

See the complete [California Policy Center](#) report [For the Kids: California Voters Must Become Wary of Borrowing Billions More from Wealthy Investors for Educational Construction](#) (complete, printable PDF Version, 4 MB, 361 pages)

Executive Summary: "For the Kids" – Comprehensive Review of California School Bonds

Few Californians realize how much debt they've imposed on future generations with their votes for bond measures meant to fund the construction of new and modernized school facilities.

From 2001 to 2014, California voters considered 1147 ballot measures proposed by K-12 school districts and community college districts to borrow money for construction via bond sales. Voters approved 911 of these bond measures, giving 642 school and college districts authority to borrow a total of \$110.4 billion.

California voters also approved three statewide ballot measures during that time to authorize the state to borrow \$35.8 billion. That money has supplemented local borrowing for construction projects at school and college districts, and the state has spent all but \$195 million of it.

That's a total of \$146.1 billion authorized during the last 14 years for state and local educational districts to obtain and spend on construction projects. All of it has been borrowed or will be borrowed from wealthy investors, who buy state and local government bonds as a relatively safe investment that generates tax-exempt income through interest payments.

Current and future generations of Californians are already committed to paying these investors about \$200 billion in principal and interest — a number that will grow as school and college districts continue to borrow by selling bonds already authorized by voters but not yet sold.

And more borrowing is coming.

In 2016 California voters may be asked to authorize the state to borrow as much as \$9 billion for school construction. More than 100 school and college districts may ask voters to approve borrowing a total of several billion more dollars. Officials at the country's second largest school district, the Los Angeles Unified School District, claim they need more than \$40 billion for additional construction and plan to ask voters to approve borrowing several billion in 2016.

It is time to be wary. The California Policy Center believes that most Californians are unaware and uninformed about this relentless borrowing and the amount of debt already

accumulated to pay for school construction. Most voters cannot explain how a bond measure works and do not get enough information to make an educated decision about the wisdom of a bond measure.

California voters who want to learn more before voting will have difficulty finding relevant information. Where does an ordinary Californian find out how much money a school or college district has already been authorized to borrow from past bond measures, or the principal and interest owed from past bond sales that still needs to be repaid, or the projected changes in assessed property valuation and how they affect tax and debt limits, or the past and projected student enrollment? The state does not offer a clearinghouse of information for the public to research and compare data about bond measures and bond debt for educational districts. Much of the information available about debt finance for educational districts is oriented toward interests of bond investors rather than people who pay the debt.

Californians who recognize a need for their own local educational districts to refrain from accumulating additional debt have significant obstacles to overcome. State law gives supporters of bond measures a systematic strategic advantage when local districts develop bond measures and put them before voters for approval. Campaigns to support bond measures are funded and even managed by financial and construction industry interests that will profit after passage. And after voters approve a bond measure, educational districts are tempted to take advantage of ambiguities in state law and use bond proceeds for items and activities not typically regarded by the public as construction.

To help to fix these deficiencies, this report encourages the California legislature and the executive branch to adopt five sets of recommendations:

At a time of low interest rates, California school and community college districts may benefit in some circumstances from borrowing money to fund school construction, just like households benefit from home mortgages and car loans. But California voters — and their elected representatives — need to become much more informed about the debt legacy they are leaving to their children and grandchildren.

Emotional sentiment, lobbying pressure from interest groups, and eagerness to circumvent frustrating tax and debt limits in state law can overwhelm a prudent sense of caution. Irrational decisions that burden future generations cannot necessarily be fixed after the public finds out about them.

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## **Section Summaries**

## [Section 2. Why This Report Matters: More Borrowing in 2016](#)

Californians will be asked in 2016 to continue taking on debt for construction of educational facilities, but one elected official is leery. Governor Jerry Brown wants to change the funding system for school construction. He is concerned about debt that Californians have accumulated from years of allowing the state and local educational districts to relentlessly borrow.

That money borrowed through bond sales will have to be paid back — with interest — to the investors who bought them. Voters have limited understanding of bonds and how bonds provide funds for construction, and elections focus on what voters will get rather than how they will pay for it. To the detriment of future generations, few Californians realize the huge amount educational districts have been authorized to borrow and the huge amount of debt accumulated.

## [Section 3. Quantifying and Explaining California's Educational Construction Debt](#)

Whatever voters are asked to approve in 2016 will not launch a new program to fix long-neglected schools to serve a rapidly expanding state population while providing smaller class sizes. That thinking is a legacy of the 1990s that seems to endure today despite 14 years of most bond measures passing at a 55 percent threshold for voter approval. Arguments for another state bond measure in 2016 ignore or downplay how local school and college districts and the state obtained authority in the past 14 years to borrow \$146.1 billion for educational construction.

If voters are not told or reminded of recent borrowing patterns, how can they make an informed decision on future borrowing? To rectify the lack of availability of statistics on total bond debt in California for educational facility construction, the California Policy Center collected, synthesized, and analyzed data regarding California educational construction finance. The California Policy Center believes it is the first and only entity to painstakingly research and present an accurate and comprehensive record of all state and local educational construction bond measures considered by voters from 2001 through 2014.

