

CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY
BOND FINANCING PROGRAM
Meeting Date: December 12, 2018

***Request to Approve Amendment to Indenture for Arakelian Enterprises, Inc.,
d.b.a Athens Services***

Prepared by: *Andrea Gonzalez*

Applicant: Arakelian Enterprises, Inc. d.b.a. Athens Services	Amount Issued: \$138,525,000
Project Los Angeles and Locations: San Bernardino Counties	Application No.: 869 Closing Date: 4/2/2018

Summary. Arakelian Enterprises, Inc. d.b.a. Athens Services (the “Company”) requests an amendment to the Indenture dated April 1, 2014. The amendment to the Indenture seeks to revise the mechanism setting the pricing, or interest rate, of the financing, as a result of recent and future changes to the federal corporate tax rate.

Borrower. The Company was incorporated on February 28, 1991 in California and is owned by the Arakelian family. The Company provides organic waste composting, residential and commercial solid waste collection, transfer and material recovery, special waste transportation, disposal services and hauling in areas throughout San Bernardino, Los Angeles and Riverside Counties.

Background. On April 2, 2014, the California Pollution Control Financing Authority (the “Authority”) issued Variable Rate Demand Solid Waste Disposal Revenue Notes for Arakelian Enterprises, Inc. dba Athens Services for an aggregate principle amount of \$138,525,000 (the “2014 Athens Notes”). Note proceeds were used to:

- 1) refund four Solid Waste Disposal Revenue Bonds previously issued by CPCFA;
- 2) finance the acquisition of equipment for use at fifteen waste processing sites located in San Bernardino County, as well as various improvements to additional sites located in Los Angeles County; and
- 3) pay certain costs of issuance.

The Notes issued were privately placed with three financial institutions: Wells Fargo Bank, National Association (55%); Bank of the West (20%); and Union Bank, National Association (25%), all as Qualified Institutional Buyers (“QIBs”). The Notes carried features consistent with the banks’ treatment of these Notes as loans: no CUSIP numbers, physical delivery of Notes (i.e. no book entry), no ratings, no official statement, large denominations, and transfer restrictions. The Notes on the refunding amount were sold separately to retain their exemption from the Alternative Minimum Tax (“AMT”), and the new money Notes are subject to the AMT.

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Pursuant to the terms of the Notes, on December 4, 2018 the three-bank group transferred the Notes to a new four-bank group, including: Wells Fargo Bank, National Association; Comerica Bank; Umpqua Bank; and MUFG Union Bank, N.A.

Current Request: The Athens 2014 Notes are governed by an Indenture, dated April 1, 2014 (the “Athens Indenture”), in the form of the Authority’s model note documents as amended to reflect the unique relationship between the three QIBs in this deal. The Company seeks an amendment to the Indenture to conform the pricing on the Notes to the recent changes in the federal corporate tax rate pursuant to the Tax Cuts and Jobs Act of 2017 (the “2017 Act”), and to future changes to the federal corporate tax rate as well, as well as an additional change in the pricing terms to reflect the current business arrangements among the QIBs and the Company.

Request Based on the 2017 Act

Various terms of the Athens Indenture were based on a 35 percent federal corporate tax rate. Given that the federal corporate tax rate was reduced to 21 percent pursuant to the 2017 Act, the bank group negotiated a new formula with the Company to share a higher percentage of the tax savings with the Company. The Athens Indenture amendment would contain a formula negotiated between the QIBs and the Company which would take effect immediately under the current 21 percent rate, and which would also automatically adjust the pricing in the event of future changes to the federal corporate tax rate, rather than requiring additional amendments.

The reason for the requested amendment is as follows. Most tax-exempt direct placements under CPCFA’s model documents are priced based on a formula similar to: X percent of LIBOR + credit spread, with the discount off the LIBOR rate representing some portion of the bank purchaser’s tax savings since interest on the notes is not subject to income taxation. The amount of the discount off LIBOR that banks give their borrowers when using tax-exempt notes is based on their federal corporate tax rate. Prior to the 2017 Act, most banks paid a corporate tax rate of 35 percent. Under this formula, the banks would then pass on a discount of 30 percent, resulting in an interest rate on the notes at 70 percent of LIBOR (the “Applicable Factor”). To compare, on a taxable loan if LIBOR was 2 percent and the bank spread was 2 percent, the interest cost to the borrower would be 4 percent. In contrast, for tax-exempt notes utilizing this formula, the interest cost to the borrower would be 70 percent of 4 percent, or 2.8 percent.

The 2017 Act reduced the maximum federal corporate tax rate from 35 percent to 21 percent. This reduction increased the after-tax return on taxable investments currently held by bank lenders but did not affect the after-tax return on their tax-exempt investments. As a result, the change in law reduced the after-tax return on tax-exempt investments relative to the return on comparable taxable investments.

The Athens 2014 Notes currently include gross-up adjustment provisions to deal with the effect of corporate tax rate reductions on banks on the relative return on such loans. According to the Company’s special counsel, the gross-up provisions were intended to protect each bank’s investment return, because as marginal federal corporate tax rates decrease, the tax-exemption becomes worth less to the lender.

