



## HERE COMES THE SUN...(OR IT'S NOT EASY BEING GREEN)

BY DAN WILES, PRINCIPAL

At the intersection of economics and “green thinking” governments find the catalyst for implementing solar energy as a source to generate electricity. There is a reasonable basis to expect that when compared to the cost of coal or gas-generated electricity from investor-owned utilities, a

*“Here comes the sun, and I say it’s all right.”*

GEORGE HARRISON

solar generation system can generate present value savings and that pricing competition between solar project developers can increase those savings. The best application of this expectation occurs when the solar equipment is installed on property already owned by the government. This means that the only real additional cost is that of the equipment itself. Often we see this manifest when we have reviewed solar projects that generate a portion of power for utilities, such as water or wastewater treatment plants.

The goal of the solar project is fundamental - reduce electricity costs by more than the cost to acquire the project. While there are a number of different types of solar energy generators, for this type of small scale project, the primary vehicle is the photovoltaic cell. There are three basic methods to finance the acquisition of solar generated power:

1. Direct Purchase,
2. Lease Option, and
3. Power Purchase Agreement.

Direct Purchase involves purchasing equipment from a provider. There is a capital

cost upfront, either through the issuance of debt or through the use of funds on hand. You own it, if it wears out, is damaged or becomes obsolete, you have the risks. Feasibility of the project means simply that the cost of the equipment, including the opportunity cost on investment of funds (or the financing cost) is less than the potential savings from avoided energy costs. We should note that there are federal incentives to financing solar projects, such as Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds, both of which involve direct federal subsidy of the interest costs.

Lease Option typically involves leasing the solar project from a provider for about 10 years with the option to buy the project at the end of the lease. This can allow the lessor to gain the value of federal investment tax credits

*“It’s not easy being green.”*

KERMIT THE FROG

for the equipment. At the end of the lease term, you could then either finance the project through internal funding or by issuing tax-exempt bonds.

A Power Purchase Agreement is an agreement to purchase power from a privately built solar project for a designated time at a designated price. A Power Purchase Agreement makes future energy costs predictable and reduces technology and obsolescence risk.

For our water district clients the Power Purchase Agreement option has demonstrated

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## SCHOOLS “PAY NO INTEREST” LOTTERY

BY ADAM BAUER, PRINCIPAL

Many California school districts have been disappointed as a result of the recent oversubscription of Qualified School Construction Bonds (“QSCBs”). QSCBs are a new financing option created by the America Recovery and Reinvestment Act (“ARRA”) of 2009 and are a form of tax-credit bonds to promote the construction and improvement of public schools. When an investor purchases a QSCB they receive a federal tax credit instead of a full interest payment. This reduces debt service paid by the school district. Depending on the credit quality of the school district and the type of financing the interest cost could be as low as zero percent. Generally, proceeds of QSCBs are to be spent on constructing, rehabilitating, or repairing a public school facility, or for acquiring land on which such facility is to be constructed or repaired.

It was announced on July 3, 2009 that the California Department of Education (“CDE”) would accept applications for QSCB allocations. The 11 largest school districts within the State, which have already received allocation from the federal government, were not a part of this allocation process. The CDE received 231 allocation applications totaling \$3.66 billion.

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# IFAQs

## INFREQUENTLY ASKED QUESTIONS

BY TOM JOHNSEN, PRINCIPAL

### Q. *What is the current status of Build America Bonds?*

**A.** Since April 15, 2009 approximately \$27 billion of Build America Bonds (“BABs”) have been issued nationally. About 290 BABs have been issued in at least 34 states. The median size BAB nationally approximates \$21 million. In recent weeks approximately one-third of new municipal bond issuance has been taxable BABs. Their market activity has been so significant that the issuance of tax-exempt bonds has decreased and are in short supply. All BABs issued so far have been the Direct Payment type with issuers receiving a subsidy towards debt service from the federal government.

As of late August, California municipalities have issued approximately 25 BABs with about \$7.3 billion in proceeds. Others are in process and will come to the market in the near future. The median BAB issuance in California is about \$56 million. The State of California has been the largest issuer in the state and it has been joined by various cities, water districts and community college districts. In Arizona six BABs have been issued and three in Nevada. California and Texas issuers alone have accounted for about half of all BABs issued. Listings of BAB issues may be found at [www.bondbuyer.com](http://www.bondbuyer.com) and [www.treas.gov/press/releases/tg221.htm](http://www.treas.gov/press/releases/tg221.htm). Buyers of BABs have primarily been institutional investors such as insurance companies and U.S. and foreign pension funds. It is estimated that only around 5% of BABs have been sold to retail investors. Institutions have bought BABs because of the ability to earn taxable interest rates while enjoying the security of local and state government backing.