## [Section 4. How Educational Districts Acquire and Manage Debt](#)

It's likely that most California voters have limited familiarity with the organization and governance of their local school and community college districts. When voters authorize their local educational districts to borrow money for construction by selling bonds, presumably they trust that the local school or college district will exercise prudence in managing the process. Sometimes their trust is betrayed.

To discourage abuse of the school construction finance system, voters need to be aware of how their local government is organized and managed. They also need to realize that state law does not explicitly give Independent Citizens' Bond Oversight Committees broad authority to review construction programs funded by bond measures.

How can voters become informed about bonds and the process of borrowing money for educational construction through bond sales? Is there a way to explain in clear plain language what actually happens after voters approve a bond measure and authorize a school or college district to borrow money via bond sales?

### [Section 5. Capital Appreciation Bonds: Disturbing Repayment Terms](#)

In 1993, California law was changed so that school and college districts could use an innovative form of debt finance called zero-coupon bonds, also known as Capital Appreciation Bonds. These bonds allow school and college districts to borrow now for construction and pay it back — with compounded interest — many years later. The borrowing strategy has been a tempting and dangerous lure for elected school and college boards.

Some people think Capital Appreciation Bonds are a “ticking time bomb” or the “creation of a toxic waste dump.” Others regard critics as uninformed and contend that these debt finance instruments are beneficial for school and college districts. Since the people who will be paying off many of these Capital Appreciation Bonds are now children or not even born yet, there isn't much incentive to stop the flow of borrowed money that doesn't need to be paid back for a generation or two.

### [Section 6. Tricks of the Trade: Questionable Behavior with Bonds](#)

Californians who want more spending on educational construction often express their resentment of a 2000 law limiting taxes and debt resulting from bond sales. It was passed in order to strengthen campaign arguments to voters in support of Proposition 39, which lowered the approval threshold for local bond measures from two-thirds to 55%. School districts have adopted several strategies to get around these limits in state law. One of them is very obscure but 100% successful: obtaining waivers from the State Board of Education.

Meanwhile, some districts are stretching legal definitions to use proceeds from bond sales to pay for items that resemble instructional material more than construction. One example is personal portable electronics such as iPads. Some of the state's largest districts are purchasing this kind of technology while giving little assurance to the public that long term bonds aren't the source of the money. This equipment may be obsolete well before the

bonds mature, meaning that future generations will pay for these devices long after they are outdated and discarded.

### [Section 7. The System Is Skewed to Pass Bond Measures](#)

Considering the advantages that supporters have in preparing and campaigning for a bond measure, perhaps it's noteworthy that voters reject about 20% of local bond measures for educational construction. At every stage of the process, interests that will benefit from bond sales can take advantage of a system that favors passage of a bond measure. Some issues of concern include use of public funds to develop campaigns to pass bond measures, significant political contributions to campaigns from interests likely to benefit from construction, involvement of college foundations as intermediaries for campaign contributions, and conflicts of interest and alleged pay-to-play contracts.

### [Section 8. More Trouble with Bond Finance for Educational Construction](#)

While compiling the comprehensive information provided in this study, California Policy Center researchers identified numerous other troubling aspects of bond finance. School and college districts are evading compliance with the law and making irresponsible decisions. Ordinary voters lack enough data to make an informed vote. Community activists who seek deeper understanding find themselves stymied.

### [Section 9. Improving Oversight, Accountability, and Fiscal Responsibility](#)

This report encourages the California legislature and the executive branch to adopt five sets of recommendations that will help to fix these deficiencies.

The California Policy Center rejects the idea that additional oversight and accountability isn't needed or desirable. Some legislative reforms and education programs (both public and private) can overcome voter cynicism, frustration, apathy, and ignorance.

### [Tables and Appendices of "For the Kids: California Voters Must Become Wary..."](#)

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[Table A-2 California Community College District Enrollment Fall 2014 Ranked by Number of Students](#)

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[Appendix L – All Educational Districts in Which Voters Authorized Borrowing Via Bond Sales Since November 2000 Enactment of Prop 39 – Ranked by Amount Authorized Per Yes Vote](#)

## More Borrowing for California Educational Construction in 2016

Californians will be asked in 2016 to continue taking on debt for construction of educational facilities, but one elected official is leery. Governor Jerry Brown wants to change the funding system for school construction. He is concerned about debt that Californians have accumulated from years of allowing the state and local educational districts to relentlessly borrow.

That money borrowed through bond sales will have to be paid back — with interest — to the investors who bought them. Voters have limited understanding of bonds and how bonds provide funds for construction, and elections focus on what voters will get rather than how they will pay for it. To the detriment of future generations, few Californians realize the huge amount educational districts have been authorized to borrow and the huge amount of debt accumulated.

### **Interest Groups Want Voters to Consider Another State Bond Measure**

When the California Policy Center published this report, the California Attorney General had approved circulation of petitions through September 21, 2015 for a proposed statewide ballot initiative entitled the “Kindergarten Through Community College Public Education Facilities Bond Act of 2016.” Professional signature gatherers set up tables at grocery stores and other public locations trying to cajole citizens into signing petitions to “help the kids” by putting the measure on the ballot.

