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California school districts face huge debt on risky bonds

About 200 districts have borrowed billions of dollars using so-called capital appreciation bonds. Districts may have to pay 10 to 20 times the amount borrowed.

By Dan Weikel, Los Angeles Times

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Two hundred school districts across California have borrowed billions of dollars using a costly and risky form of financing that has saddled them with staggering debt, according to a Times analysis.

Schools and community colleges have turned increasingly to so-called capital appreciation bonds in the economic downturn, which depressed property values and made it harder for districts to raise money for new classrooms, auditoriums and sports facilities.

FOR THE RECORD:
School bonds: An article in the Nov. 29 Section A about a risky type of construction financing used by school districts said that news of one bond issued by the Poway district was first reported by the Voice of San Diego website. That website has acknowledged that its work was assisted by Joel Thurtell, a retired reporter for the Detroit Free Press who had previously written about the bonds in a blog post. —

Unlike conventional shorter-term bonds that require payments to begin immediately, this type of borrowing lets districts postpone the start of payments for decades. Some districts are gambling the economic picture will improve in the decades ahead, with local tax collections increasingly enough to repay the notes.

DATABASE: Bonds by district

CABs, as the bonds are known, allow schools to borrow large sums without violating state or locally imposed caps on property taxes, at least in the short term. But the lengthy delays in repayment increase interest expenses, in some cases to as much as 10 or 20 times the amount borrowed.

The practice is controversial and has been banned in at least one state. In California, prominent government officials charged with watching the public purse are warning school districts to avoid the transactions.

One sounding the alarm is California Treasurer Bill Lockyer, who compares CABs to the sort of creative Wall Street financing that contributed to the housing bubble, the subsequent debt crisis and the nation's lingering economic malaise.

"They are terrible deals," Lockyer said. "The school boards and staffs that approved of these bonds should be voted out of office and fired."

Most school bonds, like home mortgages, require roughly $2 to $3 to be paid back for every $1 borrowed. But CABs compound interest for much longer periods, meaning repayment costs are often many times that of traditional school bonds.

And property owners — not the school system — are likely to be on the hook for bigger tax bills if the agency's revenues can't cover future bond payments, Lockyer and other critics say.

Several financial consultants who advise school districts on CABs declined to comment, as did the chairman of their trade group. Education officials acknowledge some drawbacks with CABs, but argue that the bonds are funding vital educational projects.

The Newport Mesa Unified School District in Orange County issued $83 million in long-term notes in May 2011. Principal and interest will total about $548 million, but officials say they are confident they can pay off the debt.

The bonds "have allowed us to provide for facilities that are needed now," said the district's business manager, Paul Reed. "We could not afford to wait another 10 years."

Overall, 200 school systems, roughly a fifth of the districts statewide, have borrowed more than $2.8 billion since 2007 using CABs with maturities longer than 25 years. They will have to pay back about $16.3 billion in principal and interest, or an average of 5.8 times the amount they borrowed.

Nearly 70% of the money borrowed involves extended 30- to 40-year notes, which will cost district taxpayers $13.1 billion, or about 6.6 times the amount borrowed on average.

State and county treasurers say debt payments of no more than four times principal are considered reasonable, though some recommend a more conservative limit of three times.

"This is part of the 'new' Wall Street," Lockyer said. "It has done this kind of thing on the private investor side for years, then the housing market and now its public entities."

The Poway Unified School District, which serves middle-class communities in north San Diego County, is one of the school systems faced with massive CAB debt payments. In 2011, it issued $105 million in capital appreciation bonds to complete a school rebuilding program.

Because the recession had depressed property values and tax revenue, Poway district officials realized that using conventional bonds might jeopardize a promise to district voters to limit the tax rate.

So on the advice of an Irvine-based financial consulting firm, they turned to the long-term notes. Under the deal, the school board could keep construction moving, avoid reneging on its pledge to voters and stay within the legal limits. And it would not have to repay the bonds for decades.

