California ISO
Your Link to Power

California Independent
System Operator Corporation

Memorandum

To: ISO Board of Governors

From: Steve Berberich, Vice President Corporate Services,
Interim Chief Financial Officer and Treasurer

Date: May 8, 2009

Re: **Decision on Iron Point Facility Budget, Financing, Reimbursement Resolution, and Financing Agreement Resolutions**

This memorandum requires Board action.

EXECUTIVE SUMMARY

This memorandum asks the California Independent System Operator Corporation's (the ISO) Board of Governors (the Board) to take the following actions related to the new ISO facility on Iron Point Road (the Facility):

- Approve the budget for all the elements of the design, construction, commissioning, furnishing, equipping and occupancy of the Facility in an amount not to exceed $160 million;

- Authorize the issuance of a bond offering in an amount not to exceed $210 million that will include funds for the construction of the new Facility, the furnishing and partitions, audio/visual equipment and tools, data center equipment, relocation costs to the Facility and a contingency. The balance of the bond funds are providing for capitalized interest, debt service reserve funds, and issuance costs expenditures;

- Adopt a reimbursement resolution regarding the use of existing corporate funding to meet the Facility and other capital expenditure funding needs until the availability of bond proceeds; and

- Approve and authorize the use of the Loan Agreement(s), Bond Purchase Agreements, Letters of Representation, the Deed of Trust, the Preliminary Official Statement and other related documents to the bond offering in substantially the form provided to the Board.

This memorandum will provide background on the Facility and related matters including the proposed budget and the proposed financing for the Facility.[1]

BACKGROUND

As has been discussed in previous Board meetings, the current ISO facility no longer serves the current and future needs of the corporation, particularly with regard to security, functionality, and physical space. Specifically, the ISO has identified that, as part of its Five-Year Strategic Business Plan, the ISO must address the need for a permanent facility. The ISO conducted a real estate feasibility and cost study to consider a number of options, including constructing a new facility or upgrading and retrofitting the current buildings occupied by the ISO. Based on the results of the cost studies and due to security considerations, the ISO concluded that constructing a new facility on the Iron Point site was the best option.

Thus, with direction and authorization from the Board at the July 2007 Board meeting, the ISO procured a schematic design for the Facility. Subsequently, during the March 2008 Board meeting, the Board approved funding for the design development and cost finalization of the Facility. The Board also encouraged Management to achieve the highest LEED rating that could be economically justified, and the ISO is now planning for a LEED Gold rating for the Facility.

Last fall, the ISO developed a competitive process for selecting a design-builder to construct the new Facility. The ISO developed a Request for Proposal (RFP) based on the documents completed at the 60% milestone in the design development process, outlining the design goals and objectives for the project and establishing an objective-based evaluation method. The RFP process used specific weighted categories to aid in the evaluation of the final proposals.

The categories included such things as:

- Capability and experience;
- Compliance with the performance criteria in the RFP;
- Overall project management experience;
- Completeness and quality of the proposal;
- Presentation and response to questions;
- Proposed schedule for completion; and
- Fixed price for the design and construction of the project.

In the RFP, the target construction budget was set at $115 million, substantial completion was set for the end of February 2011, and final completion was set for mid-April 2011. The ISO provided the RFP to three pre-qualified design-build entities.

The evaluation team tasked with assessing the responses to the RFP included staff from the ISO, a construction management company, and subject matter experts. The team evaluated each proposal and project approach carefully and, based on this review, identified one company as the preferred design-build contractor. (A separate executive session memorandum details

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[1] The proposed motion is lengthy and thus appears at the end of the memorandum.

Management's recommendation to select this company as the design build contractor and seeks the Board's authorization to enter into a design-build agreement with the entity.)

IRON POINT FACILITY BUDGET

Based upon the bids received during the RFP process and additional known and foreseeable project costs, Management recommends a Facility budget of $160 million. Of this $160 million, approximately $110.9 million would be attributable to the design-build contract.

Management anticipates that the recommended budget of $160 million would be allocated as shown below.

Category	Current Estimated Costs
Schematic Design	$2M
Design Costs to 60% Design Development	$2.9M
Design Completion and Construction	$110.9M
Owner Costs	$34.2M
Subtotal Project Costs	$150M
Owner Contingency	$10M
Total Project Total	$160M

Of the owner costs referenced above, over half of the costs will go towards audio/video equipment, furniture and demountable partitions, and the relocation and equipping of the control room and data center. Other owner costs include planning and permit fees, moving expenses, project management, legal costs, and utility connection and service costs.