If this proposal qualifies for the ballot and voters approve it, the State of California will have the authority to borrow \$9 billion through selling bonds to investors. According to the petition, this \$9 billion will ensure that “K-14 facilities are constructed and maintained in safe, secure and peaceful conditions.” As reported in the Sacramento Bee, school construction interests and residential housing developers want this bond measure, or one like it, on the ballot in 2016.

Proponents point out, accurately, that most of the money that voters authorized the state to borrow in 1998, 2002, 2004, and 2006 has been distributed as matching grants to local educational districts. As of April 15, 2015, \$195.4 million remains<sup>3</sup> from \$35.4 billion approved to borrow as a result of three statewide ballot propositions in the 2000s.

The petition for the Kindergarten Through Community College Public Education Facilities Bond Act of 2016 lists four “findings” explaining what the state could do if it borrowed \$9 billion:

***1. Career technical education facilities to provide job training for many Californians and veterans who face challenges in completing their education and re-entering the workforce.***

The history of recent bond measures on the state and local level shows that voters are inclined to support more government spending when veterans are cited as beneficiaries. Poll results confirm this. A “State of California School Bond Measure Feasibility Survey” of likely voters conducted January 30 to February 9, 2014 for California’s Coalition for Adequate School Housing (C.A.S.H.) indicated that “more than six-in-ten are highly concerned about unemployment among veterans.”

***2. Upgrade aging facilities to meet current health and safety standards, including retrofitting for earthquake safety and the removal of lead paint, asbestos and other hazardous materials.***

Again, the “State of California School Bond Measure Feasibility Survey” concluded that “more than two-thirds agree that many California public schools need significant health and safety improvements,” specifically the statement that “many schools and community colleges throughout California are old, outdated and need upgrades to meet current health and safety standards, including retrofitting for earthquake safety and the removal of lead paint, asbestos and other hazardous materials.”

***3. Studies show that 13,000 jobs are created for each \$1 billion of state infrastructure investment. These jobs include building and construction trades jobs throughout the state.***

Influential construction interests are part of the coalition supporting this statewide bond measure. This statement acknowledges their pivotal role in the campaign to pass it.

***4. Academic goals cannot be achieved without 21st Century school facilities designed to provide improved school technology and teaching facilities.***

Once again, the “State of California School Bond Measure Feasibility Survey” concludes that “in particular, voters believe that funds must be directed towards upgrading vocational/career education programs, repairing classrooms and science labs and upgrading technology.”

These are deliberately chosen arguments to justify borrowing another \$9 billion for community college and K-12 school district construction projects. In fact, these were the same arguments used in newspaper opinion pieces and position papers in 2014 to support Assembly Bill 2235, which if signed into law would have asked state voters in the November

2014 election to authorize borrowing \$4.3 billion for school construction through bond sales.

Regardless of whether the four arguments listed above for a statewide bond measure are factually valid, they have been tested through polling and other voter research and shown to be effective in winning voter support. Surely a 2016 campaign for a state bond measure will use them.

How do these arguments stand in the larger context of bond indebtedness for the State of California and its community college districts and K-12 school districts? This report provides some of that context and introduces information never before available to the public.

### **Governor Brown Worries About Debt and Seeks Change in School Construction Finance**

Governor Jerry Brown has used his executive power to thwart legislative efforts to place a statewide bond measure for educational construction on the 2016 ballot. Assembly Bill 2235 never received an opposition vote as it passed the Assembly and moved through Senate committees with support from numerous interest groups. Voters didn't get to consider it in the November 2014 election only because Governor Brown didn't want it on the ballot. As reported by a Capitol Public Radio reporter, the bill author issued a statement explaining its abandonment: "The governor has made it clear that he does not want a school bond on the same ballot as the water bond and rainy day fund. We do not expect the legislature to send the bill on him."

Meanwhile, the Governor is taking a leading role in calling for change in how state and local governments fund California school construction. He submitted a state budget proposal to the California legislature in January 2015 with an introduction stating that funding commitments "must be honestly confronted so that they are properly accounted for and funded." It warned that "budget challenges over the past decade have also resulted in a greater reliance on debt financing, rather than pay-as-you-go spending...From 1974 to 1999, California voters authorized \$38.4 billion of general obligation bonds. Since 2000, voters authorized more than \$103.2 billion of general obligation bonds"

### **Concern About Debt Growing from State Matching Grants for Local Educational Districts**

One funding commitment Governor Brown "confronted" in his proposed fiscal year 2015-16 budget was the State of California's debt accumulated from funding construction of facilities for local school districts. California voters approved bond measures in 2002,

2004, and 2006 authorizing the state to borrow \$35.4 billion via bond sales for school and college construction, and only \$195 million remains to be borrowed. According to internal California State Treasurer documents, debt service on those three state bond measures is \$56.7 billion.

According to the Governor's 2015-16 Budget Summary, "the Administration has noted the following significant shortcomings" related to school bond finance over the past two years:

The current program does not compel districts to consider facilities funding within the context of other educational costs and priorities. For example, districts can generate and retain state facility program eligibility based on outdated or inconsistent enrollment projections. This often results in financial incentives for districts to build new schools to accommodate what is actually modest and absorbable enrollment growth. These incentives are exacerbated by the fact that general obligation bond debt is funded outside of Proposition 98. These bonds cost the General Fund approximately \$2.4 billion in debt service annually.

