

THE CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE
March 24, 2010
REQUEST FOR A QUALIFIED PRIVATE ACTIVITY BOND ALLOCATION FOR AN
EXEMPT FACILITY PROJECT

Prepared by: John Weir

Applicant: California Infrastructure and Economic Development Bank

Allocation Amount Requested: \$530,000,000

The Project originally received an award of Allocation on January 27, 2010. On March 12, we received notice that the Applicant was returning the allocation as they would be unable to issue bonds by the April 27, 2010 expiration date due to an outstanding approval required by the San Diego County Water Authority. At the Applicant's request, the Project is being reconsidered for a new allocation in the same amount; providing additional time to secure the San Diego County Water Authority and California Infrastructure Bank approvals needed before issuing the bonds.

Project Information:

Name: Poseidon (Carlsbad) Desalination Project
Project Address: 4600 Carlsbad Blvd.
Project City, County, Zip Code: Carlsbad, San Diego, 92008

Project Sponsor Information:

Name: Poseidon Resources (Channelside) L.L.C.
Address: 501 W. Broadway, Suite 2020
San Diego, CA 92101
Principals: James M. Donnell, President; Andrew P. Kingman, Treasurer &
Vice President; Peter Maclaggan, Vice President
Contact: Andrew Kingman
Phone: (203) 327-7740

Project User Information:

Name: Same as Project Sponsor
Address: Same as Project Sponsor
Same as Project Sponsor
Contact: Same as Project Sponsor
Phone: Same as Project Sponsor

Project Financing Information:

Bond Counsel: Orrick, Herrington & Sutcliffe LLP
Underwriter: Barclays Capital Inc.
Credit Enhancement Provider: See Attachment A
Private Placement Purchaser: Not Applicable
TEFRA Hearing Date: October 21, 2009

Project Sponsor's Principal Activity:

According to the Applicant, the principal activity of the project is the construction and operation of a reverse-osmosis seawater desalination plant and associated delivery of potable drinking water for the San Diego region.

First Tier Business (Yes/No): Yes

Regulatory Mandate (Yes/No): No

Details of Transaction:

Sources of Funds:

Tax-Exempt Bond Proceeds	\$	530,000,000
Contingency	\$	25,000,000
Other Sources	\$	85,000,000
Total Sources	\$	640,000,000

Uses of Funds:

Site Preparation and Improvements	\$	3,000,000
Construction of New Buildings	\$	30,000,000
Utilities Connection	\$	18,500,000
New Equipment Purchase & Installation	\$	258,000,000
Engineering/Architecture	\$	90,000,000
Legal Permits	\$	40,000,000
Cost of Issuance (incl. discount)	\$	9,000,000
Letter of Credit or Bond Insurance Fee	\$	25,000,000
Net Interest During Construction	\$	93,500,000
Other	\$	73,000,000
Total Uses	\$	640,000,000

Description of Proposed Project:

According to the Applicant, the project consists of a 50 million gallon per day reverse osmosis desalination plant that draws raw seawater from the Encina Power Station cooling system to produce potable drinking water for transmission to the region. Contracts for water delivery are already in place and upon completion, the plant will provide San Diego County nearly 10% of its total water supply. The plant's salinated by-product ("brine"), will be discharged and mixed with the cooling water for dilution and eventual return to the ocean. See Desalination Technology Review summary attached.

Environmental Impact:

1) Air Quality:

According to the applicant, the desalination process will not involve heating and vaporization of the source water and thus does NOT create emissions of water vapor, carbon dioxide or other gases. The project will be powered by electricity purchased from SDG&E. Approximately 65% of the electricity supplied by SDG&E is generate from fossil fuels. As a result, the project will indirectly affect air quality with the increased use of electrical consumption.

2) Water Quality:

According to the applicant, the daily output of the project will produce about 50 million gallons per day of potable drinking water, sufficient to serve approximately 300,000 individuals annually or about 9% of San Diego County's water supply. Nine municipal water agencies in the county have executed 30 year purchase agreements for the full capacity of the project. The project will supply a reliable drought-resistant water supply that meets all State and Federal standards as well as a 30% to 50% reduction in total dissolved solids as compared to the water currently imported for other sources.

