

**CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK  
(IBank)**

**THE INFRASTRUCTURE STATE REVOLVING FUND (ISRF) PROGRAM**

**STAFF REPORT**

**Issue:**

IBank was established in 1994 pursuant to the Bergeson-Peace Infrastructure and Economic Development Bank Act (the “IBank Act” or the “Act”, Government Code Sections 63000-63002). IBank’s mission is to finance public infrastructure and private development projects that promote economic growth, protect and sustain the environment, support clean energy and efficiency, revitalize communities and enhance the quality of life for the people in the State of California (the “State”). The Infrastructure State Revolving Fund (“ISRF”) Program is one of the primary financing mechanisms employed by IBank to carry out its mission.

The ISRF Program is governed by the Criteria, Priorities, and Guidelines for the Selection of Projects for Financing under the ISRF Program (the “ISRF Criteria” or the “Criteria”), a document which is based on the provisions of the IBank Act. The ISRF Criteria requires periodic updates to reflect relevant updates to the Act, as well as to respond to market changes, refine and clarify existing language, and reflect strategic initiatives. This Staff Report outlines proposed amendments and revisions to the ISRF Criteria related to guidelines for setting interest rates on ISRF Financings. The IBank Board of Directors (“IBank Board”) last approved such updates to the Criteria on November 16, 2022, following a thorough review by IBank Staff (“Staff”) of the document, which at the time had not received any update since February 2016, and no comprehensive revisions since October 2013.

Any material amendments and revisions to the ISRF Criteria must be approved by the IBank Board. A redlined version of the proposed new Criteria document appears in **Attachment A** (the clean version is attached to Resolution No. 23-08). Staff believes all proposed changes either conform to or do not conflict with existing Statute or the IBank Act. Subject to the discussion below, IBank staff recommends the IBank Board approve Resolution No. 23-08, adopting the proposed ISRF Criteria as of today’s date.

**Discussion:**

When the IBank Board approved comprehensive revisions to the ISRF Criteria on October 29, 2013, it directed Staff to develop an interest rate-setting methodology for loans made under the ISRF Program. The methodology was intended to replace the prior approach of pricing all ISRF Financings at 67% of the interest rate charged on a single-A rated municipal bond of equivalent maturity. The old approach was considered no longer viable for a variety of reasons, mostly due to the lingering effects of the Great Recession. On

December 17, 2013 the Board approved the new rate-setting guidelines via Resolution 13-22. Those guidelines are included in **Attachment B** for reference.

As described in **Attachment B**, the 2013 rate-setting guidelines represented a more dynamic approach than the old method, by instituting risk-based pricing based on publicly available Municipal Market Data (MMD) bond interest rates, which reflect both credit rating level (from AAA to BBB) and strength of revenue pledge (e.g. General Obligation vs. Revenue Bonds). The new methodology also incorporated a general rate subsidy intended to attract higher-rated credits, while offering specific rate subsidies based on median household income and unemployment rates, with the aim of making ISRF Financings viable for lower-rated credits. This two-pronged approach was intended to enable IBank to meet its mission while maintaining the strong credit quality of the ISRF Bonds it issues to capitalize the ISRF Program. The rate-setting guidelines formed the basis for a sophisticated spreadsheet-based pricing model which Staff was to use for determining rates on ISRF Financings.

While the 2013 rate-setting guidelines are briefly referenced in the ISRF Criteria, they were never directly incorporated into the Criteria, and although the guidelines document is posted on IBank's website and available internally, over time it fell into obscurity, and both Staff and prospective Borrowers grew less familiar with the guidelines. Similarly, the spreadsheet model developed flaws and glitches which Staff had limited capacity to troubleshoot or fix. Feedback from both Staff and external stakeholders also consistently conveyed that both the guidelines and the pricing model were overly complex for day-to-day use.

Starting in 2022, these factors prompted Staff to work with IBank's Financial Advisor (who had helped develop the 2013 guidelines) to review and refresh the guidelines. The aim of this exercise was to both preserve the essential components of the existing analytical framework, while making it more 'user-friendly' for both Staff and external stakeholders by streamlining its pricing mechanics. This process has resulted in an upgrade of the spreadsheet model, and several updates intended to simplify internal procedures. Over the course of this work Staff has determined that certain updates to the ISRF Criteria are either required or desired in order to successfully implement the new interest-rate setting methodology. The essential aspects of the Criteria updates are highlighted below:

- **Streamline rate-setting guidelines and include them directly in the Criteria.** Rather than existing in a separate document that includes an excessive amount of procedural detail for external stakeholders, the high-level guiding principles of the ISRF rate-setting approach are now stated directly in Criteria, paraphrased as follows:
  - Consider risk when determining the rate.
  - Maintain the strong credit quality of the ISRF loan portfolio.

- Make subsidies available where appropriate, mainly for disadvantaged communities and/or green projects.
- Consider IBank's cost of funds to capitalize the ISRF loan pool.
- Use publicly available data to determine pricing.

Staff believes this focus will simplify discussions about ISRF rates, and the goals the Program aims to achieve with its rates. The operational details of how the rates are produced, including the mechanics of whatever pricing model is in current use, will be reflected in internal procedural documents to help ISRF Staff manage the model and rate calculations. This will functionally rescind the approach previously approved by the Board in Resolution 13-22 in favor of this new method.

- **Annual servicing fee lowered from 0.30% to 0.15%.** In Staff's review of the rate-setting guidelines, we determined that the current annual servicing fee of 0.30% was too high given other changes contemplated in our pricing model. Consequently, Staff is proposing to lower the annual servicing fee from 0.30% to 0.15%. Technically the proposed new Criteria language simply states that the annual servicing fee will be charged as a percentage of the outstanding loan balance, to allow flexibility for future adjustments that respond to market conditions and IBank's costs to support the Program, as well as the use of subsidies to advance Program goals.
- **Describe Subsidies in more general terms.** The 2013 rate-setting guidelines specifically define economic subsidies as a function of a Borrower's relative ranking vs. state averages for unemployment rate and median household income. While these variables are important, over the last decade there have been great advances in developing more dynamic impact measurement tools, such as [CalEnviroScreen 4.0](#) and the related [SB 535 Disadvantaged Communities Map](#), which include the same or similar variables, but also several other data points, including climate-related factors, to allow for a much more robust analysis. With this in mind Staff has proposed defining subsidies in more general terms, in order to provide IBank flexibility to explore alternative subsidy tools such as those mentioned above, as well as outcomes-based subsidies based on the nature of the project (e.g. the conversion of a brownfield into an organic waste facility).

It is worth highlighting here that in practice Staff will include in ISRF Financing Staff Reports a brief explanation of the MMD scale and any subsidy factors that were used for a given rate recommendation. All recommended interest rates will continue to be subject to Board approval, as explicitly stated in the revised principles in the Criteria.

Taken together, Staff feels the proposed changes to the interest rate language in the ISRF Criteria will bring the program's rate-setting principles and practices current while making them easier to understand for both internal and external parties, all of which will

help make the ISRF Program more effective in meeting the infrastructure financing needs of the State's municipalities and other public entities.

## RECOMMENDATION

Staff recommends approval of Resolution 23-08 directing Staff to change the Criteria, Priorities, and Guidelines for the Selection of Projects for Financing under the Infrastructure State Revolving Fund (ISRF) Program.

June 28, 2023

### **Attachments**

#### Attachment A

ISRF Criteria: Redline of proposed amendments compared to Criteria document dated November 16, 2022.

#### Attachment B

ISRF Interest Rate Setting Guidelines approved by the IBank Board on December 17, 2013 via Resolution 13-22.