Sperry Capital Inc.

September 12, 2005

Mr. Thomas L. Beckett
Public Finance Manager
County of Orange
10 Civic Center Plaza, 3rd Floor
Santa Ana, CA 92701-4062

RE: Financing Feasibility Analysis of the Cogeneration and Photovoltaic Projects.

Dear Tom:

Sperry Capital was retained by the County of Orange to prepare a feasibility analysis and strategy for the possible tax-exempt financing of the Cogeneration Project and the Photovoltaic Project (the "Projects"). As part of the analysis, we reviewed the opportunities for internal funding either directly through the County general fund or indirectly through the County investment pool and the use of a master lease financing program. We conclude that the Cogeneration Project can be financed successfully as an individual project or combined with other projects as separate standalone issues or under a Master Lease Indenture financing structure so that the County can take advantage of the current low tax-exempt financing interest rate environment. The primarily equipment nature of the Cogeneration Project would be best accomplished through an asset transfer master lease structure. The Photovoltaic Project would be most efficiently financed if it were combined with the Cogeneration Project, or another project if there are timing issues, due to the small capital requirements of the project.

ASSUMPTIONS

1. With the County's current ratings, bond insurance is not necessary if the projects are financed in an asset transfer master lease structure. However, bond insurance is available and may be used if it provides savings to the County.

2. The financing(s) can be structured as lease revenue bonds or certificates of participation (the "Obligations") in a stream of payments associated with either a lease or installment purchase contract for the equipment associated with each project.

3. Estimated financing costs, including underwriter's discount and costs of issuance, do not exceed \$300,000 for a standalone Cogeneration Project financing, or \$330,000 for an asset transfer and master lease indenture. If financed on a standalone basis, the Photovoltaic Project financing may be able to be completed as a private placement for approximately \$50,000 of financing costs. Combining the Photovoltaic Project financing with another project financing will result in significant financing cost efficiencies.

475 Gate Five Road, Suite 208
Sausalito, CA 94965
(415) 339-9202
FAX: (415) 339-9203

4. Capitalized interest would normally be funded for a period of 3 to 6 months past the expected completion date of the projects. With an asset transfer structure, capitalized interest does not have to be funded. Capitalized interest is excluded from the analysis of alternatives to simplify the analysis and because it would not effect the results of the analysis.

5. A Debt Service Reserve Fund is normally funded from proceeds of the Obligations in an amount equal to the smaller of maximum annual debt service or 10% of the issue size. Funding of a reserve fund is excluded from this analysis of alternatives to simplify the analysis and because it would not effect the results of the analysis.

6. The Cogeneration Project is estimated to cost $23.56 million, and 100% of the costs can be financed. The Photovoltaic Project is estimated to cost $1.8 million. However, 40% of the project costs are expected to be reimbursed by federal/state grants, therefore we recommend that only 60% of the project costs be financed and the balance should be funded by County funds.

7. The Obligations will be amortized over a period of 20 years for the Cogeneration Project and 15 years for the Photovoltaic Project, which is less than but consistent with the expected useful life of the projects.

FINANCING ALTERNATIVES

The alternative strategies for the tax-exempt financing of the Projects include:

1. Standalone lease revenue bond financing of the individual projects.
2. Combined lease revenue bond financing of the projects.
3. Standalone or combined lease revenue bond financing through a non-rated master lease financing structure.
4. Standalone or combined lease revenue bond financing through an asset transfer and rated master lease financing structure.
5. Creation of two separate master lease financing structures, one rated and one non-rated.

The alternatives to tax-exempt financing are:

1. Cash funding of the projects from the general fund; or
2. Purchase of Obligations by the County Treasurer through the County investment pool.

A brief description and analysis of the five tax-exempt financing strategies are presented below.

1. *Standalone Lease Revenue Bond Financing of the Individual Projects.* This option is perhaps the most expensive strategy since there would be two separate bond issues resulting in higher costs of issuance and slightly increased underwriter and bond insurance costs. In addition, the rating agencies generally rate lease revenue bonds or COPs that finance equipment at least one notch lower than essential purpose capital projects that involve bricks and mortar or longer useful life capital equipment such as buses and electric generators. Telecommunications equipment, computers and software are examples of equipment that have limited use for other purposes, may have problems with ultimate acceptance by the user and have little salvage value no matter how essential the equipment is to the ability of the user to perform its public functions. A significant portion of the equipment for both Projects would not have application at another site or salvage value.

2. *Combined Lease Revenue Bond Financing of the Projects.* This strategy is an improvement over the standalone financing of the projects discussed in #1 above in that cost efficiencies from combining the two issues into one (lower costs of issuance and slightly lower underwriter costs) can be realized. The one notch lower credit ratings would still represent a cost for this strategy.