3) Energy Efficiency:

According to the applicant, the plant will require 28 to 35 megawatts of power per day or the equivalent of what 40 to 46 houses would consume annually. Energy use is being limited by the installation of solar panels and the use of a pressure exchanger that recovers and reuses 33.9% of the energy associated with the reverse osmosis process. Carbon credits and LEED construction principles will also be used to offset energy consumption.

4) Recycling of Commodities:

None indicated.

5) Safety and Compliance:

According to the applicant, the project sponsor is in compliance with all applicable state and federal regulations.

6) Consumer Costs Savings and Efficiencies:

According to the applicant, the project will deliver water at or below the cost of imported water. In addition, the water delivered by the project will contain fewer dissolved solids which will extend the life of existing pipes used throughout the system.

Local Government Support:

See Attachment B for letters of support for the project.

Legal Questionnaire:

No information was disclosed that raised any question regarding the financial viability or legal integrity of the applicant.

Recommendation:

Staff recommends that the Committee approve \$530,000,000 in tax-exempt bond allocation for the Carlsbad Desalination Project.

Attachment A – Description of Financing Structure

Poseidon Resources has engaged Barclays Capital as the financial advisor and underwriter for the purpose of securing debt financing for the Carlsbad Desalination Project. The proposed plan will be to market a BBB- rated, tax-exempt fixed rate limited public offering to qualified institutional investors without credit enhancement, issued in minimum denominations of \$500,000. Poseidon is continuing to evaluate the economic feasibility of a monoline insurance policy from Assured Guaranty for all or a portion of the bonds.

The proposed financing structure meets the requirements of the Committee's Procedures for rated or non-rated bonds without credit enhancement (Section 9.III.A). Particular attention was given as to whether BBB- bonds would be marketable in today's investment climate. According to Barclays, the market for low investment grade tax-exempt bonds is strong. This is due in part to the success of taxable bonds which have pulled demand for mid to high rated bonds away from tax-exempt issues. Investors looking to meet higher yield targets have instead been targeting lower rated issues for investing. This market condition is evidenced by the increasing volume of these types of transactions over the last quarter of 2009. In addition, the financial strength of the Project and Project Sponsor was evaluated. In its ratings analysis, Standard & Poors evaluated the strength of the Project and all of the project counterparties, including equity sponsors, contractors, the operator and all nine of the water districts entering into purchase agreements. Through its review of Standard & Poors' analysis (as summarized in its Rating Determination Letter), CDLAC Staff believes that their conclusions were sound. Finally, attention was also given as to whether the proposed financing has reasonable protections in place for bond purchasers and issuers in case of default. All amounts due will be secured by a first priority security interest in all of the borrower's assets including, but not limited to rights to receive payments from all purchase agreements, construction guarantees secured by performance bonds, and all project related accounts and insurance policies of the borrower.

The Committee has previously approved two Exempt Facilities projects with non-rated bonds without credit enhancement in the past four years. This project would be the largest of its kind.

In addition, staff also recommends that the following be memorialized in the Resolution: (a) that prior to bond closing the Applicant agrees to report back to CDLAC with information on bond purchase commitments, (b) that bonds, if unenhanced, must be marketed to qualified institutional investors only, and (c) that bonds be issued in minimum \$500,000 denominations. If the structure should change, the Applicant will be required to return to CDLAC for approval of the revised structure prior to issuance.

Attachment B – Evidence of Local Government Support

This sheet outlines the public support letters/documents in support of the Carlsbad Desalination Project that were included in the original Application to CDLAC or delivered to the Committee at a later date.

Support Letters To the California Debt Limit Allocation Committee (CDLAC) from:

Christine Kehoe (California State Senate, 39th District)
City of Carlsbad
City of Oceanside (Jim Wood, Mayor)
Martin Garrick (California State Legislature, 74th District)
Mary Salas (California State Legislature, 79th District)
Mary Block (California State Legislature, 78th District)
Olivenhain Municipal Water District (Edmund Sprague, Board President)
Rainbow Municipal Water District (Rua Petty, Board President)
Rincon del Diablo Municipal Water District
Santa Fe Irrigation District (Michael Hogan, Board President)
Sweetwater Authority (W.D. "Bud" Pocklington, Chair)
Vallecitos Water District (Dennis Lamb, Deputy General Manager)
Valley Center Municipal Water District (Gary Brommell, Board President)