This statement is surprising and controversial recognition that some school districts spend money on new school construction that perhaps isn't needed. The proposed budget summary also notes that large school districts have in-house professional facilities departments that can take advantage of the first-come, first-serve application system to get funding from the State Allocation Board for local school construction.

Another surprising admission in the Governor's budget proposal is acknowledgement that voters approve four out of five proposed local bond measures, thus providing a relatively easy flow of money for school construction: "The current program was developed before the passage of Proposition 39 (which reduced the local bond vote threshold from a two-thirds supermajority to 55 percent) in 2000, which has since allowed local school bonds to pass upwards of 80 percent of the time."

The budget summary also reported that the California Department of Finance had met with parties interested in educational construction and developed a set of recommendations, including three related to bond finance:

**1. Increase Tools for Local Control: Expand Local Funding Capacity**

*While school districts can pass local bonds with 55% percent approval, assessed valuation caps for specific bond measures and total caps on local bonded indebtedness have not been adjusted since 2000. In order to provide greater access to local financing, these caps should be increased at minimum by the rate of inflation since 2000.*

Based on the Consumer Price Index of the U.S. Bureau of Labor Statistics, the inflation rate from November 2000 (when voters approved Proposition 39) to May 2015 was 36.6%. Therefore, under this proposal the California legislature would increase tax and debt limits at least 36.6% above existing amounts. However, the flaw in this proposal is that it does not account for increases in property value or total assessed property valuation in California since 2000. (See Section 5 of this report for background on tax and debt limits.)

## **2. Expand Allowable Uses of Routine Restricted Maintenance Funding**

*Current law requires schools to deposit a percentage of their general fund expenditures into a restricted account for use in maintaining their facilities. Rather than requiring that these funds be used solely for routine maintenance, districts should have the ability to pool these funds over multiple years for modernization and new construction projects. Expanding the use of these funds will provide school districts with yet another funding stream to maintain, modernize, and construct new facilities.*

This proposal injects a bit of “pay-as-you-go” from district general funds into educational facilities construction — a departure from the bond debt financing that has driven school construction since the enactment of Senate Bill 50, the Leroy F. Greene School Facilities Act of 1998.

## **3. Target State Funding for Districts Most in Need**

*State funding for a new program should be targeted in a way that: (1) limits eligibility to districts with such low per-student assessed value they cannot issue bonds at the local level in amounts that allow them to meet student needs, (2) prioritizes funding for health and safety and severe overcrowding projects, and (3) establishes a sliding scale to determine the state share of project costs based on local capacity to finance projects.*

This recommendation is based on the perception that the current first-come, first-served funding system allows certain school and college districts to win a disproportionate amount of state matching grants at the expense of other districts that may have a more legitimate need but lack the resources and wherewithal to take advantage of opportunities.

Finally, the list of recommendations concludes with a message:

...it is the intent of the Administration to advance the dialogue on the future of school facilities funding. School districts and developers should have a clear understanding of which limited circumstances will qualify for state assistance. Over the course of the coming months, the Administration is prepared to engage with the Legislature and education stakeholders to shape a future state program that is focused on districts with the

greatest need, while providing substantial new flexibility for local districts to raise the necessary resources for school facilities needs.

These proposals are not new ideas. A 2003 report from the Public Policy Institute of California analyzed school bond measures and identified disparities among districts based on wealth and region. In response to these findings, the report suggested raising state debt limits for bond measures to reduce the impact of changes in assessed property valuation. It also recommended adoption of a plan that would give deserving school and college districts access to state construction funds without having to match these grants with local funding.

### **State Legislative Initiatives**

The stage is set for change in California school construction financing. Subsequent to the release of the proposed budget from the Governor, state legislators introduced bills such as Senate Bill 114 and Assembly Bill 148. These bills would make some mild changes to the state's school construction program, while at the same time placing a statewide bond measure on the November 2016 ballot to borrow money (for a yet unidentified amount) via bond sales for school construction.

The author of Senate Bill 114 explained the purpose of the bill:

Funding for the School Facilities Program is virtually gone and there is a backlog in applications for state assistance...while the state's growing debt service is of concern, it is unclear whether local districts have the capacity to generate sufficient revenue at the local level to meet their specific facility needs. The "winding down" of the current program, and the Governor's call for change, present an opportunity to rethink the administrative and programmatic structure of the State Facilities Program...

Supporting one or both of these bills are the California School Boards Association, the California Faculty Association, the California Association of School Business Officials, the American Federation of State, County, and Municipal Employees union (AFSCME); the Los Angeles Unified School District, and the Riverside County Superintendent of Schools. Further debate will reveal if these groups are willing to withhold potential objections to some of the Department of Finance proposed changes to educational construction finance in exchange for having another statewide bond measure on the 2016 Presidential general election ballot.

No formal opposition to these bills has yet emerged, but at this time the bills are just a frame, to be expanded with more detailed proposals.

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## Quantifying and Explaining California’s Educational Construction Debt

Whatever voters are asked to approve in 2016 will not launch a new program to fix long-neglected schools to serve a rapidly expanding state population while providing smaller class sizes. That thinking is a legacy of the 1990s that still seems to endure today despite 14 years of most bond measures passing at a 55 percent threshold for voter approval. Arguments for another state bond measure in 2016 ignore or downplay how local school

and college districts and the state obtained authority in the past 14 years to borrow \$146.1 billion for educational construction.

