IMPACT OF THE CALIFORNIA STATE TREASURER'S OFFICE PROGRAMS ON ECONOMIC DEVELOPMENT IN CALIFORNIA

Hearing of the Little Hoover Commission – October 22, 2009

Testimony by
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According to the International Economic Development Council (IEDC), economic development is "…a program, group of policies, or activity that seeks to improve the economic well-being and quality of life for a community, by creating and/or retaining jobs that facilitate growth and provide a stable tax base."[1] The California Association for Local Economic Development (CALED) more specifically defines economic development as "…the allocation of limited resources – land, labor, capital and entrepreneurship in a way that has a positive effect on the level of business activity, employment, income distribution patterns and fiscal solvency…Sustained economic growth can provide sufficient incomes for the local labor force, profitable business opportunities for employers and tax revenues for maintaining an infrastructure to support this continued growth." According to CALED, the three paths to economic development are the retention and expansion of existing businesses within the state, the attraction of businesses from other states or countries, and the support of start-up businesses within the state.[2]

Modern Infrastructure is the Foundation of Economic Development

Given that the pillars of economic development are job and business creation and retention, which in turn both support and are supported by a modern infrastructure, the State Treasurer's Office (STO) infrastructure bond programs provide a critical foundation for California's economic growth. The STO manages the sale of voter-approved general obligation (GO) bonds and public lease revenue bonds to fund a variety of infrastructure projects throughout the state. Since November 2006, voters have approved more than $63 billion in GO bonds to build schools, roads, housing, parks, levees, high-speed rail and other infrastructure projects. These projects not only provide workers, communities and businesses with the infrastructure needed to compete in the global economy; they also provide jobs to Californians and business opportunities to the state's private enterprises. The rule of thumb is that every $1 billion in infrastructure spending creates, directly and indirectly, about 18,000 jobs.

The impact of the STO's infrastructure bond program on California's economic development was highlighted when, due to the state's prolonged budget stalemate and the turmoil in the credit markets, the state was unable to sell any GO infrastructure bonds for nine months beginning in July 2008. Normally, the state's Pooled Money Investment Account (PMIA) provides loans to fund voter-approved infrastructure projects, and the

[1] Excerpted from IEDC's website: www.iedconline.org.
[2] Excerpted from CALED's website: www.caled.org.

PMIA is later reimbursed when bonds are sold. The state's inability to sell bonds for this nine month period coincided with the fact the state's fiscal crisis lead to a cash crunch, which together forced the PMIA to discontinue loans to fund voter-approved infrastructure projects. The effect was that work on more than 5,000 infrastructure projects around the state was delayed or stopped, which had negative consequences for thousands of jobs, billions of dollars in revenues for private businesses, and the fiscal soundness of many community-based and nonprofit organizations.

The state reentered the bond market in March 2009 with $6.67 billion in GO bonds, which were successfully marketed to individual investors as well as to the traditional institutional investors.[3] The STO then issued $6.85 billion in bonds in April 20009, of which $5.2 billion was issued as taxable Build America Bonds (BABs).[4] Again with a marketing campaign aimed at individual investors as well as institutional investors, the STO is set to issue $4.5 billion in bonds this month to finance voter-approved infrastructure projects. Going forward, with Department of Finance estimates that California's population will reach 50 million by 2035, there will be ever greater demand for infrastructure that is designed and built for such population levels. Some analysts estimate that California will need $500 billion in new or replacement infrastructure over the next 25 years.

STO's Economic Development Programs

The boards, commissions, and authorities under the umbrella of the STO administer programs that directly contribute to local economic development in California's communities. The following summarizes these programs:

California Industrial Development Financing Advisory Commission (CIDFAC)

CIDFAC oversees the state's tax-exempt Industrial Development Bond (IDB) program. Under federal tax law, IDBs are a type of private activity bond which can be sold as tax-exempt in the municipal bond market. In California, IDBs can be issued by authorized state or local government agencies to finance private capital projects (e.g., the acquisition, construction, or rehabilitation of facilities and equipment) for businesses. Eligible businesses include traditional manufacturers and now, due to a provision in the American Recovery and Reinvestment Act of 2009 (ARRA), knowledge-based industries such as biotech, high tech, nanotech, pharmaceutical and entertainment industries. The IDB transaction is similar in many ways to a private commercial loan between a bank and a business except that the source of capital is the tax-exempt municipal bond market.

