California Independent
System Operator

Memorandum

To: ISO Board of Governors

From: Philip Leiber, Chief Financial Officer & Treasurer

Steve Berberich, VP Corporate Services

Date: July 1, 2008

Re: **Report on 2008 Bond Issuance**

This memorandum is for information only. No Board action required.

EXECUTIVE SUMMARY

On June 19, the CAISO issued fixed rate bonds in the amount of $196,970,000. The bonds provided funding to retire all previously outstanding debt, and new money for capital expenditures budgeted for 2008-2009. The bonds were issued at fixed interest rates with yields varying from 2.2% to 3.58%, depending on maturity, with an "all-in true interest cost" to CAISO of 3.56% (including amortization of issuance costs). All previously outstanding CAISO debt was retired on July 1. The decision to refinance has to date been validated, as high interest rates on CAISO's existing debt continued through June due to downgrades of CAISO's bond insurers Ambac and MBIA from AAA to AA. The new debt will provide for a stable and low cost source of funding for CAISO's capital needs, and will help assure that CAISO meets its goal of maintaining a bundled GMC at about the current level of 76 cents per MWh over the next several years. We have also laid the groundwork for the upcoming facility financing in early 2009 by creating a full disclosure official statement that provides investors necessary information about CAISO and by establishing a narrow pricing expectation for CAISO bonds above the MMD (Municipal Market Data) index, an interest rate benchmark consisting of high-quality municipal bonds. As requested by the Governing Board, the final Official Statement is included in your Board materials.

OVERVIEW OF BONDS

CAISO issued its new fixed rate bonds on June 19. The bonds were "priced" on June 4, when interest rates were set for the various annual maturities of the bonds (ranging from 2009 to 2014) and purchase commitments were made by investors. CAISO obtained favorable interest rates in relation to comparable transactions around that date. The interest rate spread on CAISO bonds above the benchmark MMD index was comparable to that for general obligation bonds of the State of California with similar maturities. CAISO's solid and improved credit ratings (A-/A2)[1], and successful marketing of the bonds resulted in a significant demand for CAISO's bonds by institutional investors, including Vanguard. According to our underwriters, Vanguard was interested in CAISO bonds because they were not insured; again a measure of the strength of CAISO's improved rating and the general concern over bond insurers. Vanguard's interest drew the attention of other large institutional investors, such as Blackrock, USAA, Fidelity and Schwab. There was interest in all maturities of CAISO bonds with oversubscription from 1.25 times for the middle

[1] See Attachments A and B for the ratings reports by Standard and Poor's and Moody's.

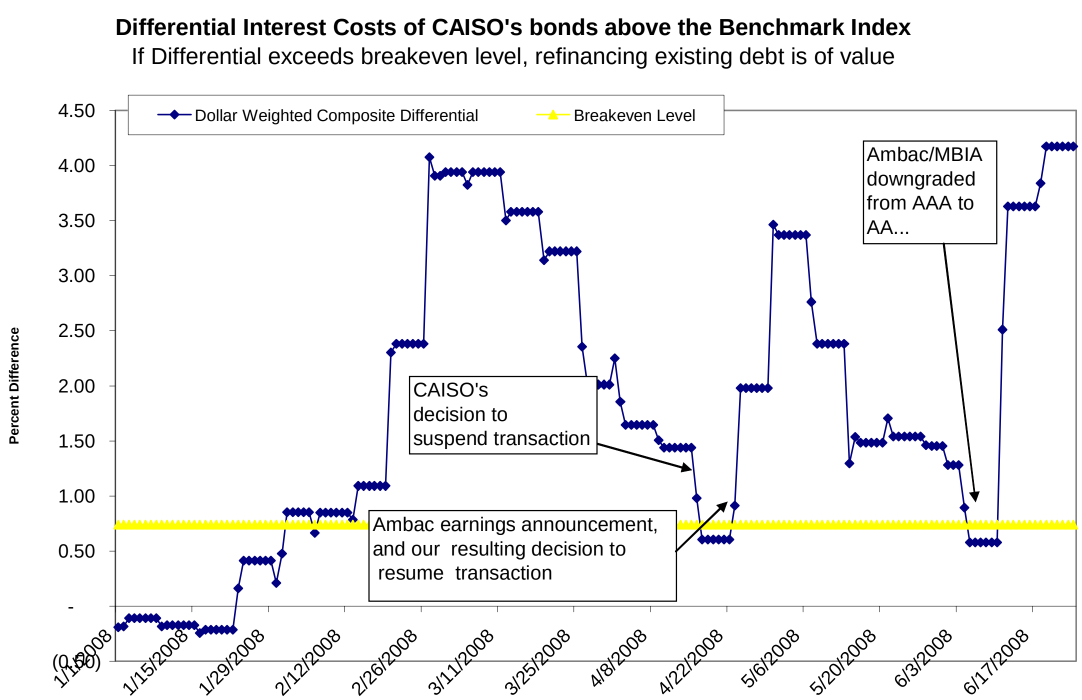
maturities and up to 5 times for the shortest maturity. This competition resulted in an interest rate slightly lower than anticipated, even though comparable rates were increasing at that time.[2]

New Money Component

The bond offering was structured to provide $60 million to fund 2008-2009 capital expenditures, including compliance and regulatory requirements (such as market design enhancements including convergence bidding and scarcity pricing), essential projects (including an Energy Management System operating system upgrade), strategic initiatives (including Payment Acceleration) and other future market system enhancements. These proceeds will also be used to provide temporary funding for the development of CAISO's new headquarters facility. Upon the availability of permanent building program financing, the temporary use of funds from this bond offering would be repaid, and made available for other capital expenditures.