If voters are not told or reminded of recent borrowing patterns, how can voters make an informed decision on future borrowing? To rectify the lack of availability of statistics on total bond debt in California for educational facility construction, the California Policy Center collected, synthesized, and analyzed data regarding California educational construction finance. The California Policy Center believes it is the first and only entity to painstakingly research and present an accurate and comprehensive record of all state and local educational construction bond measures considered by voters from 2001 through 2014.

The amount of authority approved by voters is a higher percentage than the percentage of the number of bond measures approved by voters because larger bond measures proposed by larger districts passed at a higher rate than smaller bond measures proposed by smaller districts.

### **How Did It Become So Easy to Pass Bond Measures?**

A new era of generous borrowing for educational construction in California was inaugurated by the enactment of Proposition 39. Approved by 53.4% of voters in the November 7, 2000 election, it reduced the voter approval threshold for most educational construction bond measures from two-thirds to 55 percent. (Because the measure imposes restrictions on districts using the new 55 percent threshold, a minority of districts have continued to propose measures requiring a two-thirds vote.)

This lowered obstacle apparently encouraged local educational districts to take the risk of proposing many more bond measures at much higher amounts for voters to approve. As shown in Tables 3 and 4, dropping the voter threshold from 66.67% to 55% transformed the approval of educational bond measures from a 50-50 chance to a commonplace outcome.

As shown in Table 5, between now and 2055, California's taxpayers will pay about \$200 billion in principal and interest payments to investors who have bought bonds issued by the state and by local educational districts in order to get funding for facility construction.

### **How Was Debt Service Determined?**

California Policy Center researchers identified, calculated, and tallied aggregate debt service for almost all of the 642 California local educational districts in which voters approved borrowing money for construction through bond sales after the election of November 7, 2000. On that date, California voters approved Proposition 39 and reduced

the threshold for voter approval of most bond measures for construction from two-thirds to 55 percent.

This debt service data was obtained using tables included in about 650 “Official Statements” posted on a publicly-accessible and free-to-use Electronic Municipal Market Access (EMMA) website administered by the Municipal Securities Rulemaking Board (MSRB).

What are these statements? Federal law generally requires underwriters in a primary offering of municipal bonds of \$1 million or more to obtain and review an Official Statement from the issuer of those bonds. (Many smaller bond offerings also have Official Statements.) In a dense report of more than 200 pages, these statements disclose financial information meant to inform a potential buyer and reduce the chance of “fraudulent, deceptive, or manipulative acts or practices.”

Official Statements include a chart that indicates how much aggregate principal and interest the issuer of the bonds would owe each year if the bonds weren’t refunded (“called in” or redeemed so that new bonds can be issued at a lower interest rate) or paid off early. California Policy Center researchers entered each district name into the EMMA system, identified the most recent bond offering or bond refunding from the list of bond issues, downloaded the associated Official Statement, located the aggregate debt service chart, and calculated the total debt service for 2015 and/or later years.

Using these Official Statements to extract data required diligence. Firms that produce the statements do not use a specific standard format, so the aggregate debt service table appears in different places. Tables differ in title, format, or details of content. Older Official Statements are not optimized for word searches. A few tables do not total up the annual debt service, thus forcing the user to convert the table into a spreadsheet and calculate the total using a formula. A handful of Official Statements outright lacked aggregate debt service tables.

Tables may even contain erroneous data. After some confusion, researchers realized that an Official Statement for the Napa Valley Unified School District contained major errors. It indicated total debt service as \$77 million instead of the actual \$665 million and also indicated a November 5, 2002 bond measure as authorizing \$219 million instead of the actual \$95 million. This was an unfortunate district to have an erroneous Official Statement: a *California Watch* article published in the *San Francisco Chronicle* just three months before the Official Statement was posted identified the Napa Valley Unified School District as a district where taxpayers will eventually “pay dearly for bonds.” In 2009 it

borrowed \$22 million through Capital Appreciation Bond sales that will cost \$154 million by the time the last bonds in the series mature forty years later, in 2049.

Researchers also had to be cautious about accurately identifying school districts with similar names. For example, Central, Oak Grove, and Columbia are words shared by more than one school district. And “College School District” in Santa Barbara County is not a community college district. Some of the inconsistencies found in cross-referencing various sources for bond measure data seem to be a result of misidentifying districts with similar-sounding names.

Even after these challenges were overcome, researchers recognized that the list of debt service for school and college districts needs to be considered with some caveats. (Table 6 is “Cautionary Considerations When Evaluating Current Debt Service Data for School and College Districts.”) Researchers are also aware of arguments that debt service — even when considered with other financial data — is not always a useful way to assess whether or not school or college districts have been irresponsible in their choices for debt finance of facilities construction. A few of those arguments are listed in Table 7: Why Some Analysts Downplay Debt Service Data.

Despite these potential limitations, aggregate debt service amounts available through Official Statements posted on EMMA provide new insight into the long term debt obligations owed by California local educational districts for facilities construction. This data set represents a major advance in informing Californians about the tremendous debt accumulated by educational districts that borrow money for school construction by selling bonds.