In connection with this proposed budget is a construction schedule that anticipates final completion of the building by March 2011.

PROJECT SCHEDULE

Specifically, the projected schedule includes the following milestones:

Milestone	Expected Date
Notice to Proceed, first phase	2nd quarter, 2009
Owner Commissioning Date – Furniture, Fixtures & Equipment, Mission Critical Move In	3rd quarter, 2010
Owner Commissioning Date – Furniture, Fixtures & Equipment, Office Building Move In	4th quarter, 2010
Mission Critical Loading and Testing Date	4th quarter, 2010
Substantial Completion of All Work	1st quarter, 2011
Final Completion of Work and Certificate of Occupancy	2nd quarter, 2011

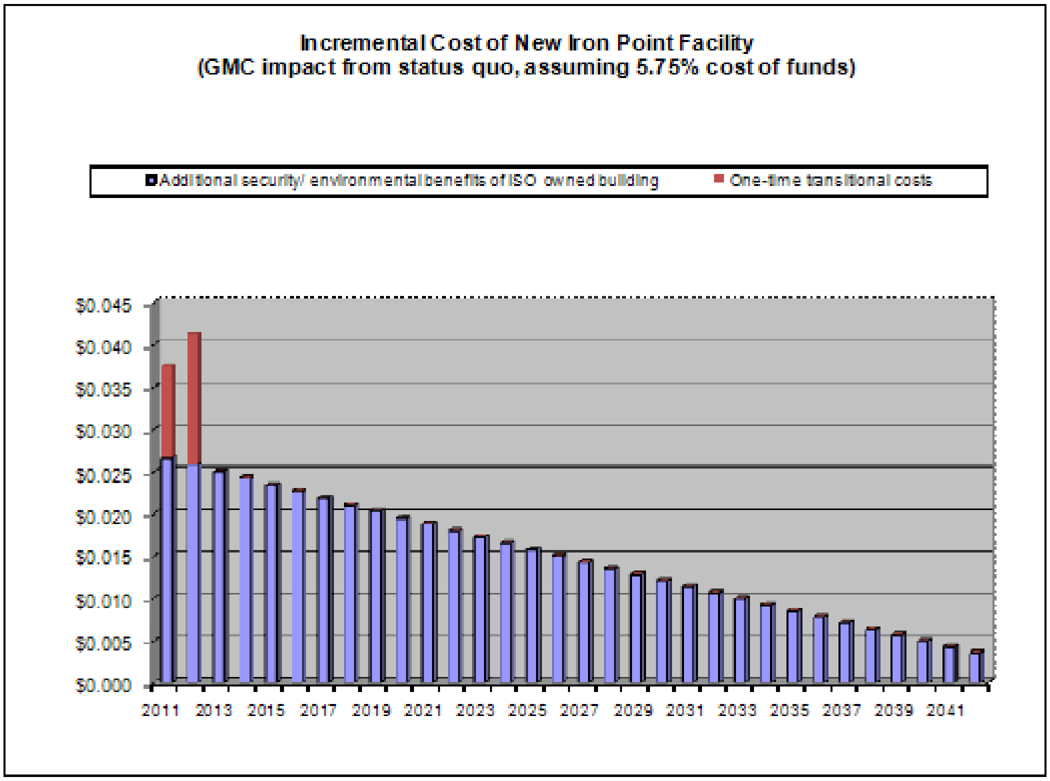
PROGRAM OVERSIGHT

Management has put in place a comprehensive structure to manage and oversee the building program. The ISO has retained an outside consulting group to advise management and provide program oversight because the ISO recognizes its core skills are not constructing buildings. The outside consulting group will provide management over the general contractor, vendors and ISO staff involved in the program and will be held accountable for execution. Roles and responsibilities for all those involved with the program have been clearly spelled out. Finally, there is a well established program schedule with associated incentives and penalties for deviating from the schedule.

FINANCIAL IMPACT TO GMC

Management has prepared a financial projection of the incremental cost of the new facility. The incremental cost of the new facility does not include approximately 2 cents per MWh per year of GMC which would be incurred regardless of if the ISO were to stay at the current location over the long-term or build the new facility. These costs would address an aging infrastructure, security issues, and procurement of additional space to address inadequate workspaces.