Refinancing Component

CAISO's 2000, 2004 and 2007 variable rate demand bonds ("VRDBs") totaling $139 million were retired on July 1. Since January 2008, investors have been concerned about the financial viability of the bond insurers supporting CAISO's VRDBs. As a result, the interest rates on CAISO's VRDBs have been high and volatile. The differential above the rate CAISO should have been paying on these bonds under normal conditions, or "basis risk" is illustrated on the following chart[3]:



Through the end of June, CAISO paid approximately $1.5 million more in interest expense than would be expected under normal conditions (if CAISO's bond rates approximated the SIFMA index), and approximately $1 million

[2] See Attachment C: June 5, 2008 letter from Sperry Capital, CAISO financial advisor on this transaction, describing bond pricing results.
[3] Break-even level has been updated based on actual interest rates achieved on the 2008 bonds. Breakeven level has fallen from the earlier estimated level of 1.125% to 0.74%.

more interest than what was budgeted for that period (interest was budgeted in December 2007 based on a forecast of interest rates). Because of these continuing concerns, the decision made in March to refinance has proven thus far to be the correct one.

Along with the retirement of CAISO's VRDBs, CAISO also terminated certain agreements related to those bonds, including two interest rate swaps and investment agreements for the debt service reserve fund and monthly bond repayment funds. The net amount payable in connection with the termination of these agreements was funded from 2008 bond proceeds.

Final Bond Structure and Pricing

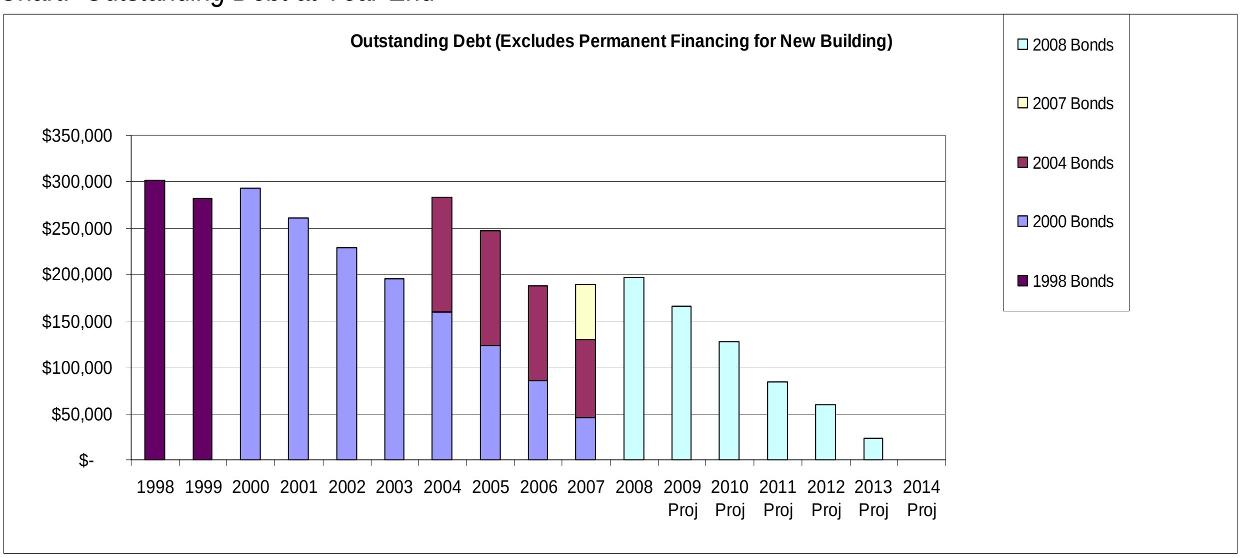
The bond issue was structured into six maturities, designed to minimize the impact on the revenue requirement and the unbundled GMC rate over the next 6 years. The maturities, amounts, coupons and yields are shown in the table below.