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In the Athens 2014 Notes, as with most other CPCFA model note documents, the gross-up adjustment takes the form of the “Margin Rate Factor,” which comes into play at the occurrence of a change in the federal corporate tax rate. The Margin Rate Factor was calculated as the greater of 1.0 and the product of one minus the maximum federal corporate tax rate multiplied by 1.53846. In the past, the result was a Margin Rate Factor of 1.0, which yielded an Applicable Factor of 70%. Once the 2017 Act lowered the corporate tax rate, the Margin Rate Factor is no longer 1.0.

Thus, the amendment to the Athens Indenture proposes an Applicable Factor of 79.1% for the current federal corporate tax rate and an automatically-adjusting Applicable Factor based on the corporate tax rate after any further changes. Likewise, the Margin Rate Factor is based on an equation reflecting any future changes to the tax rate. For example, if the federal corporate tax rate were to increase to 25 percent then Athens would receive a 25 percent discount off of LIBOR. Consents from the Company and each of the Noteholders, or banks, are required before the amendment would be executed.

Request Reflecting the Current Business Negotiation among the Company and the QIBs

The Company and the QIBs have negotiated a revision to the definition of the “Applicable Spread.” This amendment to the Indenture is driven not by the changes to the federal corporate tax rate but rather a new business arrangement between the Company and the Noteholders unique to this issuance. The Applicable Spread is based initially on the Applicable Rate as defined in the Credit Agreement entered into separately between the Company and the banks, and requires the consent of CPCFA.

If approved by the CPCFA Board, the Company requests the Authority’s Executive Director and/or Deputy Executive Director to execute the amendment to the Indenture to authorize the changes in the document.

Staff Analysis: The Company’s special counsel states that if the Applicable Factor were to remain unchanged, the result in this case is less advantageous for the Company, and further that the proposed changes should be advantageous to the Company now and in the future to allow for the rate to be more easily modified by the terms of the Indenture, even where the corporate tax rate changes. Staff is not in a place to independently verify whether this is true. Indeed, staff is advised by Issuer’s Counsel that conduit issuers do not typically insert themselves in business negotiations between private placement lenders and conduit borrower absent a compelling public policy reason. Bond counsel has further explained that the change in the pricing will trigger a new tax analysis at the time of the execution of the amendment to the Indenture, and that such tax analysis may result in either a no adverse tax opinion, or a finding that a tax-reissuance to has occurred under federal tax law. Again, we presume that as a sophisticated borrower and based on conversations with the Company’s special counsel, the Company is aware of and has accepted full responsibility for either of these outcomes. The amendment to the Indenture includes such acknowledgment by both the noteholders and the Company. Issuer’s counsel has advised that the risk of liability to the Authority in approving the amendment is the same as when the Authority issues bonds with those same terms. The amendment to the Indenture includes a provision shielding the Authority from any

claims of liability by the noteholders and the Company as a result of the Authority's execution of this amendment.

Financing Team.

Bank Purchasers: Wells Fargo Bank, National Association;
Comerica Bank; Umpqua Bank; MUFG Union
Bank, N.A.

Bond Counsel: Orrick, Herrington & Sutcliffe LLP

Issuer's Counsel: Office of the Attorney General

Special Counsel to the Borrower: Andrew S. Rose, Attorney at Law

Staff Recommendation. Staff recommends approval of the amendment to the Indenture for the Arakelian Enterprises, Inc. d.b.a. Athens Services project.

**RESOLUTION OF THE
CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY
APPROVING AMENDMENTS TO THE INDENTURE RELATING TO ITS
VARIABLE RATE DEMAND SOLID WASTE DISPOSAL REVENUE NOTES
(ATHENS SERVICES PROJECT) 2014 SERIES A-1, A-2, B-1, B-2, C-1 AND C-2**

December 12, 2018

WHEREAS, the California Pollution Control Financing Authority (the “Authority”), a public instrumentality of the State of California, is authorized and empowered by the provisions of the California Pollution Control Financing Authority Act (Division 27 (commencing with Section 44500) of the California Health and Safety Code) (the “Act”) to issue bonds to finance the acquisition, construction, expansion, remodeling, renovation, improvement, furnishing or equipping of any Project as such term is defined in Section 44508 of the Act;

WHEREAS, on April 2, 2014, the Authority issued its Variable Rate Demand Solid Waste Disposal Revenue Notes (Athens Services Project) 2014 Series A-1 (the “A-1 Notes”), 2014 Series A-2 (the “A-2 Notes” and together with the A-1 Notes, the “2014A Notes”), 2014 Series B-1 (the “B-1 Notes”), 2014 Series B-2 (the “B-2 Notes” and together with the B-1 Notes, the “2014B Notes”), 2014 Series C-1 (the “C-1 Notes”), and 2014 Series C-2 (the “C-2 Notes” and together with the C-1 Notes, the “2014C Notes” and collectively with the 2014A Notes and the 2014B Notes, the “CPCFA Notes”), in the aggregate principal amount of \$138,525,000, pursuant to an Indenture, dated as of April 1, 2014 (the “Indenture”), by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”);