Since the first issue in mid April, BAB structure has evolved from one more consistent with the taxable corporate bond market to a more hybrid structure

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# CFD ISSUANCE UPDATE

BY TOM JOHNSEN, PRINCIPAL

In the last edition of Eye on Finance we reported that the issuance of Community Facility District (“CFD”) bonds has greatly reduced in 2009 from prior years. Since then reduced issuance has continued. The table on page 3 provides information on CFD bonds issued this calendar year through September 1.



For CFDs issued in 2009, interest rates for bonds with a 30

year maturity have ranged from 7.875% to 11.625%. This compares to interest rates in the low 5% range at the peak of the real estate bubble. Generally, interest rates for CFDs have decreased as 2009 has progressed. This is especially so in the last month with the lack of supply of CFD bonds, driving prices up and interest rates down. Value to lien ratios for bonds sold this year have generally been higher than those historically seen. This year value to lien ratios have ranged from a low of 7 to 1 to a high of 44 to 1. The average value to lien ratio on a 2009 transaction has been

approximately 15 to 1. More critical than value to lien ratio however, to a buyer’s decision have been bond structures providing for additional reserves and higher debt service coverage ratios than historically seen. Additionally, a few of the CFDs issued this year have been rated, there’s been one variable rate CFD, and several have been refundings.

It appears CFD issuance for 2009 will remain low. Total issues sold for the year could number as few as fifteen to twenty. During the month of August the lack of available CFD bonds, in both the primary market and secondary markets, has caused pricing changes significantly lowering market interest rates. Non-rated CFD 30 year bond yields are 75-100 basis points lower on September 1 than approximately one month prior.

A summary of CFDs sold in 2009 would include the following general trends and characteristics:

1. Investors desire and may only purchase CFD bonds that have a bond size based upon special tax revenues from developed property. Market access and/or significant interest rate reductions have been provided to CFD transactions with special tax revenues from developed property, preferably

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## BASE YEAR VALUES

BY TOM JOHNSEN, PRINCIPAL

On September 2, 2009 the State Board of Equalization distributed to all County Assessors a brief memorandum entitled “Factoring to Base Year Values.”

The memorandum recounts the process for the establishment of a base year for real property subject to Article XIII A of the California Constitution (Proposition 13) and discusses the history of applicable adjustment factors by the State Board of Equalization.



The memo states “In the more than 30 years since the passage of Proposition 13, the annual adjustment has never resulted in a

reduction to base year values.

However, if current trends continue, the announced factor could result in reductions to base year values. The final announced factor will depend on price level changes between now

and October. The California Consumer Price Index (CCPI) dropped sharply (3 percent) between October 2008 and December

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## COMMUNITY FACILITIES DISTRICT BONDS

Issued January 1, 2009 to September 1, 2009

ISSUER / TRANSACTION	DATED DATE	TOTAL PROCEEDS	BACKGROUND
SAUGUS UNION SCHOOL DISTRICT CFD No. 2006-1, Improvement Area No. 2 2009 Special Tax Bonds	1/29/2009	\$5,560,000	Non rated Complex circumstances including developer bankruptcy Bonds sized to active planning areas Special Reserve
SAUGUS UNION SCHOOL DISTRICT CFD No. 2006-1, Improvement Area No. 3 2009 Special Tax Bonds	1/29/2009	\$3,230,000	Non rated Complex circumstances including developer bankruptcy Bonds sized to active planning areas Special Reserve
BEAUMONT FINANCING AUTHORITY 2009 Local Agency Revenue Bonds Series A Improvement Areas Nos. 7B and 7C	2/11/2009	\$1,725,000	Non rated. Sizing limited by development status Cash Flow Management Fund
RIVERSIDE UNIFIED SCHOOL DISTRICT CFD No. 26, Special Tax Bond 2008 Series A	2/12/2009	\$2,265,000	Non rated Special Reserve
TWIN CITIES POLICE AUTHORITY CFD No. 2008-1 2009 Special Tax Bonds	3/19/2009	\$20,000,000	J.P.A. comprised of Larkspur and Corte Madera. CFD comprised of parcels in both cities. S&P rated AA Competitive sale Bank Qualified
IRVINE UNIFIED SCHOOL DISTRICT CFD No. 06-1 (Portola Springs), Adjustable Rate Special Tax Notes	3/25/2009	\$44,000,000	Moody's rated Aa2/VIG1 S&P rated SP-1/A-1
PLACENTIA PUBLIC FINANCING AUTHORITY 2009 Special Tax Revenue Refunding Bonds	6/16/2009	\$9,715,000	S&P rated A Last maturity 2015 Refunding
BEAUMONT FINANCING AUTHORITY 2009 Local Agency Revenue Bonds, Series B Improvement Areas Nos. 8D and 17B	6/18/2009	\$2,640,000	Non rated Debt service based on developed parcels.
POWAY UNIFIED SCHOOL DISTRICT Public Financing Authority 2009 Revenue Bonds	7/2/2009	\$9,515,000	Non rated Coverage from developed property.
JURUPA COMMUNITY SERVICES DISTRICT CFD No. 29 Special Tax Bonds 2009, Series A	7/8/2009	\$6,525,000	Non rated. Special Reserve. Debt service based on taxes of developed parcels. Coverage from developed property 130%
WEST PATTERSON FINANCE AUTHORITY CFD No. 2001-1 Special Tax Refunding Bonds Series 2009-A	7/28/2009	\$2,615,000	Non rated. Refund Notes / New Money Bank qualified
WEST PATTERSON FINANCE AUTHORITY CFD No. 2001-1 Subordinate Special Tax Refunding Bonds Series 2009-B	7/28/2009	\$3,240,000	Non rated. Subordinate. Refund Notes Bank qualified.
RIVERSIDE UNIFIED SCHOOL DISTRICT CFD No. 12 (Bridle Creek) Special Tax Bonds, 2009 Series A	8/6/2009	\$1,385,000	Non rated. Special Reserve.