3. *Standalone or Combined Lease Revenue Bond Financing through a Non-rated Master Lease Financing Structure.* A non-rated Master Lease financing structure involves the creation of a trust indenture that permits a succession of multiple series of lease financings for similar projects that are approved and qualify for financing under the master lease indenture. The security provisions of each issue will be consistent with the indenture and the legal documentation associated with each new financing will be significantly reduced. The master lease indenture and lending provisions would be negotiated with a municipal leasing company as the master lessor and the terms of each financing (maturities, par amounts and interest rates) will be negotiated in a private placement negotiation between the lessor and the County. While the costs of issuance and underwriter costs will be significantly reduced or eliminated, the interest rate for each financing will be higher than that which is available for a rated public offering. Discussions with lease financing providers have indicated that the financing rates are roughly equivalent to rates achieved by BBB+ or A- rated entities. In essence, the lessor is paid a higher interest rate in exchange for the simplified and lower issuance costs associated with this type of financing.

4. *Standalone or Combined Lease Revenue Bond Financing through an Asset Transfer and a Rated Master Lease Financing Structure.* An Asset Transfer involves the transfer of an existing asset to a financing entity and the leasing of the asset to the County. The obligations that are issued are secured by the payment obligation of the County and the asset. The County essentially used an asset transfer for the 1996 Recovery Certificates of Participation financing and the County approved the use of an asset transfer financing structure for the Theo Lacy III Jail Expansion Project. That financing was not completed when the County ultimately decided to use cash to fund the improvements. The asset transfer can be combined with a Master Lease financing structure similar to that described in #3 above except that the Master Lease Indenture would provide security provisions and terms for the issuance of high credit quality rated obligations under supplemental indentures. Certain existing County assets would be transferred into the trust subject to the Master Lease and lease revenue bonds, secured by the trust assets and County lease payments would be issued to fund specific County projects.

   Additional advantages of an asset transfer that are not available with the other lease financing strategies are that there is no completion risk. Since the transferred financing assets are completed improvements, the debt can begin to be amortized prior to completion of the project, and the County can determine the amount and timing of capitalized interest, if any, to fund for a project.

5. *Creation of Two Separate Master Lease Financing Structures, One Rated and One Non-rated.* The County does not have to accomplish all future financings of equipment through either a rated or non-rated master lease financing structure. The County can initiate two separate master lease financing programs, one non-rated for small individual financings under $7 million and with amortization periods of less than 10 years, and one rated for financings above $7 million and longer amortization periods. The two programs do not need to be mutually exclusive. For instance, in 2002 the County combined an approximate $700,000 financing of computer hardware and software for the County Treasurer's office with the Juvenile Justice Center Refunding. If that refunding had not occurred for whatever reason in 2002, the County might have determined to finance the Treasurer's project through a non-rated lease. Generally, a small project like the Treasurer's project or other small projects, if they are not funded by the general fund, are most efficiently financed when combined with another larger financing requirement.

A brief description and analysis of the two alternatives to tax exempt financing are presented below.

1. *General Fund Cash Financing.* The Projects can be funded from the General Fund if the County programs the costs of the Projects in the budget or amends the budget to provide the funding. The current Strategic Financial Plan provides for tax-exempt financing of the Projects. Pay-as-you-go or upfront cash funding from the General Fund may take funds away from other County needs that cannot be isolated as a project for tax-exempt financing. If General Funds were used to fund the Projects, the funds spent for the Projects would not be available for investment once they are spent. Investments in the County pools have a current earnings rate of approximately 3.0%; however, the long term average investment return of the County pool exceeds 5.0%. It is likely that any of the financing strategies discussed above would result in financing costs less than 5.0%.

2. *Purchase of Obligations by the County Treasurer through the County Investment Pool.* The County's Investment Policy and State code have credit quality and maturity restrictions for local government investments and other investments. The County Investment Pools managed by the County Treasurer would be able to purchase obligations issued by the County, even if the State code or the County Investment Policy do not permit them, as long as the Board of Supervisors authorized the Treasurer to make the purchases. However, since the state and federal governments do not tax investment earnings of the County investment pools, the County investment pools invest in higher interest rate taxable securities in order to maximize investment returns. Tax-exempt securities, which can provide lower cost financing for the Projects, would generally be considered an inappropriate investment for the County pools.

ANALYSIS OF TAX-EXEMPT FINANCING STRATEGIES

Based upon the discussion above, we believe that the tax-exempt financing strategies provide more benefits to the County than the options to cash fund the projects from the general fund or to purchase securities to finance the projects from the County investment pools. These benefits are primarily the opportunity to finance the projects with historically low-cost tax-exempt financing interest rates and the flexibility provided to the County to use general funds for other priority purposes that couldn't be tax-exempt financed.

