy Bond Program. It is anticipated that together, these projects will result in the installation of approximately 6.0 megawatts of solar power.

Solar Installation Program: High Desert Campus – Solar Farm

The installation of a 2-megawatt, ground-mounted solar panel farm will be proposed at the County's High Desert Campus, located on vacant land between Mira Loma Detention Center and Challenger Probation Camp in the City of

Lancaster. The electricity generated by the proposed solar farm would be used by the County facilities on the campus and generate sufficient energy to offset a substantial share of their electricity costs. The project is also eligible for incentives from the California Solar Initiative, a State program which provides payment for solar electricity power. State incentives for solar energy electricity generation are estimated to cover approximately one-quarter of the project's costs. A Mitigated Negative Declaration is being prepared and should be completed in August. When factoring in bond issuance costs, a total of $15.0 million in authorization would be required for the project.

Solar Installation Program: Roof Installations on County Facilities

It will be recommended that the remaining $24.0 million in Energy Bond issuance authorization be committed to the installation of solar panels on the roofs of selected County facilities. We have identified a "short-list" of County facilities that present the best opportunities for County solar rooftop installations, a list of which is attached to this memorandum. It is conservatively estimated that the remaining Energy Bond allocation of $23.0 million will fund roof installations with a capacity of 4.5 megawatts. Potential sites are listed below, along with a projected system size to be installed at each site based on the conservative assumption of four megawatts of installed capacity.

Facility	Location	Potential Megawatts
Humphrey Comp. Health Center	Los Angeles	0.75
Sheriff STARS Training Center	Whittier	0.75
Nidorf Juvenile Hall	Sylmar	0.75
Los Padrinos Juvenile Hall	Downey	0.75
Palmdale Sheriff Station	Palmdale	0.3
LAC+USC Medical Center (General Hospital)	Los Angeles	0.3
Probation Camps Miller/Kilpatrick	Malibu	0.3
Century Regional Detention Center	Lynwood	0.3
El Monte Comprehensive Health Center	El Monte	0.3

My office is working with ISD to validate building conditions, such as roof profiles and conditions, as well as building energy data, and are budgeting project cost estimates. We are planning to present final cost and savings projections to your Board for approval, along with final financing recommendations that will be developed in collaboration with the Treasurer's office, by the end of December, 2010.

Solar Energy Generation Incentives

Owners of solar installations in Southern California Edison's service area can receive incentive payments under the California Solar Initiative program based on the amount of power produced. These State incentives for solar energy electricity generation presently provide $0.19 per kilowatt hour (kWh) produced for the first five years.

Los Angeles Department of Water and Power (LADWP) service areas are not eligible to receive these incentives. LADWP does offer, however, a separate incentive program which provides a one-time incentive payment for anticipated electricity generation over a 20-year period. The incentive rates are $0.059 per kWh, or $0.11 per kWh if the County irrevocably gives up the rights to the Renewable Energy Credits from the installation to LADWP.

Recovery Zone Bonds

The Recovery Act also authorizes the issuance of two types of bonds for projects in Recovery Zones: Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds. Both types of bonds may be used, subject to certain restrictions, to finance capital expenditures that are made within designated "Recovery Zones", which are defined under the Recovery Act as any area designated by a jurisdiction as experiencing significant poverty, unemployment, rates of home foreclosures or general distress, economic distress related to military base closures, and any area currently designated as an Empowerment Zone or Renewal Community.

On January 26, 2010, your Board designated the entire County as its Recovery Zone, based upon an analysis of relevant US Census, Housing and Urban Development statistics and other socio-economic data.

Economic Development Bonds

Economic Development Bonds are taxable bonds with a Federal subsidy of bond interest payments. They are subject to the same private use restrictions applicable for tax-exempt bonds. Economic Development Bonds may be issued to finance expenditures made for purposes of promoting development or other economic activity in a designated Recovery Zone, including costs related to property, public infrastructure, public facility construction, or job training and education programs. The bonds are also subject to Davis-Bacon federal prevailing wage requirements. The Federal interest subsidy is set at 45 percent and under present law the bonds must be issued no later than December 31, 2010. The County received an allocation of $180,989,000 in Economic Development Bond authorization, which should be sufficient to finance approximately $150.0 million in project costs.

The January 26, 2010 Board report discussed the use of the County's $180,989,000 Economic Development Bond allocation toward financing project expenses associated with the design and construction of the Martin Luther King Jr. (MLK) Multi-Service Ambulatory Care Project (MACC). Since that time, our office has continued to monitor the progress and refinement of cost estimates on several projects to determine the most appropriate project(s) to finance with these bonds. Such a determination is based on two primary factors:

- how closely a project's capitalized cost fits within the authorized allocation; and

- the lowest differential between the interest that is earned on bond proceeds expended during a project's construction and the interest that is accrued for the bondholder's benefit on the amount borrowed for the project's construction. This differential is often referred to as "negative carry".

