CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (CHFFA)
CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY (CEFA)

Non-Investment Grade and Unrated Bond Issuance Guidelines

October 25, 2012

Background

CEFA and CHFFA (together, the "Authorities") established written bond issuance guidelines (the "Guidelines") in 1999 and 2000, respectively. These Guidelines covered the entire range of ratings for bond issuances, from investment grade to non-investment grade to unrated debt. In 2010, the Authorities formed a working group to evaluate the Guidelines and to research and discuss whether they merited an update, given the changes in the market, the increased number of exceptions to the Guidelines borrowers were requesting from the Authorities and the near decade of time that had passed since the Guidelines were originally implemented. The Authorities formed a working group composed of representatives from the following: (1) staff from both Authorities, (2) counsel routinely serving as bond counsel to the Authorities, (3) counsel from the Treasurer's office, (4) counsel from the Attorney General's Office, (5) the Authorities' financial advisor, Public Financial Management, and (6) the State Treasurer's Office Public Finance Division.

The working group first identified the dividing line between investment grade and non-investment grade securities. After considering previous board presentations from representatives of Moody's Investor's Services and Public Financial Management, the working group concluded the threshold for investment grade securities should be Baa3/BBB-/BBB- and above. The group then worked to develop a new process for staff diligence and investigation for reviewing the credit package proffered by borrower finance teams for investment grade rated transactions. In September 2010, staff presented to their respective boards, the Revenue Bond Application Resources and Review Process for investment grade rated debt which the boards then approved. The working group agreed to reconvene at a later time to revise the non-investment grade and unrated debt guidelines.

Proposed New Guidelines for Non-Investment Grade Rated and Unrated Transactions

Presently, the Authorities continue to follow the Guidelines developed in 1999 and 2000, respectively, for less than investment grade and unrated bond issuances. In addition to other requirements, the Guidelines call for issuances in such cases to be privately placed with a Qualified Institutional Buyer[1] ("QIB"). Over the last several years, due in part to the current state of the market and the general lack of availability of credit enhancement, the Authorities have experienced an increase in the number of borrowers requesting bond financings as unrated debt. As such, the Authorities decided it was an appropriate time to evaluate the Guidelines to determine if provisions, such as private placements with QIBs, for non-investment grade and unrated bond transactions merited an update.

As with the investment grade review exercise, the members of the working group engaged in a variety of activities to evaluate the less than investment grade and unrated portion of the Guidelines. The group assessed and discussed each of the provisions in the Guidelines to determine their validity in the current market. Additionally, the group reviewed the policies of other conduit issuers who also issue non-investment grade or unrated bonds.

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[1] Institutional investors that own and invest at least $100 million in securities.

Prior to making any conclusive decisions regarding provisions for non-investment grade and unrated debt, the working group contemplated various scenarios to aid in their evaluation. Should the Authorities allow public offerings for less than investment grade or unrated issuances and if so, should the Authorities consider different policies for private placement versus public offerings? Should there be different policies for borrowers with an underlying investment grade rating versus borrowers with no underlying rating? Does it make sense to routinely require borrowers to fund a debt service reserve fund? If the Authorities require restrictions on transfers and minimum denominations, would this eliminate the possibility of bonds being split by selling participatory shares?

After discussing the questions in the above paragraph as well as reviewing the policies of other conduit issuers, the working group agreed upon the following set of minimum requirements for all non-investment grade and unrated bond transactions:

1. Must be privately placed with and transferred only to a "Qualified Institutional Buyer" as defined by SEC Rule 144a,
2. Minimum denominations of $250,000,
3. Unconditional Promise to Pay from Borrower,
4. An Investor Letter is required at initial issuance (The Authority reserves the right to discuss and require a Traveling Investor Letter as circumstances may warrant),
5. Bond transfer restrictions must be noted conspicuously on the bond itself and bonds must be physically delivered*

*If a borrower prefers book-entry DTC and provides a reasonable rationale for its use to the Authority, the Authority will consider reassurances that subsequent transfers will comply with applicable transfer restrictions.

These requirements are designed to minimize the Authorities' risk exposure while establishing minimum parameters for borrowers requesting bond issuances as unrated debt or with a bond rating of less than Baa3/BBB-/BBB-. It should be noted that these requirements may be amended for a borrower following board approval if the borrower obtains an investment grade rating at a later time.

