

**CALIFORNIA POLLUTION CONTROL
FINANCING AUTHORITY**

915 CAPITOL MALL, ROOM 457 (95814)
P.O. BOX 942809
SACRAMENTO, CA 94209-0001
TELEPHONE: (916) 654-5610
TELECOPIER: (916) 657-4821

ATTACHMENT B

November 30, 2004

The Honorable Dean Florez
Senator, Sixteenth District
California State Senate
State Capitol, Room 4090
Sacramento, CA 95814

Dear Senator Florez:

In your letter of October 14, 2004, you requested answers to several questions concerning the California Pollution Control Financing Authority (CPCFA) financing of solid waste control facilities at California dairies. I am pleased to supply those answers.

The Authority's bond program provides private activity bond financing to California businesses to reduce or manage solid waste. The public benefit to the borrowers is the tax exemption on the bonds, which allows the borrowers to pay lower interest rates. The Authority is a conduit issuer, selling bonds and loaning the funds to its borrowers. The bonds are not obligations of the State; they are repaid by the dollars that flow from the borrowers. The State General Fund and the Authority are not exposed to any financial risk in a default. Small business borrowers may receive financial assistance from CPCFA to defray part of the cost of issuing bonds, but these funds come from fees paid to the Authority by larger business borrowers, not from the General Fund.

When a business files an application for financing, the Authority staff reviews the proposed solid-waste project to determine its eligibility under state and federal law. Before bonds can be sold, the Attorney General (or a law firm selected by CPCFA to act as counsel when the Attorney General is unavailable due to workload) provides an opinion certifying that the bonds have been legally approved, and bond counsel provides an opinion that the project to be financed is a qualified pollution control facility eligible for tax-exempt financing. Most conduit bond issues, and all of the dairy solid waste control projects, are guaranteed by a bank letter of credit.

There seems to be some public misunderstanding of the Authority's dairy solid waste pollution control project financings. The tax-exempt bond financings carried out by the Authority are available, by terms of federal law, for facilities and equipment that manage solid waste. The decision about whether a dairy can locate or expand at a particular site is made by local land-use authorities, subject to applicable environmental reviews and receipt of discretionary permits. The dairies are subject to federal and state clean water laws, which regulate discharges into surface and groundwater. The Authority's tax-exempt bonds cannot be used, and have not been approved, for purchasing land or for relocation and expansion of dairies.

The following are answers to your October 14 questions:

1. How and when did dairies gain access to loans from the California Pollution Control Financing Authority?

Facilities and equipment to manage solid waste are qualified "pollution control facilities" under state and federal law. (See Attachment 1-- a sample tax certificate and Attachment 2 -- a sample bond counsel opinion) The CPCFA Act has authorized financing for solid waste disposal purposes since 1975. The first dairy application was filed in August 2000, and the bonds for its pollution control facilities were issued in October 2001.

2. How is the "public benefit" of dairy projects established and/or verified.

The Authority is guided by federal and state statutes. The Legislature has made findings that the Authority's financing of projects, including solid waste pollution control facilities and equipment, "is in the public interest and serves a public purpose and will promote the health, welfare, and safety of the citizens of the State of California." (Health and Safety Code Section 44501)

3. Does the Authority have a process that applicants must follow to apply for a loan? If so, what does it consist of, and does it include a review from any agency that monitors/oversees air and water pollution? For example, does the borrower merely certify that they will expend project funds to conform with a certified engineer's plans, or do they submit building inspection reports to the CPCFA?

Prospective borrowers submit an application. (See Attachment 3-- a sample application) Staff verifies that the application is complete and that the proposed solid waste pollution control facilities are eligible for financing under the terms of state and federal law. Applicants are required to certify that they have requested and received all necessary discretionary permits and approvals from all local, State, and federal regulatory agencies, as applicable. Applicants also certify under penalty of perjury that all information supplied in the application is true.

Before bonds are sold, the Attorney General provides an opinion that they may lawfully be sold. (See Attachment 4 -- a sample Attorney General opinion) In two of the 18 dairy financings, the Attorney General was unavailable due to workload and other counsel to the Authority provided an opinion. Bond counsel prepares the tax certificate, which, among other things, describes the project to be financed, and provides an opinion that the facilities being financed are qualified pollution control projects eligible for tax-exempt bond financing. (See Attachment 1-- a sample tax certificate and Attachment 2 -- a sample bond counsel opinion)

Once a financing is approved, bond funds are placed with a third-party bank trustee. The trustee disburses the proceeds under the terms of the Indenture and in accordance with the loan agreement between CPCFA and the borrower and other bond documents. (See Attachment 5--a sample

indenture's application of proceeds section) The trustee disburses the funds only in response to requests signed by both the borrower and the bank providing the letter of credit for the bonds and consistent with the bond documents. Disbursements by the trustee are generally made in response to invoices or under the normal procedures for bank monitoring of a construction loan. As the true credit provider in the transaction, the bank providing the letter of credit has a direct financial interest in making certain that the facilities described in the bond documents, which are its collateral for the loan, are properly built and receive all necessary inspection reports and approvals to allow them to operate. The letter of credit bank conducts on-site inspections of the facilities constructed.

4. Are businesses required to provide any mitigation of air and water pollution from the use of the loans?

As explained above, the Authority is authorized to finance projects that control or manage solid waste. Applicants are required to certify that they have requested and received all necessary discretionary permits, to the extent that they are required. While not required to do so, fifteen of the 18 dairies that got CPCFA financing sought and received conditional waivers or reviews of Waste Discharge Requirements from the Regional Water Quality Control Board. These waivers or reviews set specifications for the waste control projects. (See Attachment 6--a sample copy of a waiver)

5. Does the Authority audit the financial records of loan recipients for acquisition, construction, or installation of qualified pollution control, waste disposal, waste recovery facilities, and the acquisition and installation of new equipment, as stated in the Authority's guidelines?