Using bond proceeds to fund construction, and with deferral of debt service costs until the building is occupied in 2011, there is no incremental impact of the Facility on GMC rates until 2011. From 2011 forward, the incremental increase to GMC is shown in the table below. The average incremental impact to GMC over 30 years is 1.6 cents per MWh per year, and in Management's view, this incremental increase is an appropriate price to pay for the enhanced security, environmental benefits, and workspace enhancements available to employees of the new Facility. This cost includes the additional security and environmental benefits shown in blue and the one time transition costs (maintaining existing leased space and new Facility) shown in orange. Rent payments on the existing leased building space will continue through 2012 (and we assume partial offsets of lease costs in 2012 through a sublease).



FACILITY BUDGET RECOMMENDATION

Assuming the project schedule above is maintained, Management recommends the Board approve the Facility's budget in the amount not to exceed $160 million, as set forth in the resolution that appears at the end of this document.

In order to fund the Facility project, the ISO must seek financing. To evaluate the most desirable financing structure for this purpose, the ISO established a financing team comprised of a senior underwriter, two co-managers, bond counsel, issuer counsel, and a financial advisor. After reviewing multiple financing structures and given the current economic conditions, Management has determined that it is in the best interest of the ISO to issue fixed rate bonds, targeted for a July 2009 issuance. The issuance would be a single offering of a 30-year fixed rate bond secured with a mortgage on the Facility. At a time closer to the issuance date, Management will perform a cost/benefit analysis of whether it would be prudent to obtain bond insurance. Management requests the authority to obtain bond insurance if market conditions indicate the investment is in the best interest of the ISO. The costs for the insurance would likely be offset by a reduction in interest rates because of a lowered risk premium and would only be pursued if market conditions required it or it presented a more favorable cost structure.

Bond proceeds would be allocated as follows:

Bond Sizing

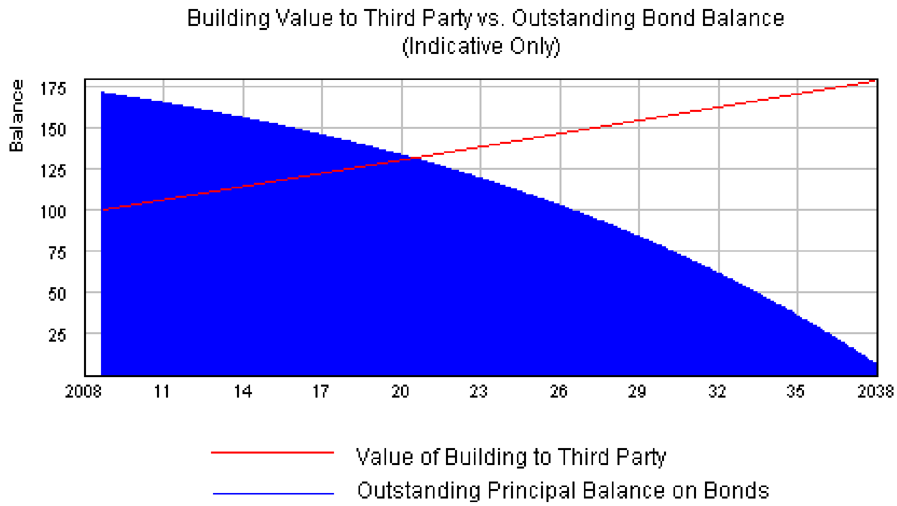
Category	Estimated Amount (in millions)
Facility Design and Construction Costs	$115.8
Associated Costs (move data center, consultants, construction management, furniture, fixtures, contingency, audio/visual)	$44.2
Subtotal, Building Funding Need	$160.0
Capitalized Interest	$25.7
Issuance Costs	$2.5
Subtotal, prior to Debt Service Reserve Fund	$188.2
Debt Service Reserve Fund	$17
Total Issuance Amount	$205.2-$210.0

Note that the proceeds include the reference to a debt service reserve fund (DSRF). A DSRF is considered a necessary element of the bond structure to attract bond investors in this offering and was used in the 2004, 2007 and 2008 bond transactions. The DSRF will result in the issuance of bonds in an amount that exceeds what the ISO needs for construction fund proceeds. The excess amount (not to exceed 10% of the issuance amount) is maintained as a separate investment by the bond trustee. The DSRF would be used to meet interest or principal payments if the ISO is unable to do so, and will be released for other uses or to pay debt service in the final year the bonds are outstanding. Interest earned on the DSRF is available to pay interest on the bonds throughout the term of the bonds.

