

MINUTES

**California Pollution Control Financing Authority
915 Capitol Mall, Room 587
Sacramento, California
November 30, 2012**

1. CALL TO ORDER & ROLL CALL

Bettina Redway, Chairperson, called the California Pollution Control Financing Authority (CPCFA or Authority) meeting to order at 10:30 a.m.

Members Present: Bettina Redway for Bill Lockyer, State Treasurer
Alan Gordon for John Chiang, State Controller
Pedro Reyes for Ana J. Matosantos, Director of Finance

Staff Present: Michael Paparian, Executive Director
Sherri Kay Wahl, Deputy Executive Director

Quorum: The Chairperson declared a quorum

2. EXECUTIVE DIRECTOR'S REPORT

Mr. Paparian stated that the purpose of the additional November Board meeting was to take action on the proposed desalination facility in Carlsbad.

Mr. Paparian attended the San Diego County Water Authority (SDCWA) meeting on November 29. He reported that the Water Authority Board had a thorough discussion of the issues, both for and against the desalination project, at that meeting as well as at prior meetings. The SDCWA Board heard from over fifty witnesses regarding the proposal.

The SDCWA Board voted overwhelmingly in favor of the project. SDCWA has a weighted voting system, and the vote tally was 85% in favor, 11% against and, approximately, 4% of the votes were not cast.

Mr. Paparian reported that the desalination project is the second largest bond issue that CPCFA has brought before its Board. The largest bond deal involved Pacific Gas & Electricity in the 1990's for \$965 million in refunding.

3. BUSINESS ITEMS

A. REQUEST TO APPROVE FINAL RESOLUTION AUTHORIZING THE ISSUANCE OF REVENUE BONDS AND APPROVE TAX-EXEMPT BOND VOLUME CAP ALLOCATION

Deanna Hamelin provided the staff presentation and introduced the various members of the financing team and the attorneys present: Brian Dugan and Andy Kingman of Poseidon, Tracy McCraner of the SDCWA and John Wang of Orrick, Herrington & Sutcliffe.

1) Poseidon Resources (Channelside) LP and/or its Affiliates (Poseidon) and San Diego County Water Authority Financing Agency (SDCWAFAs) and/or its Affiliates (which Affiliates shall include the San Diego County Water Authority), as co-applicants, #849(SB), Water Furnishing, \$840,000,000 of bonds as follows:

- \$570,000,000 of Private Activity Bonds on behalf of Poseidon to finance the construction of a desalination plant (Plant Bonds) to supply water to the San Diego area.
- \$570,000,000 of Private Activity Bond Volume Cap Allocation for the Plant Bonds.
- \$270,000,000 of Governmental Purpose Bonds on behalf of the SDCWAFAs to finance the associated water pipelines (Pipeline Bonds) to supply water to the San Diego area.

The transaction is different than most CPCFA deals the Board has seen in that it involves both a public and private entity in partnership to build portions of the project.

Both bond issues contemplate issuance of negotiated limited offerings to Qualified Institutional Buyers (QIBs as defined in SEC Rule 144 under the Securities Act of 1933) in minimum denominations of \$250,000 or any integral multiple of \$5,000 in excess thereof. The co-applicants expect at least two investment grade ratings from Fitch and Moody's. Poseidon will enter into a Collateral Trust Agreement in which it will pledge all of its assets to a collateral agent that will hold them for the benefit of the Trustee for the Plant Bonds and the Pipeline Bonds, and ultimately for the bond holders.

For the Pipeline Bonds, the Water Authority will pay the purchase price in installments under an installment sale agreement between the Water Authority and the SDCWAFAs. The installment payments will be applied by the Water Authority Financing Agency to secure loan repayments under a loan agreement between it and CPCFA.

Underwriters for the Bonds include:
JP Morgan Securities LLC
Barclays Capital, Inc.

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Merrill Lynch Pierce Fenner & Smith Incorporated
Goldman Sachs and Co.
Stifel, Nicolaus & Company Incorporated, DBA Stone & Youngberg, a Division of
Stifel Nicolaus.

Drinker Biddle & Reath, LLP is serving as Underwriter's Counsel.

Staff worked closely with numerous members of the financing team including John Wang from Orrick as Bond Counsel; as well as Special Counsel to CPCFA, Rick Jones from Nixon Peabody; Issuer's Counsel, Tad Egawa from the Attorney General's (AG) Office; and Jade Turner-Bond, Counsel to the State Treasurer's Office, to get the bond documents in substantially final form prior to today's Board meeting.

The TEFRA hearing was held on November 8, 2012; no verbal or written comments were presented at the hearing.

Subsequent to the TEFRA, staff received numerous letters in support of the project. Staff also received emails and letters from the Coast Law Group representing the Coastal Environmental Rights Foundation that provided staff with an Independent Financial Analysis of the Carlsbad-Poseidon Water Purchase Agreement and associated press release. All of these letters were provided to the Board members.

Staff recommended approval of Final Resolutions in the amounts of \$270,000,000 and \$570,000,000, respectively, and a volume cap allocation resolution for an amount not to exceed \$570,000,000 for the Project.

Ms. Redway asked if there were any questions or comments from the Board or public.