Table: *Maturity and Interest Rate Schedule for 2008 Bonds*

Maturity	Amount	Coupon	Yield
2/1/2009	$31,000,000	4.00%	2.20%
2/1/2010	$39,100,000	5.00%	2.74%
2/1/2011	$42,250,000	5.00%	3.10%
2/1/2012	$25,130,000	5.00%	3.33%
2/1/2013	$36,025,000	5.00%	3.45%
2/1/2014	$23,465,000	5.00%	3.58%
Total	$196,970,000		Average all-in Interest Cost: 3.56%

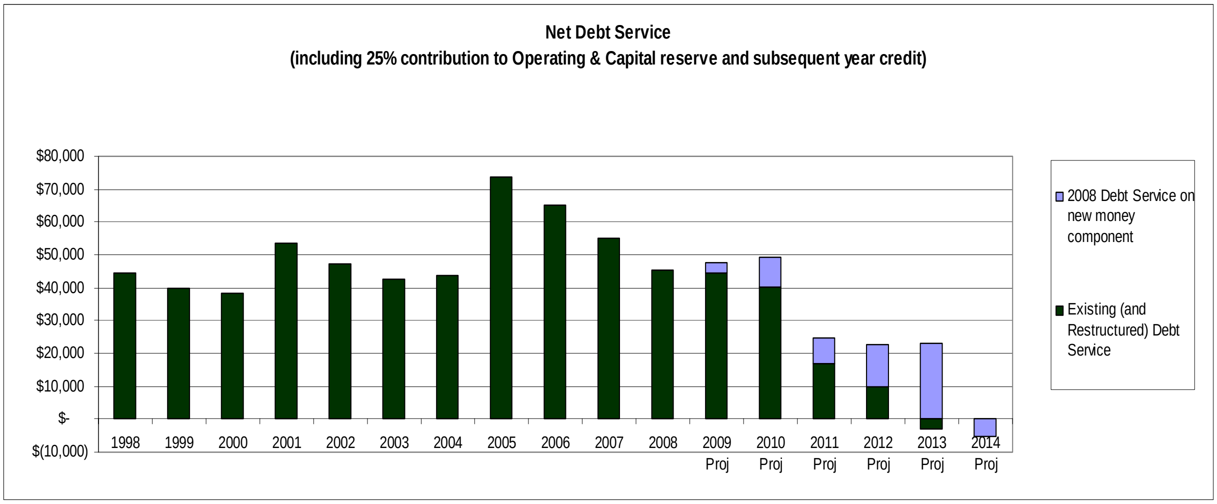
The following charts provide an overview of outstanding debt and annual debt service. The debt has been structured to provide overall GMC rate stability at about the current level of $0.76 per MWh[4] until 2014. In 2014, the bundled GMC rate is projected to drop to about $0.70 cents when the existing debt is fully retired.

Chart: *Outstanding Debt at Year-End*



[4] The new building is anticipated to result in a temporary increase in the GMC during 2010-2013 to about 78 cents.

Chart: *Annual Debt Service*



OTHER ASPECTS OF THE BOND TRANSACTION

Other Proceeds

The bond offering also provided funding for bond issuance costs (including underwriter discount of $1,021,365 and other issuance costs of $531,983), capitalized 2008 interest ($1,171,502, as CAISO's 2008 revenue requirement does not include interest costs for the new bonds), and $19,697,000 for a debt service reserve fund. Costs of issuance are detailed in Attachment D. CAISO will issue a report to FERC by July 19th that summarizes the transaction and the final cost of issuance.

Two Part Transaction

It was necessary to structure the transaction in two parts to comply with certain tax and other provisions of the existing bond documents. This also required the reallocation and reassignment of certain funds as described in the table below. At the culmination of these two parts and with these reallocations, CAISO achieved its objective of retiring the old debt, and having sufficient funding for new capital expenditures.

The new bonds were issued on June 19th, and CAISO received proceeds from the offering on that date. Funding for new money capital expenditures of $41,590,000 was deposited in a "2008 Construction Fund", and $140,321,639 was deposited in an escrow account to retire the prior bonds on July 1. On July 1, upon the retirement of the prior bonds, additional funds[5] totaling $35,563,709 were released and deposited in the "2008 Construction Fund". As a result of this, CAISO has $77,153,709 in the "2008 Construction Fund". This is more than the $60 million initially targeted for 2008/2008 capital expenditures, however, only $3.7 million represents available proceeds beyond the $60 million originally contemplated. The following table illustrates how that additional $17.154 million of funds ($77,153,709 balance in 2008 construction fund less $60 million originally contemplated) will be used:

[5] These funds were related to the previous debt, including the debt service reserve fund and the bond fund containing principal payments CAISO had been making throughout 2008 to pay-down debt in early 2009.

Table: *Planned Use of Additional Proceeds in Construction Fund*

Description	**Amount**
Pay debt service on bonds due 2/1/2009 (funds that CAISO had been sending to the Trustee for debt service on the 2000/2004/2007 bonds was deposited in this account)	$5.992 million
Fund 2008 capital expenditures that were to be funded directly from rates. Now, $7.5 million of those projects will be funded from the 2008 construction fund, and the moneys CAISO collected through rates will be used to meet the 2/1/2009 debt service payment.	$7.500 million
Available for other Capital Expenditures in 2008-2010	$3.700 million
Total additional proceeds in 2008 Construction Fund	$17.154 million

Preparations for Facility Financing

The success of this financing has laid the groundwork for financing of the new CAISO headquarters, which will take place by the first quarter of 2009. Management has begun preliminary discussions with the financing team to develop a strategy for successfully financing the new facility. Management will return to the Board later in 2008 to establish the schedule for that transaction.