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[3] The effect of attracting individual as well as institutional investors is lower interest costs driven by greater overall demand for the bonds.

[4] BABs are a new type of municipal bond created by the American Recovery and Reinvestment Act of 2009. BABs are taxable bonds that can be used to finance projects that are eligible for tax-exempt bonds, and the BABs issuers receive a cash subsidy equal to 35% of the total interest cost. California's $5.2 billion BAB issue is the largest BAB issued to date and, with a 4.83% net interest rate in the long maturities, it is estimated that taxpayers saved $1.68 billion in interest costs as compared to the March 2009 tax-exempt GOs.

IDBs provide a means for California businesses to buy land, construct buildings, renovate existing buildings, and equip or re-equip their facilities at a lower cost of capital. This creates a financial incentive for them to remain in the state, and to grow and expand in response to market demands.

In calendar years 2007 and 2008, CIDFAC approved more than $214 million in IDB financing for 32 businesses, which resulted in the creation of more than 1,400 jobs in California.

California Pollution Control Financing Authority (CPCFA)

CPCFA adminsiters a number of programs that directly contribute to local economic development:

- CPCFA issues tax-exempt private acitivity bonds to finance waste and recycling projects throughout the state. Under federal tax law, this program provides California businesses access to the lower-cost, tax-exempt municipal bond market to finance capital costsneeded to acquire, construct, renovate, or equip qualified pollution control, waste disposal or recycling projects. Similar to the state's IDB program, CPCFA's tax-exempt bond program provides businesses with a financial incentive to continue operations and to grow and expand in the state.

  In calendar years 2007 and 2008, CPCFA sold more than $580 million dollars in tax-exempt pollution control bonds on behalf of 25 private companies.

- Through its California Capital Access Program (CalCAP), CPCFA encourages banks and other financial insitutions to make loans to small businesses that otherwise would not qualify under the insitutions' underwriting standards. The small businesses use these loan proceeds to purchase inventory, buy buildings and equipment, and to cover operational expenses. For each loan made under the CalCAP program, the lender and/or the borrower and CPCFA contribute to the lender's CalCAP reserve fund, which is used to reimburse the lender up to 100 percent of the original loan amount in the case of a default. Loan amounts range from $500 to a maximum of $1.5 million.

  For calendar years 2007 and 2008, CPCFA enrolled 1,223 loans totaling more than $137 million in the CalCAP program. These loans created or affected more than 4,800 jobs in California. Since the program's inception in 1994, CPCFA has enrolled 7,335 loans totaling $1.29 billion in the CalCAP program.

- CPCFA administers the California Recycle Underutilized Sites (CALReUSE) Program, which provides funding to assess property with real or perceived contamination – brownfields. These assessments help return many properties to productive use and create economic opportunities in California's blighted areas. The CALReUSE Assessment Program provides forgivable loans to finance professional site assessments. In 2008, CPCFA approved eight new loans totaling $1,126,237 under the Assessment Program.

The CALReUSE Remediation Program was initiated with $60 million in Prop 1C (the Housing and Emergency Shelter Trust Fund Act of 2006) funding and is administered by CPCFA in consultation with the Department of Housing and Community Development. The Remediation Program provided grants and loans to finance brownfield cleanup that promotes infill residential and mixed-use developments consistent with regional and local land use plans.

In November 2008, CPCFA funded 32 Remediation Program projects with an overall award of $53,854,235.

Both the assessment and remediation programs work in conjunction with local government or statewide strategic partners, who in turn work closely with private developers.

- CPCFA's Sustainable Communities Grant and Loan Program (SCGL) provides funds to cities and counties for the development and implementation of policies, programs and projects that reduce pollution hazards and the degradation of the environment, assist in the revitalization of neighborhoods suffering from high unemployment levels, low-income levels, or high levels of poverty, or promote Infill Development.