By the maturity date of 2051, however, the $105 million in Poway notes will cost district taxpayers almost $1 billion in principal and interest — more than $9 for every $1 borrowed.

That deal, first reported by the Voice of San Diego news website, raised alarms. But some Poway officials defend it as necessary to complete much-needed projects.

"It was well worth it," said Jennifer Zaheer, president of the Palomar Council Parent Teachers Assn., which serves Poway Unified. "In my son's experience, there's a big difference between using a trailer and having a new classroom."

Poway Supt. John P. Collins said the bond deal was one of the only options the district had. Property taxes are limited by voter-approved state laws, which cap the amount districts can levy on landowners. In addition, the Legislature cannot raise taxes without a two-thirds majority and state education funding has been cut because of the economic downturn.

"How does the state expect school districts to fund facilities given all the restraints today?" Collins said. "Capital appreciation bonds are a necessary tool right now."

While expensive, Collins said Poway's long-term notes should be viewed in the context of all the bonds issued for its construction program. Because the district also issued conventional notes, he said, the overall debt repayment ratio for $377 million in bonds is about 4.2 times principal, close to San Diego County treasurer guidelines.

However, Lockyer and some county treasurers say the guidelines apply to individual bond sales, not broader repayment cost averages. They note that the principal and interest of Poway's CABs represent more than half the district's total debt obligations of almost $1.6 billion.

Poway is not the only school district to sign on for large CAB repayments, according to the Times analysis that examined statewide records for hundreds of bonds issued by school and community colleges. Some of the more extreme cases include:

• The Fairfax Elementary School District in Bakersfield issued $1.02 million in capital appreciation bonds in 2011. By the final maturity date in 2048, the district will have to pay back $15.6 million — $15.25 for every $1 borrowed.

• The Santee School District in San Diego County issued $3.53 million in capital appreciation bonds in 2011. By the final maturity date in 2051, it will have to pay back $58.6 million — $16.57 for every $1 borrowed.

• What appears to be the most expensive deal in the state was made by the Rim of the World Unified School District in Lake Arrowhead. It issued $283,612 in bonds in 2010. By the final maturity date in 2039, the district will have to pay $6.65 million in principal and interest — $23.45 for every $1 borrowed.

In Los Angeles County, 29 districts have issued $556 million in long-term CABs with repayment obligations totaling $2.3 billion. Pay-back ratios range from $2.40 for every dollar borrowed in the El

Camino Community College District near Torrance to $9.20 per dollar borrowed in the Westside Union School District in the Antelope Valley.

"These things are all over the place right now and should be of massive concern to taxpayers," said David Wolfe, the legislative director for the Howard Jarvis Taxpayers Assn. Capital appreciation bonds "kick interest and principal payments 40 years down the line. Property owners who never voted for these bonds will have to pay for them."

School officials cite economic forecasts predicting that the bonds can be repaid without increasing tax rates. That's partly based on the assumption that California's historically high property values will rise over the next 20 to 40 years along with district populations and tax revenues.

Some county treasurers are concerned that those calculations may be overly optimistic or designed to make the CAB deals work.

"The projections can be unrealistic, especially for assessed valuations," said San Bernardino County Treasurer-Tax Collector Larry Walker, noting that the Fontana school system issued CABs at the bottom of the Great Recession.

"They said we'd be back to normal in three years," Walker said. "Property values were down then and it's clear they are not going to come back in any short time period."

Lockyer and county treasurers also say the high debt payments could threaten a school district's ability to borrow for future construction projects or pay for instructional improvements.

"There could be financial and political ramifications that tie the hands of districts," said Jordan Kaufman, a Kern County assistant treasurer who has studied the use of such bonds statewide. "In most cases, taxpayers don't know what has gone on, and in some cases board members do not know what they were doing."

No California school bond can be issued without voter approval, but details of how the money is borrowed is left to district officials.