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## How California School and College Districts Acquire and Manage Debt

It's likely that most California voters have limited familiarity with the organization and governance of their local school and community college districts. When voters authorize their local educational districts to borrow money for construction by selling bonds, presumably they trust that the local school or college district will exercise prudence in managing the process.

Sometimes their trust is betrayed.

To discourage abuse of the school construction finance system, voters need to be aware of how their local government is organized and managed. They also need to realize that state law does not explicitly give Independent Citizens' Bond Oversight Committees broad authority to review construction programs funded by bond measures.

How can voters become informed about bonds and the process of borrowing money for educational construction through bond sales? Is there a way to explain in clear plain language what actually happens after voters approve a bond measure and authorize a school or college district to borrow money via bond sales?

### **Bonds Help Local Governments Borrow Money to Better Serve the People**

When people talk about municipal securities or municipal bonds, they're talking about state governments or local governments borrowing money from investors with the promise to pay it back to them later, with interest. Municipal (derived from the Latin word *municipium*, meaning a free city) simply means a local government, such as a county, city, water district, sanitation district, irrigation district, utility district, transportation district, cemetery district, mosquito vector district, and many other kinds of special districts formed by the people to serve the people. And it includes school districts and community college districts.

Despite a lack of public attention to bonds, this method of debt finance is important, especially for governments such as California's school districts and community college districts that want to initiate or continue major construction programs. U.S. Securities and Exchange Commissioner Luis A. Aguilar recently described the importance of municipal bonds:

It is difficult to overstate the importance of the municipal securities market. There is perhaps no other market that so profoundly influences the quality of our daily lives. Municipal securities provide financing to build and maintain schools, hospitals, and utilities, as well as the roads and other basic infrastructure that enable our economy to

flourish. Municipal bonds' tax-free status also makes them an important investment vehicle for individual investors, particularly retirees. Ensuring the existence of a vibrant and efficient municipal bond market is essential, particularly at a time when state and local government budgets remain stretched.

Such comments are appreciated by state and local governments as murmuring continues in Washington, D.C. that income from municipal bonds should lose tax-exempt status.

### **Basic Information About California K-12 School Districts**

In the case of a local elementary school district (kindergarten through eighth grade), high school district (ninth through twelfth grade), or unified school district (kindergarten through twelfth grades), voters elect a board of trustees (often called a "school board" or a "board of education") to oversee operations of the school district and make major decisions as representatives of the people. The board appoints a District Superintendent and other professional administrators to handle day-to-day management of the district.

In addition, each county has an elected County Board of Education and an elected County Superintendent of Schools with specific responsibilities. There is also a State Board of Education appointed by state elected officials to oversee education policies that are common for all school districts in the state. There is also a State Superintendent of Schools elected by the people of California.

Table A-1 ("California K-12 School Districts 2013-2014 – Ranked by Enrollment") lists 945 elementary school districts, high school districts, and unified school districts with enrollment tracked by the California Department of Education as of June 15, 2015.

### **Basic Information About California Community College Districts**

In the case of a local community college district, voters elect a Board of Trustees (often called a "college board" or a "governing board") to make decisions for the college district as representatives of the people. There is also a Board of Governors of the California Community Colleges appointed by state elected officials to oversee education policies that are common for all college districts in the state. The Board of Governors appoints a Chancellor of the California Community Colleges and other professional administrators to handle day-to-day management of the state college system.

Boards for the University of California and California State University systems are appointed by state elected officials and not directly chosen by the people.

As of June 15, 2015 there are 72 community college districts in California with 112 colleges. (Some districts contain multiple colleges.) Table A-2 ("California Community

College District Enrollment Fall 2014 – Ranked by Number of Students”) lists these districts.

### **What Are the Independent Citizens’ Bond Oversight Committees?**

To strengthen the arguments for Proposition 39 in 2000, the California legislature passed Assembly Bill 1908, the “Strict Accountability in Local School Construction Bonds Act of 2000,” with these stated intentions:

1. Vigorous efforts will be undertaken to ensure that school and college districts spend the proceeds of bond measures, including those passed under criteria of Proposition 39, in strict conformity to law.
2. Taxpayers will directly participate in the oversight of bond expenditures.
3. Members of the oversight committees appointed for these purposes will promptly alert the public to any waste or improper spending of money borrowed through bond sales.
4. Unauthorized expenditures of school construction bond revenues will be vigorously investigated, prosecuted, and restrained by the courts.

A school or college district board must appoint an independent citizens’ bond oversight committee with 60 days after the board enters the election results in its minutes. The committee must include at least seven members to serve for a term of two years and for no more than two consecutive terms. District employees, officials, vendors, contractors, or consultants are prohibited from serving on the committee, and it must include at least one “active” representative of the following groups:

1. a business organization, located within the district, representing the business community
2. a senior citizens’ organization
3. a bona fide taxpayers’ organization
4. for a school district: parents or guardians of children enrolled in the district
5. for a school district: parents or guardians of children enrolled in the district who are also active in a parent-teacher organization, such as the Parent Teacher Association or school site council
6. for a community college district: students who are currently enrolled in the district and also active in a community college group, such as student government

7. for a community college district: organizational support groups of the district, such as advisory councils or foundations

These committees have several responsibilities listed in state law meant to ensure the district spends bond proceeds only on projects listed in the ballot statement and avoids spending bond proceeds on ineligible projects, programs, or “teacher or administrative salaries or other school operating expenses.” State law also assigns these committees to review “efforts by the school district or community college district to maximize bond revenues by implementing cost-saving measures.”