  The most recent SCGL funding cycle was in 2007, when CPCFA awarded over $2.4 million to seven communities around the state.

California Health Facilities Financing Authority (CHFFA)

CHFFA issues tax-exempt bonds for, and makes grants and loans to, nonprofit or governmental health facilities to finance capital improvement projects and other programs.

In calendar years 2007 and 2008, CHHFA made low-cost loans to 16 hospitals and 37 clinics totaling $28 million to pay for capital improvements and health-related programs. During the same period, CHFFA awarded grants to seven children's hospitals totaling $177.8 million to finance capital improvements and issued $5.5 billion in low-cost, tax-exempt bonds to finance or refinance capital improvement projects for ten hospitals and three clinics.

These investments in the state's health care infrastructure result in not only better health care for Californians but also jobs and revenues to the local communities.

California Educational Facilities Authority (CEFA) and California School Finance Authority (CSFA)

CEFA and CSFA provide low to no-cost capital expenditure financing to K-12 charter schools, and private, nonprofit higher education institutions. These projects help California's educational facilities prepare the workforce for jobs in the new economy and thereby contribute to the state's overall economic development. In the process, they provide jobs and revenues to the local communities.

- CEFA issues low-cost, tax-exempt municipal bonds to finance the construction and expansion of private, non-profit educational facilities in the state. In 2007 and 2008, CEFA issued $1.8 million in tax-exempt bonds to finance 27 projects throughout the state.

- CSFA administers two grant and loan programs that finance the construction, remodel or lease of charter schools in California. In 2007 and 2008, CSFA awarded a combined $482.2 million through the federally-funded State Charter School Facilities Incentive Grants Program (82 charter schools) and the state's Charter School Facilities Program (29 charter schools).

California Debt Limit Allocation Committee (CDLAC) and California Tax Credit Allocation Committee (CTCAC)

CDLAC and CTCAC administer federal and state programs designed to provide low-cost financing for the construction of low-income and affordable housing in the state.

For calendar year 2009, CDLAC allocated more than $1.7 billion of the state's overall private activity bond cap to its Qualified Residential Rental Project Program, which provides low-cost, tax-exempt financing to developers of multifamily rental housing units.

CTCAC awards both federal and state tax credits to projects involving the construction or rehabilitation of low-income housing. Developers use the tax-credits to attract investment capital to help finance these projects.

For calendar years 2007 and 2008, CTCAC awarded $1.6 billion in tax-credits to finance the construction of over 9,000 low-income rental units.

In September 2009, CTCAC awarded $146.9 million in state and federal tax credits to finance the rehabilitation or construction of more than 4,800 low-income rental units. In addition, to date TCAC has awarded $574.9 million in ARRA funds to revive "shovel ready" affordable housing projects unable to move forward due to current economic conditions, thereby creating thousands of jobs and low-income rental units throughout the state.[5]

California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA)

Since 2007, STO staff has been working to revive this once-dormant agency and to make it an effective program for the delivery of low-cost financing for alternative energy and alternative transportation projects in the state. This effort has included advocacy of federal and state legislation, and the adoption of regulations and policies. For example, the CAEATFA board recently directed staff to explore proposals that may provide sales and use tax exemptions for the purchase of Zero Emission Vehicle (ZEV) manufacturing equipment in California. The goal of this new ZEV program is to create a strong industry within California which will create long-term, high-paying manufacturing jobs, and produce cars that do not emit greenhouse gases.

STO Collaboration and Coordination with Other Economic Development Agencies

Since 2007, STO staff has stepped up efforts to collaborate and coordinate the delivery of their economic development programs with other state and local agencies in an attempt to extend the benefits of the programs to a greater number of workers, businesses and communities. The following are examples of such efforts:

- **CIDFAC:** On an ongoing basis, CIDFAC staff works with local agencies, largely through its membership on the CALED board, state agencies [e.g., the Governor's Jobs and Economic Growth Office, the California Business Investment Services (CalBIS) division of the state's Labor Agency, the Employment Training Panel (ETP), and the California Workforce Investment Board], and other organizations (e.g., the East Bay Green Corridor Partnership) to ensure California's businesses contemplating qualified projects are aware of, and have access to, the IDB program.