In March 2008, the Board approved a Reimbursement Resolution for the use of up to $18 million of ISO corporate funding for the Facility that would be repaid from future financings (including the 2008 and 2009 financings). Management now requests that the Board adopt a Reimbursement Resolution that would increase this limit to $40 million. Funds from the 2008 financing and July 2009 bond offering will be used to repay such interim borrowings.

Mortgage Security Interest on the Building

The ISO's previous bonds have been supported by a pledge of the net revenue of GMC (after payment of operating expenses) to bond holders. This bond offering will also follow this structure. However, because of the long-term nature of this transaction, Management believes that prospective investors in this transaction will also value a mortgage interest in the building. So bondholders will have a first priority lien on the Iron Point Facility. In order to secure this, the ISO will procure title insurance to protect the priority interest of the bondholders. Further, to the extent that investors have concerns about ongoing collections of GMC in the future, bondholders will be increasingly protected by the value of the building. The illustration below demonstrates that as the bonds are paid down, and the value of the building increases (a 2% growth rate is used), bondholders can have increasing assurance of repayment from the value of the building, in the event the ISO's GMC is not available to make debt service payments. The illustration assumes, conservatively (given the technical and special purpose aspect of the facility), that the value of the building to a generic third party may be less than the value of the outstanding debt initially, but does provide for appreciation at 2% per year. Management has retained a nationally recognized appraisal consultant to develop an appraisal and financial projection that will be used in the offering memorandum for the bonds to demonstrate this concept.



BOND ISSUANCE RECOMMENDATION

Management recommends that the Board approve a fixed rate bond offering to finance the Facility and other related expenses, as set forth in the issuance and reimbursement resolutions that appear at the end of this document. We also note that an application was filed with the Federal Regulatory Energy Commission (FERC) on April 10, 2009 requesting authorization to go forward with the offering pending Board approval.

FINANCING AGREEMENTS AND RECOMMENDATION

In connection with this bond offering, the following financing documents will be required: one or more Loan Agreements, Bond Purchase Agreements, Letters of Representation, the Deed of Trust, the Official Statement, Certifications by Officers and other related documents (collectively, Financing Agreements). In the previous 2008 bond offering, Management first obtained Board approval to go forward with the bond offering and then held a separate Board meeting to obtain authorization to enter into the Financing Agreements and to take any other actions in furtherance of the offering. In order to maintain the building schedule described in this memorandum, Management has included substantially complete Financing Agreements for the Board's review in the Board book and shall continue to keep current copies of the Financing Agreements with the ISO Corporate Secretary for the Board's review at any time. Note that the Loan Agreement for this 2009 bond offering will not be available at the time the Board book is distributed. However, the Loan Agreement for the 2009 Bonds shall be in a form substantially similar to the Loan Agreement previously executed and delivered by the ISO in connection with the issuance of the 2008 Bonds. If satisfactory, Management requests that the Board approve the resolutions as set forth in the memorandum in connection with the Financing Agreements. In the event the Financing Agreements materially change in form from those provided initially to the Board, Management shall immediately notify the Board and the Board may revoke its motion to approve the resolutions.

CONCLUSION

This memorandum has provided an overview of the background of the Facility, detailed the proposed budget and discussed the financing necessary to fund the Facility. In summary, Management seeks the Board's approval of the following resolutions as they appear at the end of this document:

- Budget Resolution
- Bond Issuance Resolutions
- Reimbursement Resolutions
- Financing Agreement Resolutions

RESOLUTIONS

Budget Resolution

Moved, that the ISO Board of Governors approves a budget for a new facility on Iron Point Road of $160 million. Management is authorized to execute contracts and incur expenditures within this budget subject to the established protocols and procedures for budgeting and approval of expenditures. Management is to keep the Board informed of the expenditures and progress toward the new facility.

Bond Issuance Resolutions

> ***MOVED, that the ISO Board of Governors approves, authorizes and directs Management in the name and on the behalf of the ISO, to perform the following actions:***
>
> > ***Issue a fixed-rate bond in an amount not to exceed $210,000,000, through the California Infrastructure and Economic Development Bank ("Bond Offering") with a term not to exceed 30 years secured by a mortgage on the Facility to finance the design, construction, commissioning, furnishing, equipping and occupancy of the Facility, other related building infrastructure costs, capitalized interest, debt service reserve funds, and bond issuance costs.***
> >
> > ***Incur other obligations and guarantee the obligations of the ISO in connection with the Bond Offering and in furtherance thereof to execute and deliver from time to time any note or other instrument evidencing indebtedness or other obligations of the ISO, including related agreements and documents and guarantees of obligations or endorsements of notes, when deemed to be in the best interest of the ISO;***
> >
> > ***Procure bond insurance to secure such bonds to the extent determined advantageous by the ISO Management, and to enter into agreements related thereto; and***
> >
> > ***To take any and all other actions necessary to effectuate the Bond Offering.***