Ms. McCraner, on behalf of the SDCWA, thanked the Board for considering the proposal at this meeting. She also thanked the CPCFA staff, the Treasurer's office, the State of California, the Department of Finance, the AG and Orrick, Herrington & Sutcliffe.

Mr. Wang of Orrick, Herrington & Sutcliffe also thanked staff for their work.

Mr. Gordon asked what would happen if the Board did not approve the agenda item during the meeting. He stated that the Controller believes the desalination project on the Southern California coast is extremely important for hardening water supplies. Mr. Gordon commented that he helped write the Delta Stewardship Act which states that local water authorities are supposed to go for regional self-reliance as good policy. He would, however, like an explanation as to exactly what would happen if the item was not passed today.

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Ms. McCraner replied that this project has been over a decade in the making and there have been many amendments allowed for the ground lease with Poseidon, but the lease will expire. The construction contracts that design and build everything have an expiration of December 30 or 31. These construction companies have stayed with the project through the whole process. Basic minimal operations have been started and, if the approval does not happen by year end, these companies will be requesting more funds or may choose to no longer participate in the project. Ms. McCraner stated that the workers those companies committed to work on the project preparation will be sent to other projects that are starting.

Mr. Gordon asked with those timelines understood, why did the SDCWA wait until yesterday to hold a public hearing on the matter.

Ms. McCraner responded that the project documents were released in September. There was a sixty day review period. Due to that, November 29 was the only available meeting date for the final approval. Typically, there is one meeting a month. The SDCWA has been holding two special meetings per month for the past four or five months in order for public review of all of the documents, for the Water Authority Board review and for feedback.

Mr. Gordon commented on the fact that the documents have been final for sixty days.

Ms. McCraner elaborated that some of the project documents were substantially final, but the financing documents have been finalized in the last couple of weeks. The SDCWA has been working on all the documents, continuously, with all parties involved for the last two to three months. CPCFA staff worked holidays and weekends, as did John Wang and his team from Orrick, Herrington & Sutcliffe, for page by page reviews over the last three months.

Ms. Redway asked if there were any further comments from the Board, or the public.

Mr. Reyes moved approval of the item.

Mr. Gordon stated that one substantive issue that has risen with the SCO is that the risks are on the SDCWA ratepayers; electricity is the cost that jumps out, having worked on power contracts over the years. Mr. Gordon stated that the cost of water is reasonable given what reclaimed water, recycled water, storm water, and delta water is going to cost in the future—assuming projects get done. Mr. Gordon commented that when he sees a 2% escalation on electricity costs and anything above that, it seems that the rate payer is going to assume all the risk. He inquired as to what the thinking was of the SDCWA in shifting that cost to the rate payer as opposed to sharing the costs with the equity partners at Poseidon.

Agenda Item 2.

Ms. McCraner stated that on the SDCWA side an enormous review was done between Poseidon as the project company and the SDCWA regarding the project risks. In the negotiations between the two parties, the one risk the SDCWA determined to assume was the electricity price risk. The Poseidon side has taken on the usage risk. There were many other risks that were left with the project company. She stated that upon review of this project, as well as others, that electricity will be a large part of all the SDCWA projects. It is part of the Water Authority's existing portfolio and will be a part of any future projects.

The desalination project is more energy intensive than other projects and, with all the back and forth negotiations, Ms. McCraner stated that she would like Mr. Kingman to explain the risks that are maintained by Poseidon as he was part of the negotiations. The electricity risk was the only risk that the Water Authority assumed for the rate payers. In context with other projects and other energy costs is the fact that this will be somewhat less than 10% of the Water Authority's portfolio; while the project is energy intensive, it is a much smaller portion of the Water Authority's portfolio than other areas. The SDCWA felt comfortable taking that risk.

Mr. Kingman stated that the company has all the performance risks. Poseidon has the obligation to deliver the water and perform. Poseidon takes the consumption of power risk, the operating costs risk and the quality of water risk. In the State of California it is virtually impossible to lock in a power price contract. There are no direct contracts with utilities or generators; therefore, it is not a risk that is easily mitigated. He added that, as Ms. McCraner stated, if you look at the Water Authority's overall portfolio, energy in this project is comparable to the energy in its entire portfolio.

Mr. Kingman further stated that the desalination project will use about 10% more power than is currently used by pumping the water down from the Bay Delta.

Mr. Gordon asked what will happen to the rate payer if the water is not delivered.

Mr. Kingman responded that Poseidon would not receive payment from the SDCWA.

Ms. McCraner stated that there is protection in place stating that until the commercial operation date, as well as all performance testing reviewed by an engineer, there will be no payment by the Water Authority until receiving quality water that goes through several months of testing. Poseidon will make contracted short-fall payments which are backed and assigned to the bond holders.

Mr. Gordon stated that he was ready to move the project.

Ms. Redway stated that there was already a motion. Mr. Gordon seconded the motion. The item was unanimously approved.

4. PUBLIC COMMENT

Ms. Redway asked if there were any comments from the public. There were none.

5. ADJOURNMENT

There being no further business, public comments, or concerns, the meeting adjourned at 10:47 a.m.

Respectfully submitted,

Michael Paparian
Executive Director