Problems with CABs prompted Michigan to outlaw them in 1994. One of the first warnings in California came in May 2011 when Los Angeles County Treasurer-Tax Collector Mark Saladino cautioned financial firms that advise school districts to avoid borrowing agreements with pay-back schedules longer than 25 years.

Last month, the California Assn. of County Treasurers and Tax Collectors suggested that legislation be drafted that would limit bonds to 25 years, bar balloon payments, allow future CABs to be refinanced for better terms and increase oversight of such transactions by outside government agencies.

"We want to keep it simple," said Glenn Byers, an assistant treasurer for L.A. County. "If we can limit the term of the debt and level the annual debt payments, we will eliminate the problem."

dan.weikel@latimes.com

Times staff writers Doug Smith and Maloy Moore contributed to this report.

School District Bond Legislative Proposal
California Association of County Treasurers and Tax Collectors

Issue	CACTTC Proposed Legislation	Explanation
30 notice to County Supt, Country Treasurer and County Auditor-Controller	The resolution shall be adopted no earlier than 30 days after the district has given written notice to the county superintendent of schools, county treasurer and county auditor-controller which have jurisdiction over the district, with respect to the structure and terms of the proposed bond issue. (Ed Code 15140 (a)) If the Issuer is a school district or community college district, the resolution shall be adopted no earlier than 30 days after the district has given written notice to the county superintendent of schools, county treasurer and county auditor-controller which have jurisdiction over the district, with respect to the structure and terms of the proposed bond issue. (Govt Code 53507.5)	Provide that Boards of Education and Boards of Trustees of school and community college districts are better informed before authorizing bonds to be issued, by requiring that the Board may only take action to grant such authority 30 days after the district has provided written notice as to the proposed structure and terms of the bond issue to the County Superintendent of Schools, County Treasurer and County Auditor-Controller. This will enable independent financial officers to assess the fiscal impact of the proposed bond issue on property owners before the bonds are issued, and it will promote greater transparency in the bond issuance process.
Leveling of payments to no increase year-to-year of more than 105%	The principal and interest payable with respect to the bonds in any fiscal year shall not be greater than 105% of the principal and interest payable with respect to the bonds in the immediately prior fiscal year. Each bond maturing more than 10 years after its date of issuance shall be subject to mandatory tender for purchase or redemption prior to its fixed maturity date, with or without premium, at any time or from time to time beginning on the tenth anniversary of the date such bond was issued. (Ed Code 15144) The principal and interest payable with respect to the bonds in any fiscal year shall not be greater than 105% of the principal and interest payable with respect to the bonds in the immediately prior fiscal year. (Govt Code 53508.5)	Require approximately level annual debt service payments, to prevent dramatic swings and sudden spikes in property tax levies required to repay general obligation bonds.
Limit of Terms of bond maturities to 25 years	The time or times of maturity of the bonds, not exceeding 40 25 years from their respective dates. (Govt Code 53508 (f))	**Establish a maximum maturity of 25 years for all general obligation bonds** by repealing the 40-year maturity limit which was added to the Government Code effective January 1, 1994 (Stats. 1993, Chap. 841).