WHEREAS, pursuant to a Loan Agreement, dated April 1, 2014, by and between the Authority and Arakelian Enterprises, Inc. d.b.a. Athens Services, a California corporation (the “Borrower”), the Authority loaned the proceeds of the CPCFA Notes to the Borrower to, among other things, finance and refinance certain land, vehicles and equipment and acquire, construct, rehabilitate, renovate, install, improve and equip certain solid waste disposal facilities in the State of California;

WHEREAS, Wells Fargo Bank, National Association is the sole holder of the 2014A Notes (the “2014A Holder”);

WHEREAS, Umpqua Bank and Comerica Bank are the holders of the 2014B Notes (collectively, the “2014B Holder”);

WHEREAS, MUFG Union Bank, N.A. is the sole holder of the 2014C Notes (the “2014C Holder” and, together with the 2014A Holder and the 2014B Holder, the “Holders”);

WHEREAS, pursuant to Section 9.01 of the Indenture, the Indenture may be modified or amended from time to time and at any time by an indenture or indenture supplemental thereto, which the Authority and the Trustee may enter into upon filing with the Trustee of the written consent of the Holders of 60% in aggregate principal amount of all CPCFA Notes then Outstanding, and the Bank or the Credit Bank, as applicable; provided, however, that no such modification or amendment shall (1) extend the fixed maturity of any CPCFA Note, or reduce the

amount of principal thereof, or extend the time of payment, or change the method of computing the rate of interest thereon, or extend the time of payment of interest thereon, without the consent of the Holder of each CPCFA Note so affected, or (2) reduce the aforesaid percentage of CPCFA Notes the consent of the Holders of which is required to effect any such modification or amendment, or permit the creation of any lien on the Revenues (as defined in the Indenture) and other assets pledged under the Indenture prior to or on a parity with the lien created by the Indenture, or deprive the Holders of the CPCFA Notes of the lien created by the Indenture on such Revenues and other assets (except as expressly provided in the Indenture), without the consent of the Holders of all of the CPCFA Notes then Outstanding;

WHEREAS, following the issuance of the CPCFA Notes, certain changes to the federal tax code mandated by the Tax Cuts and Jobs Act of 2017 necessitated modifications to the method of computing the rate of interest on the CPCFA Notes (the “Amendments”) pursuant to the Indenture;

WHEREAS, the Borrower and each Holder have further negotiated a new definition of the Applicable Spread based on the related Credit Agreement, which requires consent by the Authority to implement the modification;

WHEREAS, on November 15, 2018, the Borrower delivered to the Authority a Post-Issuance Request Form requesting the execution and delivery of a First Amendment to Indenture amending the Indenture (the “First Amendment”) by and between the Trustee and Authority, in connection with, and to effect, the Amendments;

WHEREAS, the Borrower has had discussions with each Holder concerning the Amendments and the Holders of all of the CPCFA Notes currently Outstanding have agreed to the terms of the Amendments and will consent to the execution and delivery of the First Amendment by the Authority and the Trustee for the purposes set forth therein;

WHEREAS, the First Amendment will become effective upon approval by the Authority of the form of the First Amendment and the execution and delivery of the First Amendment and consents of the Holders;

WHEREAS, the form of the First Amendment has been prepared and presented to the Authority, and final approval of the terms of such First Amendment is now sought;

NOW, THEREFORE, BE IT RESOLVED by the California Pollution Control Financing Authority as follows:

Section 1. The First Amendment is hereby approved in substantially the form on file with the Authority prior to this meeting, with such insertions, deletions or changes therein (including, without limitation, insertions, deletions or changes therein appropriate to reflect business terms agreed upon between the Borrower and the Holders of the CPCFA Notes) as the officer(s) executing and/or delivering the same may require or approve, such approval to be conclusively evidenced by execution and delivery of the First Amendment.

Section 2. Each officer of the Authority, acting alone, is hereby authorized and directed to do any and all ministerial acts that such officer may deem necessary or advisable in

order to effectuate the purposes of this Resolution and the First Amendment. The Authority hereby approves any and all documents to be delivered in furtherance of the foregoing purposes, including, without limitation, any certifications or written directions necessary or desirable in connection therewith.

Section 3. The provisions of the resolution of the Authority entitled “Resolution of the California Pollution Control Financing Authority Delegating Certain Powers and Authorizing Certain Actions Related to Bond Financings” adopted by the Authority on January 23, 2018 (the “Delegation Resolution”), apply to the documents and actions approved in this Resolution, and the provisions of such resolution are incorporated herein by reference. This Section 3 shall be deemed to refer to and incorporate any resolution of a similar nature adopted hereafter by the Authority which replaces or supersedes the Delegation Resolution.

Section 4. The Authority hereby approves, confirms and ratifies all actions heretofore taken by its officers, agents, members and employees prior to the date hereof with respect to the First Amendment and in furtherance of the purposes of this Resolution.

Section 5. This Resolution shall take effect immediately upon its passage.

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