Full or close to full utilization of the authorized Economic Development Bond allocation is crucial to optimizing their benefit to the County. The bond structures the County is permitted to utilize, however, generally require that projects be financed in whole by a single, rather than multiple bond issues. Bonds issued by the County, absent voter approval, must be secured by an underlying lease of the project and project site between the County and a qualified non-profit corporation or joint powers authority. Bondholders are granted a lien against the property as security against a potential bond payment default by the County. Any additional lien placed against a project and its site with respect to a second series of bonds must take a subordinate position to the lien of the initial bond series. Thus, the constraint of a single lien and bond series in financing an individual project or group of projects necessitates that projects be financed in their entirety by a single bond issue and ultimately requires a close alignment of project costs with the authorized allocation in order to optimize use of such allocation.

Negative carry is measure of a financing issue's cost to the County and a reflection of the issue's efficiency. The amount of negative carry directly impacts the amount of interest that must be capitalized during a project's construction period. In order to fund the negative carry, additional bonds must be issued, which in turn, increases repayment requirements. Likewise, a lower negative carry level will result in lower debt service costs to the County.

Recommended Projects for Financing with Economic Development Bonds

Based on our analysis of the anticipated project costs of the MLK MACC, Olive View Emergency Room/Tuberculosis Unit, Coroner Refurbishment and Expansion, and Patriotic Hall Refurbishment Projects, a package of the latter three projects with combined project costs of $149.0 million would utilize the authorized allocation more efficiently than the MLK MACC.

The project cost for the MLK MACC is being adjusted from $145.3 million downward to $127.3 million to reflect the transfer of the scope for the $18.0 million Ancillary Building to the Inpatient Tower Project, as required by the Office of Statewide Health Planning and Development and reported to your Board on July 1, 2010. The lack of a project or projects with anticipated costs of $22.7 million and that are prepared for imminent financing will preclude use of the remaining Economic Development Bond allocation and makes the MLK MACC a less than optimal candidate for the Economic Development Bond allocation.

An analysis of the negative carry on the MLK MACC and the Olive View/Coroner/Patriotic Hall Projects also indicates that use of Economic Development Bonds on the latter three projects would result in a more efficient financing issue and lower debt service costs to the County. Based on an interest rate of 4.26 percent quoted by the Wall Street Journal on July 27, 2010 for long-term municipal bond issues and a three month reinvestment rate in Treasury securities of .16 percent, the negative carry on the latter three projects was estimated at $8.97 million over a 27 month construction period. The negative carry on the MLK MACC Project was estimated at $11.98 million over the same period. The variance in negative carry primarily reflects the scheduled completion of the Olive View Medical Center Emergency Room Project in September 2010, which results in no negative carry for the project.

Based on the results of this analysis, the CEO will now be recommending that the Recovery Zone Economic Development Bond allocation be utilized to finance the Olive View Emergency Room/Tuberculosis Unit, Coroner Refurbishment/Expansion, and Patriotic Hall Refurbishment Projects.

Facility Bonds

Recovery Zone Facility Bonds are tax-exempt, private activity bonds that will finance private, depreciable property related to new facility construction or the upgrade of existing facilities in a Recovery Zone. The County received an allocation of $271,484,000 in Facility Bond authorization, which under present law must be issued no later than December 31, 2010.

Similar to Industrial Development Bonds, Facility Bonds are a conduit financing mechanism that allows private borrowers to access lower interest rates that are generally available in the tax-exempt financing market. The Facility Bonds do not offer any Federal subsidy of interest payments.

Under the proposed program, the County would issue the Facility Bonds and loan the proceeds to a private or non-governmental entity for purposes of capital improvements within the Recovery Zone. The County would not be required to pledge any funds or guarantee repayment of the bonds. The private or non-governmental entity receiving the bond proceeds would be solely responsible for repayment of the bonds. As such, the creditworthiness and liquidity of the private borrower is critical to repayment of the bonds.

The aforementioned January 26, 2010 Recovery Zone designation that was approved by your Board permits the County to approve issuance of Facility Bonds for projects throughout the County. During 2009, businesses and other non-governmental entities contacted the County with interest in using Facility Bonds to finance projects with a value exceeding $1.0 billion, substantially greater than the County's allocation. Due to the level of expressed interest, we recommended that your Board state its intent to fully use its $271,484,000 Facility Bond allocation, which your Board affirmed on January 26, 2010.

The CEO subsequently worked with the Auditor-Controller and Treasurer-Tax Collector, Board deputies, and an outside financial consultant to further develop the qualifying criteria for the County's Facility Bond Program, focusing on credit worthiness, economic development potential and protecting the County from any credit risk. On June 30, 2010, the CEO released a Request for Proposals to interested parties with a submittal date of July 14, 2010. To minimize the County's exposure to the risk of default by the proposing firms, the CEO, based upon consultation with the Treasurer's and Auditor-Controller's offices, required proposing firms to provide either a Letter-of-Credit from a qualified bank supporting the requested bond issue or a commitment from a Qualified Institutional Bank to buy the Facility Bonds in a private placement structure. These requirements are consistent with the Conduit Financing Policy adopted by your Board in 2006 and with the Facility Bond credit requirements established by other counties throughout California.