CEFA's original guidelines also address required loan security provisions for its Equipment Program. The working group reviewed these provisions and agreed they should remain as-is.

For your review and consideration, staff has included the following documents:

- **Exhibit A** – CEFA 1999 Guidelines
- **Exhibit B** – CEFA 1999 Guidelines (redlined)
- **Exhibit C** – CEFA 2012 Guidelines
- **Exhibit D** – Sample Bond Notation

Exhibit A

CEFA BOND ISSUANCE GUIDELINES
Less than BBB-/BBB-/Baa3 or Unrated Debt

While all projects must demonstrate financial feasibility, these guidelines describe what CEFA would expect to see given a transaction (or borrower) with a particular rating (or no rating). The Authority would reserve the right to use its discretion as necessary and appropriate. The Authority acknowledges that each financing must be reviewed individually and exceptions to these guidelines may be considered if the applicant demonstrates that such exception is a necessary part of a cost-effective and prudent borrowing strategy. Conversely, the Authority retains the flexibility to request additional provisions as circumstances warrant.

BOND RATING [(1)]	LOAN SECURITY PROVISIONS	BOND COVENANTS
Less than BBB-/BBB-/Baa3 or Unrated Debt	• Must be privately placed (in both primary and secondary markets), with a "Qualified Institutional Buyer" as defined by SEC Rule 144A, promulgated under the Securities Act of 1933 • Minimum denomination of $100,000 ——— • General Obligation Pledge • Revenue Pledge • Debt Service Reserve Account (must be funded at all times with internal cash, bond proceeds, letter of credit or surety bond) • Secured with real property or other assets with an appraised value of at least 100% of bond size (with appropriate release conditions), dependent on the overall asset base and financial strength of the applicant	<u>Reporting Covenants</u>: • Annual submission of Certificate of Compliance with CEFA Statute, Continuing Disclosure, financial and other covenants. • Annual Submission of Arbitrage Reports to Authority • Annual Audited Financial Statements • Interim internal financial information, if requested <u>Other Covenants</u>: • Financial and other covenants as appropriate
Unrated debt for Equipment Program (for equipment purchases generally $5 million or less) **Private placements for <u>colleges</u> with current debt ratings of BBB/BBB/Baa or higher**	• Must be privately placed (in both primary and secondary markets), with a "Qualified Institutional Buyer" as defined by SEC Rule 144A, promulgated under the Securities Act of 1933 • Minimum denomination of $100,000	<u>Reporting Covenants</u>: • Annual submission of Certificate of Compliance with CEFA Statute, Continuing Disclosure, financial and other covenants. • Annual Submission of Arbitrage Reports to Authority • Annual Audited Financial Statements • Interim internal financial information, if requested

(1) Refers to rating categories used by Standard & Poor's/Fitch/Moody's.

Revision: 9/30/1999

CEFA BOND ISSUANCE GUIDELINES
Less than BBB-/BBB-/Baa3 or Unrated Debt

Exhibit B

While all projects must demonstrate financial feasibility, these guidelines describe what CEFA would expect to see given a transaction (or borrower) with a particular rating (or no rating). The Authority would reserve the right to use its discretion as necessary and appropriate. The Authority acknowledges that each financing must be reviewed individually and exceptions to these guidelines may be considered if the applicant demonstrates that such exception is a necessary part of a cost-effective and prudent borrowing strategy. Conversely, the Authority retains the flexibility to request additional provisions as circumstances warrant.

BOND RATING [1]	LOAN SECURITY PROVISIONS	~~BOND COVENANTS~~
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Unrated debt for Equipment Program (for equipment purchases generally $5 million or less) ~~**Private placements for colleges with current debt ratings of BBB/BBB/Baa or higher**~~	• Must be privately placed ~~(in both primary and secondary markets), with~~with and transferred only to a "Qualified Institutional Buyer" as defined by SEC Rule 144A, promulgated under the Securities Act of 1933 • Minimum denomination of $100,000	~~Reporting Covenants:~~ • ~~Annual submission of Certificate of Compliance with CEFA Statute, Continuing Disclosure, financial and other covenants.~~ • ~~Annual Submission of Arbitrage Reports to Authority~~ • ~~Annual Audited Financial Statements~~ • ~~Interim internal financial information, if requested~~