The Authority has put in place a process, using the Indenture, bond trustee, and letter of credit bank, as described in the answer to Question 3, to provide that bond proceeds are used for the intended purpose. In addition, the Authority's bond agreements contain provisions that allow CPCFA to audit the borrower's financial records at any point during the life of the bonds. At the request of State Treasurer Phil Angelides, the Authority is currently examining the 18 dairy solid waste pollution control projects that it has financed.

6. Who developed and verified the rationale that CPCFA funding would divert thousands of tons of manure from disposal in landfills?

CPCFA's standard application asks prospective borrowers to "describe the additional waste diversion from landfills that will be annually diverted from landfills due to the project financing." In response, dairy applicants supplied the estimates of the amount of manure that would be diverted from landfills by the projects. Staff reports repeated the incorrect information. However, the balance of staff reports described the projects as facilities and equipment to collect, manage, and recycle manure.

7. Has the Authority ever required a loan recipient to return the loan due to non-compliance with the Authority's requirements?

The bond proceeds can only be used for the projects approved by the Authority and as disbursed through the mechanisms described in the answer to Question 3. In one instance, a portion of a bond issue in 1985 was redeemed when the borrower could not build all of the project facilities because of the terms of a lawsuit settlement.

8. Have any borrowers defaulted? If so, what happens?

Since 1974, the Authority has issued about \$11 billion of bonds in about 457 separate offerings. There have been a handful of technical and payment defaults on loans in the Authority's history, but since most of the Authority's bonds are backed by bank letters of credit, bondholders in almost every case have been fully protected. And, as previously stated, the State General Fund and taxpayers are not at risk for CPCFA bonds. The only Authority bond default that affected public bondholders occurred in the early 1980s. Two issues defaulted on payments in 2002 and 2003, but they are held exclusively by sophisticated, institutional investors who knowingly took the risks of these non-credit enhanced bonds, which were not backed by a bank letter of credit. There have been no defaults in any of the dairy financings.

9. Does the Authority know of a dairy that used CPCFA financing to develop best available retrofit control technologies to mitigate air pollution as outlined in Senate Bill 700 signed by the Governor last year?

The Authority is authorized to finance facilities and equipment to reduce or control solid waste. At the request of Treasurer Angelides, it is exploring whether it can develop possible incentives for dairies that undertake innovative advanced solid waste management measures that significantly improve air and water quality. However, federal regulations provide that tax exempt financing cannot be used for gaseous waste facilities except where such facilities are functionally related and subordinate to a solid waste disposal facility. As you know, standards for best available retrofit control technology under SB 700 have not yet been implemented.

10. Were there other loans awarded to ag-related industries?

Yes. Since 1974 the Authority has made numerous loans to ag-related industries, primarily in the area of converting agricultural waste to energy.

11. What information about a project is available on the website? What provision is made for public comment on the website?

For all tax-exempt bond financings, the Authority posts a meeting agenda and public notice on its website prior to any public hearings. The website provides an email link for public comment. Past agendas and notices are archived on the website back to 2000. In addition, the Authority conducts a public hearing on each tax-exempt financing, as required by federal law (the Tax Equity and Fiscal Responsibility Act [TEFRA]) and publishes a notice of the hearing and a description of the project in two newspapers, one in Sacramento and one in the community in which the project is located. (See Attachment 7--a sample TEFRA notice)

12. Can the money from the bonds be used for a project if it does not reduce pollution?

By State and federal law, the Authority's financing is available to businesses that acquire, construct, or install qualified solid waste pollution control, waste disposal, and waste recovery projects. As you know on October 26, the Authority adopted the Treasurer's proposal to place a moratorium on dairy financing and develop standards that assure that no future dairy projects will be financed unless they improve air and water quality.

13. What percentage of the CPCFA's State Operations fixed-cost budget have been dedicated to processing the dairy projects in the last three years.

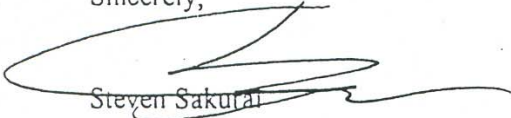
The Authority does not receive State General Fund money, and it does not segregate staff time and resources by category of applicants.

14. How much money does the State expend for the bonds and program? What costs do the CPCFA pay? Who pays the insurance on the bonds? What fees or other costs are there, and does the borrower pay all of them or does the CPCFA pick up some of them?

No State General Fund moneys are spent for the Authority or its bonds or programs. The Authority is entirely supported from the fees it collects from borrowers. Borrowers pay the costs of issuing bonds through use of up to 2 percent of the bond proceeds, and from their own funds above this amount, if necessary. The bonds are secured through bank letters of credit, which are also paid for by borrowers. Small businesses (those with fewer than 500 employees or defined as small businesses under federal law) are eligible for assistance to defray up to \$250,000 of issuance costs. These small business assistance funds are derived from fees assessed against larger business borrowers.

I hope that these answers are responsive to your questions. If you have any further questions or need additional information, please feel free to contact me.

Sincerely,



Steven Sakurai
Executive Director

cc: State Treasurer Phil Angelides
State Controller Steve Westly
Michael Genest, Acting Director,
Department of Finance