The committee does NOT have an explicit oversight role for how the district pays for these construction projects, and a narrow interpretation of the law could claim that oversight committees do not have legal authority to review bond sales. However, the California League of Bond Oversight Committees (CalBOC) believes these committees have the authority to review and comment on the structure of bond issues under the provisions for reviewing “cost-savings” measures. Districts often defer to legal counsel for interpretations of the responsibilities and limitations of oversight committees.

### **A Private Organization Has Taken Responsibility for Independent Citizens’ Bond Oversight Committees**

Currently a private organization is providing services and advice to oversight committees. The California League of Bond Oversight Committees (CalBOC), founded in 2006, is a non-profit public service organization that filled a need for training, education, and legislative advocacy for the state’s bond oversight committees.

This arrangement has shortcomings. A private organization is dependent on voluntary financial contributions and a committed volunteer leadership, and it lacks power to take action against educational districts that fail to comply with state laws. Membership and involvement is dependent on the motivations and self-initiative of individual bond oversight committee members. CalBOC does not have any professional staff to monitor districts, collect data, and provide it to the public.

In addition, school districts can discourage oversight committee members from participating in the California League of Bond Oversight Committees, and some school district administrators openly disparage it. Some district administrators and legal counsel don’t want oversight committees interpreting their purpose broadly and consuming district staff time and district funds on investigations outside of a narrowly-defined purview.

*The author of this report has been and continues to be a member of the Advisory Committee for the California League of Bond Oversight Committees (CalBOC).*

## **Translating School Finance Decisions For Ordinary People to Understand**

For many Americans, the phrase “stocks and bonds” evokes the image of an established and wealthy investor. Someone who buys a stock becomes an owner of a corporation, and someone who buys a bond becomes a creditor who is owed money by a corporation or a government. It’s likely that more Americans could explain stocks than could explain bonds.

The lack of public awareness or knowledge about bonds may be attributable to the complex provisions of certain bonds and the fact that bonds typically do not offer the very large potential returns offered by equity in growing firms.

Bonds rarely get news media attention outside of a few financial wire services such as Bloomberg, Reuters (which had a “MuniLand” blogger), and specialty publications such as *The Bond Buyer*. And in popular culture, depictions of bond brokers have been mainly limited to two books by Tom Wolfe: *The Bonfire of the Vanities* (subsequently made into a movie) and *I am Charlotte Simmons*.

### **What Is a Bond?**

Some technical definitions of a bond are listed in Table 10. But rather than focusing on the definition of a bond, Californians need to focus on what a bond does in practice.

For a school or community college district, issuing (“selling”) bonds means the district borrows money for a specific length of time from investors with the obligation to return all of that money to them when that time period ends. The amount borrowed is called the principal.

During that length of time the district pays a fee to the investors, either on a regular basis (for Current Interest Bonds) or accumulated with compounded interest at the end of the time period (for Capital Appreciation Bonds). The amount paid is called interest.

The term of maturity between borrowing the money and paying back the money with interest can be one to three years (short-term bonds) or decades (long-term bonds). Under California law, a school district or community college district cannot issue a current interest bond with a maturity over 40 years. As a result of Assembly Bill 182 enacted in 2013, California local governments are now prohibited from issuing Capital Appreciation Bonds with a maturity over 30 years.

AB 182 allows a school district or community college district to issue Current Interest Bonds bonds with a term of maturity between 30 and 40 years. The district must use that borrowed money for projects with a “useful life” that equals or exceeds the term of maturity.

## **What Are “General Obligation Bonds” Referenced in Ballot Language for Bond Measures?**

Corporations and state and local governments issue bonds to raise money. Bonds sold by local governments are called municipal bonds. An appealing aspect of many municipal bonds for investors is their tax-exempt status.

Municipal bonds such as those sold by California school districts and community college districts for construction are called general obligation bonds, meaning they are backed by the “full faith and credit” of the districts. These districts theoretically have legislative power to collect enough money through property taxes, other borrowing, selling assets, or other sources of revenue to fulfill their obligation to make payments on the bonds when due. Those taxes are collected from property owners in the district. (Revenue bonds are another kind of municipal bond, paid off through tolls, lease payments, user fees, or other service payments.)

### **Comparing Current Interest Bonds to Capital Appreciation Bonds**

When voters are asked at an election to approve a bond measure to pay for construction at a school district or community college district, they generally have been told that a “Yes” vote will authorize the sale of general obligation bonds to fund that construction.

California educational districts are issuing two kinds of general obligation bonds: Current Interest Bonds and Capital Appreciation Bonds. Usually the district does not tell voters what kind of general obligation bonds it will sell, unless it specifically passes a resolution before the election stating it will not sell Capital Appreciation Bonds and includes that condition in the ballot statement.