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Revision: ~~9/30/1999~~10/25/2012

[2] The Authority reserves the right to discuss and require a Traveling Investor Letter as circumstances may warrant
[3] If a Borrower prefers book-entry DTC and can provide a reasonable rationale for its use to the Authority, the Authority will consider reassurances that subsequent transfers will comply with applicable transfer restrictions

Exhibit C

CEFA BOND ISSUANCE GUIDELINES
Less than BBB-/BBB-/Baa3 or Unrated Debt

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BOND RATING[1]	LOAN SECURITY PROVISIONS
Less than BBB-/BBB-/Baa3 or Unrated Debt	• Must be privately placed with and transferred only to a "Qualified Institutional Buyer" as defined by SEC Rule 144A, promulgated under the Securities Act of 1933 • Minimum denomination of $250,000 • Unconditional Promise to Pay from Borrower • Investor Letter required at issuance[2] • Bond transfer restrictions must be noted conspicuously on the bond itself • Bonds must be physically delivered[3]
Unrated debt for Equipment Program (for equipment purchases generally $5 million or less)	• Must be privately placed with and transferred only to a "Qualified Institutional Buyer" as defined by SEC Rule 144A, promulgated under the Securities Act of 1933 • Minimum denomination of $100,000

Version: 10/25/12

[1] Refers to rating categories used by Standard & Poor's/Fitch/Moody's
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Exhibit D

SAMPLE BOND NOTATION

The registered owner of this bond is a Qualified Institutional Buyer that has executed and delivered to the Bond Trustee an investor letter. Any transfer of the registered ownership of this bond may only be to a Qualified Institutional Buyer that has executed and delivered to the bond trustee an investor letter as required by the bond indenture, and any such transferee, by the acceptance of this bond, represents that it is a Qualified Institutional Buyer and has executed the investor letter as required by the bond Indenture.

RESOLUTION NO. 2012-03

RESOLUTION OF THE CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY APPROVING THE ADOPTION OF REVISED BOND ISSUANCE GUIDELINES FOR NON-INVESTMENT GRADE AND UNRATED DEBT

WHEREAS, the California Educational Facilities Authority (the "Authority"), a public instrumentality of the State of California, is authorized and empowered by the provisions of the California Educational Facilities Authority Act (the "Act") to issue bonds to finance and refinance the acquisition, construction, expansion, remodeling, renovation, improvement, furnishing, or equipping of educational facilities operated by participating private colleges and universities as defined in Education Code section 94110;

WHEREAS, the Authority has previously adopted Bond Issuance Guidelines establishing required and desired elements of Authority bond financings for certain non-investment grade and unrated debt as defined herein, the most recent version of which is attached hereto as **Exhibit A** (dated 9/30/1999) (the "1999 Guidelines");

WHEREAS, staff to the Authority assembled a task force and reviewed policies and procedures of other authorities, and considered the current rating and other market approaches to conduit education financings;

WHEREAS, the Authority desires to work under guidelines that reflect the current legal, regulatory and financial marketplace while balancing the Authority's mission to provide access to capital for California private colleges and universities; and

WHEREAS, the Authority's approval is now sought for a modernized approach to reviewing and analyzing applications for the issuance of bonds that may be issued for the benefit of borrowers that obtain a rating of lower than BBB- from Standard & Poor's or Fitch Investors or Baa3 from Moody's Investors Service, or do not obtain a rating from these rating agencies (herein "Non-investment Grade and Unrated Debt"), as more fully set forth in the Non-investment Grade and Unrated Debt Guidelines, attached hereto as **Exhibit B;**

NOW, THEREFORE, BE IT RESOLVED by the California Educational Facilities Authority, as follows:

Section 1. The Non-investment Grade and Unrated Debt Guidelines is hereby approved and replaces the 1999 Guidelines.

Section 2. This resolution shall take effect from and after the date of adoption.

Date of Adoption: ______________________

Attachments:

A – CEFA 1999 Guidelines
B – CEFA Non-investment Grade and Unrated Debt Guidelines

Exhibit A

CEFA BOND ISSUANCE GUIDELINES
Less than BBB-/BBB-/Baa3 or Unrated Debt

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Revision: 9/30/1999

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CEFA BOND ISSUANCE GUIDELINES
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