To date, we have received nine proposals requesting the authorization to issue $239.7 million in Facility Bonds. Each of the proposals has been reviewed by staff from the CEO and the Treasurer's office for creditworthiness, potential economic development, and compliance with requirements established by the California Debt Limit Allocation Committee (CDLAC). None of the projects proposed, while worthy in terms of economic development, meet all the CDLAC requirements. The majority of the proposing firms have yet to conclude due diligence reviews by their proposed private placement buyers. CDLAC, however, is also requiring that your Board approve the projects for which the County intends to issue Facility Bonds by August 15, 2010. A list of the proposing firms is provided in Attachment I.

In response to this deadline and given that firms proposing have yet to complete credit reviews, we will be recommending that your Board approve the proposing firms for Facility Bond allocations, contingent upon the successful completion of their respective credit reviews by their proposed private placement buyers and compliance with CDLAC requirements prior to the August 15, 2010 deadline.

Action Required by California Debt Limit Allocation Committee

In order to utilize either type of Recovery Zone Bonds or the Energy Bonds, the State Treasurer's CDLAC has imposed a deadline of August 15, 2010 for local issuers to submit the following documentation in order to maintain access to bond allocations:

- Board of Supervisor approval of the projects to be financed through Facility Bonds by August 15, 2010;
- A Board-adopted Reimbursement Resolution for the approved projects;
- A legal opinion from bond counsel which states that the projects receiving allocation are eligible under the Federal guidelines; and
- A commitment letter outlining the bond sale structure pursuant to CDLAC Regulations.

Commitment letters are required for all Facility Bond applicants under the credit criteria employed for the Facility Bond Program. We will provide recommendations for project approval and the necessary reimbursement resolutions to your Board on your August 10, 2010 agenda and have coordinated with County Counsel to engage bond counsel to deliver the necessary legal memos.

Federal Government Failure to Extend Build America Bond Authorization

Build America Bonds

Build America Bonds are taxable bonds that can be issued by state or local governments to finance capital expenditures and certain issuance costs related to governmental, public purpose projects. Under ARRA, the Federal government has agreed to provide issuers of BABs a Federal subsidy of 35 percent of the interest payments to investors. There is no limit on the amount of BABs that may be issued. Under the original Recovery Act legislation, however, BABs must be issued no later than December 31, 2010.

A major portion of the capital financing plans has been assumed to use BABs. Should efforts by Congress to extend BAB authorizations continue to fail, the CEO, in collaboration with the Treasurer, have determined that the elimination of a continuing supply of the bonds will damage the underlying secondary market, reduce the ongoing liquidity of the bonds, and ultimately increase interest costs to the County.

- The reduction in liquidity for the bonds will cause yields to rise as investors seek to buffer the value of their bond investments from future interest rate swings. An increase in yield at the initial offering is the only method available to them since the ongoing supply and the supporting secondary market has been eliminated which constricts, if not eliminates, their ability to sell their bonds in the future.

- We are working with the Treasurer to quantify the impact of non-extension of BABs on the pricing of BABs that are issued prior to the program's expiration on December 31, 2010.

If BABs lose their cost advantage against tax-exempt leasehold revenue bonds (i.e. the rise in bond yields in response to a reduction in liquidity exceeds the 35 percent interest cost reimbursement currently offered under the BAB Program), conventional tax-exempt bonds can still be issued to finance capital improvement projects, albeit at a higher cost.

We will provide updates on the BAB and impacts on the County's capital financing program as our analysis is completed, federal legislative actions occur, and the nature and level of any impacts are determined.

Should you have any questions regarding this issue, your staff may contact Jan Takata at (213) 974-1360.

WTF:BC:SK
DJT:PB:zu

Attachment

c: Executive Office, Board of Supervisors
County Counsel
Auditor-Controller
Treasurer and Tax Collector

K:2010Word/FAM/CP/recovery act status memo

Attachment I

Recovery Zone Facility Bond Applicant Borrowers

Applicant	Project	Location	District	Allocation Amount
Fairplex	Conference Center	Pomona	1	$ 24,255,000
Lowe Enterprises	Compton Downtown North Community Development	Compton	2	$ 46,000,000
Los Angeles Biomedical Resea	Campus development	Carson	4	$ 30,000,000
Wattstar Theater	Wattstar Cinema and Education Center	Los Angeles	2	$ 15,000,000
Five Chairs Development	623 La Peer Mixed Use Development	West Hollywood	3	$ 40,000,000
ACAT	Manufacturing equipment	Long Beach	4	$ 33,000,000
Lawry's	California Center @ Fairplex	Pomona	1	$ 25,000,000
Aszkenazy Development	Gateway San Fernando Office/ Project	San Fernando	3	$ 23,500,000
Urth Caffe'	Retail and commercial development	Pasadena	5	$ 3,000,000
	Total			**$ 239,755,000**
	Total County Allocation			***$ 271,484,000***
	Allocation Not Applied For			***$ 31,729,000***