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## CFD ISSUANCE UPDATE CONTINUED FROM FRONT PAGE

property that has sold and transferred to an individual owner.

2. Investors have strong geographic and demographic preferences and will likely accept a lower yield for preferred areas.
3. There has been occasional investor reluctance to buy any California based bonds due to concerns about the State budget and diminishing State ratings. This has caused some intermittent spikes in interest rates for CFD and other financing types.
4. Most of the CFD transactions issued have provided additional reserves and/or higher debt service coverage ratios than historically seen.
5. Features of call protection have been important to buyers, with multiple transactions structured with 10 year call protection. Variations decreasing the length of call protection have impacted interest rates paid.
6. Current property tax delinquencies and the recent history of property tax delinquencies have been a focus of disclosure and credit analysis. Additionally, delinquency management and adherence to foreclosure covenants have been a focus.
7. CFD issuers have generally proceeded slowly and deliberately. Issuers of new money CFD bonds in 2009 have been selective.

Market momentum over the last few weeks seems to be pointing toward increased CFD issuance in 2010 compared to 2009. For additional information on CFDs issued during the calendar year 2009, call Tom Johnsen at (949) 660-7311. ♦

## BASE YEAR VALUES CONTINUED FROM PAGE 2

2008; however, it has been rising ever since. The 12-month period of October 2008 to October 2009 will be used to calculate the adjustment factor for the January 1, 2010 assessment date.”

The memo concludes that Article XIII A and applicable regulations limit positive adjustments to the maximum of 2 percent, however “there is no such limitation to downward adjustment, including instances which the net change... is zero or less than zero.” ♦



## IFAQS CONTINUED FROM PAGE 2

with characteristics more in keeping with those of the tax-exempt bond market. Buyers of BABs have also broadened as a group and diversified. ♦

## PAY NO INTEREST LOTTERY

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The available allocation, however, was only \$700 million. Due to the oversubscription, the CDE held a lottery on August 28th to determine which school districts would receive allocations for 2009. As a result of the lottery, 43 school districts received allocations in amounts ranging from \$1 million to \$25 million. The average allocation per school district is \$16.3 million.

For the fortunate school districts that received allocations, the race begins to issue QSCBs prior to the close of the calendar year 2009. The school districts that did not receive a 2009 allocation were ranked to determine which would receive allocation if a school district that had received an allocation could not utilize it. However, such determination must be made relatively soon or the unused allocation will be rolled into the 2010 allocation.

Further, school districts preparing for General Obligation Bonds (“GO Bonds”) Elections in 2010 are hopeful that the 2010 QSCB allocation process will occur earlier in the year. Earlier allocation will enable them to incorporate the QSCB allocation into their election materials, have enough time to get voter approval in either June or November 2010, and still issue QSCB GO Bonds in calendar year 2010. Given the high demand for school facilities statewide, we expect a strong demand for the 2010 QSCB allocation. ♦

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several advantages over the Direct Purchase and Lease Option alternatives. PPAs require smaller upfront out-of-pocket expense and negate interest expense on borrowed construction funds. Agency reserves and future investment opportunities remain undisturbed.

Every agency’s situation is different with unique financial and energy circumstances. Moreover, the costs and tax attributes relating to solar energy equipment have been changing and involve provisions subject to change, sunset or extension. For now, the Power Purchase Agreement format seems to provide the largest savings and the least intrusion on the agency’s business. However, that conclusion is dependent on the facts and circumstances and on the prevailing tax treatment.

Solar power provides the opportunity to both do “good” and be good to your income statement. The financial and tax issues are complex and easily misunderstood. In order to get the greatest benefit from solar power, every agency should carefully review and compare its alternatives and their financial impact in light of the current financial and tax environment. ♦