  These contacts stress the effectiveness of IDBs as a tool for economic development and job creation and as a means of low-cost financing for the expansion of manufacturing and knowledge-based industries in California. CIDFAC staff regularly refers businesses seeking financial assistance or incentives to CalBIS, which works closely with local economic development

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[5] ARRA includes a provision whereby previously awarded federal tax-credits, which developers have found difficult to sell as a means for attracting capital investment in the current economy, can be exchanged at 85 cents for each $1 of tax credit. While tax-credits generally are used over a ten-year period, the ARRA exchange funds will be awarded to developers in one lump sum. At the national level, the recession and financial crisis have reduced private investment in the Housing Credit Program from a high of about $9 billion in 2006-07 to $5 billion in 2008, and the expectation is that the investment will be reduced even further in 2009.

agencies. CalBIS staff regularly seeks CIDFAC's advice on possible IDB projects. CIDFAC staff also has referred the ETP to companies which access the IDB program to finance their projects – and which are creating a substantial number of jobs as a result of the projects – to determine if ETP funds can be used to cover the cost of training the new hires. Finally, CIDFAC staff has referred businesses with alternative transportation projects to California Energy Commission staff responsible for the Alternative and Renewable Fuel & Vehicle Technology Program. This program soon will provide funds for private and governmental transportation-related projects.

- **CPCFA:** CPCFA staff regularly collaborates with state and local environmental agencies in carrying out its programs. For example, under its CalCAP program, CPCFA has developed several partnerships with state agencies to assist small businesses. The California Air Resources Board (CARB) has made funds available through CalCAP to make it easier for truck owners and diesel equipment owners to borrow funds from CalCAP lenders to modify their vehicles so to bring them in compliance with new air pollution laws. CARB has made over $20 million available for this CalCAP program, which is expected to result in $300 million in loan activity. In addition, CARB is directing portions of pollution settlements to CPCFA. CPCFA will use the funds to help operators of off-highway diesel equipment such as bulldozers install clean-air retrofits on their equipment. To date, CARB has contributed about $500,000 to CPCFA for this program. Further, CPCFA has revived an almost dormant relationship with the California Integrated Waste Management Board (CIWMB) for the CalCAP program. As a result, in calendar year 2008, CIWMB paid $46,606 to banks' loan loss reserve accounts, which otherwise would have been paid by the small business borrower, for loans made to finance seven recycling related projects. The loans themselves totaled approximately $2.33 million.

- **CAEATFA:** As part of the effort to revive CAEATFA, staff has initiated collaboration with energy, transportation and other agencies. For example, as CAEATFA staff developed the sales tax exemption policy for ZEV manufacturing, they closely coordinated with CARB and based their review of transportation technologies on CARB's formal technology review process. CAEATFA recently received a financing application from a ZEV manufacturer, and CARB conducted the initial review of the project's technology to determine if it fit under CARB's current ZEV mandate. In addition, CAEATFA has been working with the California Public Utilities Commission (PUC) and ratepayer advocacy groups to develop a funding mechanism for energy efficiency projects at state facilities. This effort also has included close coordination with the Department of General Services, the Department of Finance and the Department of Corrections.

- **California Debt and Investment Advisory Commission (CDIAC):** ARRA contains provisions which create new types of tax-exempt municipal bonds for both private and governmental projects and which change some longstanding federal tax law requirements for tax-exempt municipal bonds. CDIAC is the state agency responsible for educating state and local municipal bond issuers on establishing, executing, and maintaining sound and effective bond programs. So, it was the obvious choice to partner with the California Infrastructure and Economic Development Bank (I-Bank) to conduct a workshop aimed at educating state and local issuers on ARRA's bond-related provisions. In June 2009, the joint ARRA workshop was conducted in Sacramento, which was well attended by economic development and public finance professionals. CDIAC followed-up the workshop with the publication of "The American Recovery and Reinvestment Act of 2009: Financing Opportunities for California's Public Agencies," which is available for downloading on CDIAC's website.