Reimbursement Resolutions

RESOLUTION DECLARING OFFICIAL INTENT OF
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO REIMBURSE CERTAIN EXPENDITURES FROM PROCEEDS OF INDEBTEDNESS
AND TO USE JUNE 2008 BORROWINGS ON AN INTERIM BASIS PRIOR TO THE AVAILABILITY
OF PROCEEDS FROM SUBSEQUENT FINANCING
ADOPTED MAY 18, 2009

WHEREAS, the California Independent System Operator Corporation (the "Corporation") expects to pay certain expenditures (the "Expenditures") in connection with its new facility program and other capital expenditures, such as software, computer equipment, construction costs and other capital costs (collectively, the "Project") prior to and in anticipation of the issuance of indebtedness for the purpose of financing the Project on a long-term basis;

WHEREAS, the Corporation intends to fund such Expenditures on an interim basis with general corporate funds;

WHEREAS, the Corporation will issue debt obligations during 2009 and a portion of the proceeds from that debt obligation will be used to pay or reimburse general corporate funds in an amount not to exceed $40,000,000;

WHEREAS, Section 1.150-2 of the Treasury Regulations requires the Corporation to declare its official intent to reimburse itself for prior expenditures for the Project with proceeds of debt obligations;

WHEREAS, this is an update to the previously approved reimbursement resolution;

NOW, THEREFORE, BE IT RESOLVED BY THE CORPORATION:

Section 1. The Corporation hereby declares the foregoing Recitals to be true and correct;

Section 2. The Corporation here declares that this Resolution shall constitute its declaration of official intent pursuant to Regulation § 1.150-2 to use proceeds of the debt incurred in 2009 to pay or reimburse its general corporate funds for the Project in an amount not to exceed $40,000,000.

Section 3. This Resolution shall be in full force and effect from and after its adoption as provided by law.

Financing Agreement Resolutions

Moved, that the ISO Board of Governors approves one or more Loan Agreements, Bond Purchase Agreements, Letters of Representation, the Deed of Trust, Preliminary Official Statement, one or more Indentures and any other related financing documents (collectively, the "Financing Agreements") as well as the transactions contemplated therein, in substantially the forms on file with the ISO Corporate Secretary ; provided that the Loan Agreement and the Indenture for the 2009 Bonds shall be in a form substantially similar to the Loan Agreement and the Indenture, respectively, previously executed and delivered by the ISO in connection with the issuance of the 2008 Bonds ;

Moved, that any of chief executive officer or chief financial officer (the "Authorized Corporation Representative"), with the advice of retained counsel or corporate counsel, is hereby authorized and directed for and in the name and on behalf of the ISO, to execute, acknowledge and deliver the Financing Agreements (other than the Indentures) in substantially such forms, with such changes therein as such Authorized Corporation Representative may require or approve, such approval to be conclusively evidenced by the execution and delivery thereof.

Moved, that the ISO Board of Governors approves the official statement or official statements for the Bonds, in substantially the form on file with the ISO Corporate Secretary.

Moved, that Any Authorized Corporation Representative, with the advice of retained counsel or corporate counsel, is hereby authorized and directed for and in the name and on behalf of the ISO, to complete, execute and deliver such official statement or official statements in final form. The Underwriters are hereby authorized to distribute a preliminary form of such official statement or official statements to prospective purchasers of the Bonds and is hereby authorized and directed to distribute a final form of such official statement or official statements to all actual purchasers of the Bonds.

Moved, that the ISO Board of Governors authorizes each such officer to deliver certificates confirming the accuracy of information relating to the ISO included in the bond official statement or official statements.

Moved, that the ISO Board of Governors authorize and direct any Authorized Corporation Representative, with the advice of retained counsel or corporate counsel, to do any and all things and to execute and deliver the Indenture and the Financing Agreements and any and all additional agreements, instruments, certificates and documents which they may deem necessary or advisable in order to consummate the issuance of the Bonds and the acquisition and financing of the Facility and otherwise to effectuate the purposes of this resolution, including but not limited to a tax certificate, a continuing disclosure agreement and control account agreements, rebate consultant agreements or investment agreements.