		This will limit aggregate interest costs by reducing the length of time that principal can remain outstanding.
Call option for bonds after 10 years	No Each bond maturing more than 10 years after its date of issuance shall be subject to mandatory tender for purchase or redemption prior to its fixed maturity date, with or without premium, unless it contains a recital to that effect at any time or from time to time beginning on the tenth anniversary of the date such bond was issued.	Require that all general obligation bonds with maturities longer than 10 years be callable prior to maturity beginning not later than 10 years after the date of issuance. This will facilitate refinancing at lower rates if market interest rates decline, saving taxpayers money.
County Supt to approve bond issuance of school districts and community college districts	Prior to the issuance of bonds under this article by or on behalf of a school or community college district, such issuance shall be approved by the county superintendent of schools which has jurisdiction over the district. (Govt Code 53509.7) Prior to the issuance of bonds under this article, such issuance shall be approved by the county superintendent of schools which has jurisdiction over the school district or community college district. (Ed Code 15151)	**Require that the County Superintendent of Schools approve all issuances of bonds by school and community college districts.** This will provide greater oversight and accountability to prevent taxpayer abuse.
Allow County Board of Sups waiver to approve school district & CCD bond sales	The private sale of bonds is limited to the sale of school districts' and community college districts' bonds pursuant to, and in full compliance with, Sections 15140 or 15146 of the Education Code, including approval of such sale by the Board of Supervisors of the County, the county superintendent of schools of which has jurisdiction over such school district or community college district, or the express waiver by the Board of Supervisors of its approval rights. (Govt Code 53508.7 (c))	Clarify existing law which requires that the County Board of Supervisors approve all issuances of bonds by school and community college districts, or expressly waive such approval rights. This requirement is currently clear for bonds issued under the Education Code, but bond attorneys have differing opinions as to whether it applies to bonds issued under the Government Code. This bill would remove any ambiguity by clarifying that the Board of Supervisors' approval rights would apply to all general obligation bond issuances by school and community college districts

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Capital appreciation bonds

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Hundreds of California school and community college districts have financed construction projects with capital appreciation bonds that push repayment far into the future and ultimately cost many times what the district borrowed. Government finance experts consider bonds imprudent if the total cost is more than four times the money borrowed or the maturity period is greater than 25 years.

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San Mateo	Belmont-Redwood Shores School District	2011	$3,010,856	$15,466,860	30.0	■	5.1	■
San Mateo	Belmont-Redwood Shores School District	2011	$1,654,110	$8,205,000	31.0	■	5.0	■
San Mateo	Burlingame Elementary School District	2011	$2,887,486	$13,460,000	24.3	□	4.7	■
San Mateo	Hillsborough City School District	2011	$19,660,012	$140,350,000	34.6	■	7.1	■
San Mateo	Hillsborough City School District	2008	$20,749,696	$24,795,000	5.0	□	1.2	□
San Mateo	Jefferson Union High School District	2011	$14,999,737	$126,725,000	30.5	■	8.4	■
San Mateo	Jefferson Union High School District	2009	$14,998,937	$39,270,000	21.1	□	2.6	□
San Mateo	La Honda-Pescadero Unified School District	2009	$1,203,582	$3,080,000	22.0	□	2.6	□
San	Menlo Park City	2010	$13,772,019	$57,890,000	32.3	■	4.2	■

County	District	Sale year	Principal	Total debt service	Maturity length	Maturity warning	Debt ratio	Ratio warning
Mateo	School District							
San Mateo	Menlo Park City School District	2008	$24,264,728	$91,495,000	35.0	■	3.8	□
San Mateo	Millbrae School District	2011	$2,914,527	$19,385,000	30.3	■	6.7	■
San Mateo	San Carlos School District	2008	$4,036,332	$13,800,000	24.8	□	3.4	□
San Mateo	San Mateo Union High School District	2012	$40,150,000	$42,510,000	3.0	□	1.1	□
San Mateo	San Mateo Union High School District	2012	$5,055,752	$13,515,000	25.6	■	2.7	□
San Mateo	San Mateo Union High School District	2011	$2,840,441	$9,950,000	23.2	□	3.5	□
San Mateo	San Mateo Union High School District	2011	$6,032,768	$13,375,000	17.2	□	2.2	□
San Mateo	San Mateo Union High School District	2011	$24,850,000	$29,745,000	4.0	□	1.2	□
San Mateo	San Mateo-Foster City School District	2010	$1,295,938	$4,770,000	15.5	□	3.7	□
San Mateo	South San Francisco Unified School District	2012	$56,001,757	$61,100,000	5.0	□	1.1	□
San Mateo	Woodside Elementary School District	2007	$2,499,999	$9,640,000	30.7	■	3.9	□

Sources: California Treasurer's Office

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