STO Marketing Efforts

Beginning in 2007, the STO has placed greater emphasis on marketing its economic development programs to state and local economic development professionals, business associations, environmental groups and other organizations. CIDFAC staff's recent marketing activities provide a good example of such efforts.

At its October 22, 2008 meeting, the CIDFAC board adopted CIDFAC's Strategic Plan (Plan), which provides a blueprint for establishing CIDFAC as a leader of California's economic development programs. The Plan contains action items aimed at "aggressive marketing" of the state's Industrial Development Bond (IDB) program, using "broadbased outreach" to industry groups, state and local government agencies, the economic development community and providers of credit support for bond transactions.

However, improvements to the IDB program brought about by recent federal legislation [namely, ARRA and the Housing and Economic recovery Act of 2008 (HERA)] require marketing efforts that go beyond what was originally contemplated in the Plan. CIDFAC staff now must reach out to knowledge-based industry groups and associations, and the banking industry.

The following is a summary of some of CIDFAC staff's marketing efforts in 2009, which fall under three categories: CIDFAC-sponsored workshops, speaking engagements, and web-based and other outreach.

CIDFAC-Sponsored Workshops:

- After the passage of HERA in July 2008, CIDFAC staff initiated contact with the FHLBs to discuss disseminating information regarding their new IDB credit enhancement program to California banks, finance practitioners and economic development professionals. The result was that CIDFAC and the FHLB of San Francisco jointly conducted free, half-day HERA workshops in Sacramento, San Francisco and Los Angeles in January 2009. Attendance at each workshop reached maximum levels, and the feedback from attendees was overwhelmingly positive.

- Staff's contacts with banking and economic development professionals have indicated more banks – particularly regional banks – may be willing to offer letters of credit support crucial to IDB transactions if they are made aware of the IDB program as an alternative to direct commercial lending. With the credit crunch and its harmful effects on small businesses' ability to borrow for capital expenditures, and with the enhancement of the IDB program through HERA and ARRA, CIDFAC staff believed the time was right to reach out to California's banks. On August 27, 2009, CIDFAC sponsored a free, two-hour call-in workshop for banks. Experts described the state's IDB program, the enhancements to the program brought about by HERA and ARRA, and letters of credit as an alternative lending product

Additional Outreach about ARRA and HERA:
Speaking Engagements and Panel Presentations

- CIDFAC staff organized a presentation by Treasurer Lockyer on August 21, 2009 to both the executive committee and the larger membership of the Silicon Valley Leadership Group regarding California's IDB program. Treasurer Lockyer focused on ARRA's expansion of IDB financing to knowledge-based industries. The audience included knowledge-based company executives and officers, banking professionals, and economic development practitioners.

- Staff participated in a panel presentation about HERA's effects on IDB credit enhancement and marketing at CDFA's May 2009 annual conference in Pittsburgh, Pennsylvania. The audience included banking, finance and economic development professionals from around the country.

- Staff participated in a panel presentation about ARRA's effects on California's IDB program, and about recovery zone bonds as a new class of bonds created by ARRA, at a June 2009 conference co-sponsored by the California Debt and Investment Advisory Commission and the I-Bank. The audience included state and local issuers, and finance and economic development professionals.

Web-Based and Other Outreach:

- The California Bankers Association included a message from Treasurer Lockyer about the state's IDB program, and the enhancements to the program by HERA and ARRA, in its June 8, 2009 electronic newsletter.

- Staff has contacted two biotech associations – BayBio out of the San Francisco-Bay Area and BIOCOM out of Southern California – regarding the expansion IDB financing to include knowledge-based companies, including those in the biotech industry. BayBio has agreed to include this information in an upcoming electronic newsletter to its members.

- Following contact by staff, the San Diego Regional Economic Development Corporation, which covers a region with many pharmaceutical, biotech and other knowledge-based companies, sent a notice to its board members regarding the availability of IDB financing to such companies.