As discussed above, the Projects can be financed separately or combined in the same bond issue through either an asset transfer master lease strategy, a conventional lease

revenue bond lease strategy, or a non-rated master lease strategy. The tables below analyze the two projects financed on a standalone basis and combined in the same issue for each of the three strategies. To simplify the analyses, the comparisons focus on capital costs of the projects and financing costs and assumes that capitalized interest and reserve fund requirements would be similar for each strategy even though these costs would be reduced for higher credit quality financing strategies. Tables 1 and 2 present the separate Cogeneration and Photovoltaic projects financed on a standalone basis using each strategy. Table 3 presents the combined projects financed in the same issue using each strategy.

Table 1
Standalone Cogeneration Project

	Asset Transfer	Conventional LRB	Non-rated
Project Cost	$23,560,000	$23,560,000	$23,560,000
Financing Costs	$330,000	$300,000	$250,000
Issue Size	$23,890,000	$23,860,000	$23,810,000
Rating Assumption	A+/AA-	A/A+	BBB+/A-
Interest Rate	4.5%	4.75%	5.0%
Amortization Period	20 years	20 years	20 years
Annual Debt Service	$1,837,000	$1,874,000	$1,910,600

Table 1 illustrates that the most cost effective financing strategy for a large financing requirement that can be amortized over a 15-20 year period is an Asset Transfer structure that can achieve higher ratings and lower borrowing costs than a conventional equipment lease revenue bond structure.

Table 2
Standalone Photovoltaic Project

	Asset Transfer	Conventional LRB	Non-rated
Project Cost	$1,080,000	$1,080,000	$1,080,000
Financing Costs	$100,000	$80,000	$50,000
Issue Size	$1,180,000	$1,160,000	$1,130,000
Rating Assumption	A+/Aa3	A/A+	BBB+/A-
Interest Rate	4.5%	4.75%	5.25%
Amortization Period	15 years	15 years	15 years
Annual Debt Service	$109,900	$109,900	$110,700

Table 2 illustrates that it is cost effective to finance a small capital requirement using a non-rated structure (either individual lease or master lease) if the financing costs can be minimized through a private placement.

Table 3
Combined Financing of Cogeneration and Photovoltaic Projects

	Asset Transfer	Conventional	Non-rated
Project Cost	$24,640,000	$24,640,000	$24,640,000
Financing Costs	$350,000	$320,000	$275,000
Issue Size	$24,990,000	$24,960,000	$24,915,000
Rating Assumption	A+/Aa3	A/A+	BBB+/A-
Interest Rate	4.5%	4.75%	5.0%
Amortization Period	20 years	20 years	20 years
Annual Debt Service	$1,921,100	$1,960,600	$1.999,200

Table 3 illustrates the benefits of combining multiple projects in a single financing. While the Table 3 results are very similar to Table 1, the financing costs in Table 3 are less than the combined financing costs of Table 1 added to Table 2 for each financing strategy. Assuming a two-year capitalized interest period, the present value savings of the asset transfer for the financing of the combined projects exceeds $650,000 compared to conventional lease financing of the equipment.

CONCLUSIONS AND RECOMMENDATIONS

As discussed above, it is very difficult to quantify the net benefits to the County of tax-exempt financing of the Projects. Tax-exempt financing will permit the County to pay for the costs of the Projects in an efficient manner over their useful life, and reserve County general funds for uses that can not be tax-exempt financed.

The strategies that we recommend for tax-exempt financing of the projects are:

1. We recommend that the two projects be financed together if possible. If the Cogeneration Project is financed on a standalone basis because of a delay for whatever reason of the Photovoltaic Project, or if the County cannot identify another project or financing to combine with the Photovoltaic Project, we recommend that the County finance the Photovoltaic Project through a either a rated asset transfer master lease structure or a non-rated municipal lease with a leasing company. The financing could be structured as a master lease program so that future small projects that meet certain criteria could also be cost

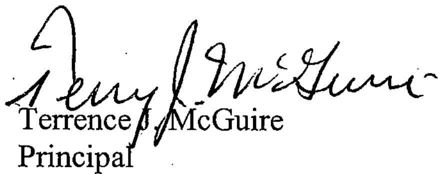
effectively financed through the same master lease agreement. Subsequent financings will have lower upfront financing costs because the master lease documentation and legal provisions will already be established.

2. If the two projects can be financed together, we recommend that the County create a new asset transfer master lease financing program that will facilitate future equipment related financings. The assets the County may wish to consider may include the Theo Lacy jail facilities or other County assets that have been released from the encumbrance of the Recovery Debt in the recent refunding. The asset transfer will eliminate completion risk, result in higher credit ratings, achieve lower borrowing costs and permit flexibility in funding of capitalized interest.

3. The County may have to address similar issues within the next 12 months related to financing of the CAPS and CalWIN computer projects. The computer projects, which involve both hardware and software, could be financed most efficiently as a follow-on financing to the asset transfer/master lease financing strategy that we recommend for the Cogeneration and Photovoltaic Projects.

Please feel free to call me at (415) 339-9202 if you have comments or questions.

Sincerely,



Terrence J. McGuire
Principal

cc: J. Snyder