#### *1. Current Interest Bonds (also called Fixed Rate Bonds)*

These are the “traditional” kind of municipal bonds. A buyer of Current Interest Bonds gets a periodic interest payment (usually semi-annually). When the bond matures, the buyer gets the principal back.

#### *2. Capital Appreciation Bonds (also called Zero Coupon Bonds)*

A buyer of Capital Appreciation Bonds does not receive semiannual or other periodic interest payments. Instead, the buyer receives all of the interest – compounded over the length of maturity for the bond – together with the principal when the bond matures. There is no regular payment of interest, but the accumulated (“accreted”) interest is compounded over many years, making the wait a worthwhile investment. Capital Appreciation Bonds are purchased at a deeply discounted amount from their face value.

Capital Appreciation Bonds are discussed in more detail in Section 5.

### **Two Costs to Educational Districts of Borrowing Money Via Bonds**

From the perspective of the school district, the additional financial cost of borrowing money by selling bonds as opposed to spending money from the district general fund results from (1) interest and (2) transaction fees.

#### ***Interest***

If someone borrows \$1000 for five years from a lender at an annual interest rate of 5 percent, the borrower and the lender agree that the borrower will pay back the \$1000 over five years and also pay 5% of that \$1000 (\$50) multiplied by five years for a total of \$1250. The borrower gets the \$1000 immediately to use, and the lender earns annual interest income of \$50 over five years for a total of \$250. Both parties consider themselves to get a benefit from the transaction.

Likewise, if a school district issues a traditional \$1000 Current Interest Bond at an annual interest rate of 5 percent with a five-year term of maturity and an investor buys the bond at its face value of \$1000, the school district gets the \$1000 immediately to use for construction, and the investor earns annual interest income of \$50 over five years for a total of \$250. When the five years are over, the investor gets the \$1000 back. Both parties get a benefit from the transaction. In addition, the investor does not have to pay taxes on the interest.

School districts usually sell series of bonds as a package with different maturities and interest rates.

#### ***Transaction Fees (Issuance Fees)***

Bond buyers are not the only party to make money from bonds issued by California school districts and community college districts. Similar to taking out a mortgage, a variety of parties in the financial services industry are involved in the preparation and sale of bonds, and each party gets a fee for participating in the transaction. These fees are classified as “costs of issuance.”

To prevent these fees from cutting into the amount of money authorized by voters for construction, educational districts routinely inflate the interest rates on bonds they sell so that the price is higher than the face value of the bond. After the bonds are sold, that extra money, or “premium,” is used to pay the costs of issuance.

### **How are Municipal Bonds Bought and Sold? Who Buys Them?**

Municipal bonds are not traded on an exchange like stocks. Instead, investors buy and sell bonds “over the counter” through dealers and brokers registered with the Municipal Securities Rulemaking Board (MSRB), a self-regulatory organization overseen by the U.S. Securities and Exchange Commission. These dealers and brokers act as underwriters or intermediaries between issuers and investors. They charge fees, or “mark-ups” for the transactions.

Once a school district sells a bond, the bond can be traded in the municipal bond market. The price will fluctuate and investors will be concerned about yield — the amount of income earned as prices rise and fall.

According to Federal Reserve statistics, individual investors hold a little more than two-thirds of municipal bonds, about 42 percent directly and about 28 percent through mutual funds and other investment vehicles. Major institutional investors include asset management firms, insurance companies, and commercial banks.

One of the arguments to cap or eliminate the federal tax exemption for income from municipal bonds is that the exemption mainly benefits wealthy individuals who buy bonds as a tax-exempt investment. Buyers of municipal bonds do not generally “keep the money in the community” because they aren’t in the community. And they generally do not buy bonds issued by educational districts to “help the children” or “provide vocational training to veterans.” They buy them to make money.

Ironically, the same Progressive activists who call for higher taxes on the rich also tend to support educational bond measures that help the rich to earn investment income that is tax-free. Forcing the rich to pay taxes on income earned through municipal bonds could collapse the demand for these bonds and make borrowing money for construction a much more expensive proposition for school and college districts.

### **How Does an Educational District Pay Back the Borrowed Principal Plus Interest on Bond Sales?**

People pay back the principal and interest on car loans, school loans, and mortgages using their income. Educational districts pay back the principal and interest on bonds using their “income,” that is, taxes collected from property owners in the district.

After a school district or community college district borrows money by selling bonds for construction, it informs the county auditor and county treasurer/tax collector. Based on the assessments of property value determined by the county assessor, the county treasurer calculates the appropriate tax rate and generates individual tax bills for owners of property such as houses, farms, apartment buildings, commercial buildings, manufacturing

facilities, business infrastructure, and undeveloped land. A specific rate and tax for each bond measure is listed on the tax bill.

These taxes are called *ad valorem* taxes. *Ad valorem* is Latin for “according to worth” and indicates that taxes are levied (imposed) on property owners in proportion to the assessed value of their property.

### **Does Renting or Leasing Mean That You Don’t Pay for Educational Construction or the Cost of Borrowing Money for It?**

Households that rent property or businesses that lease property do not pay property taxes directly. However, it is not true to claim or think that renters or lessees don’t have to pay for educational construction and the costs of borrowing money to pay for that educational construction. Property owners can and do incorporate the cost of their property taxes into their rents or leases. Bond sales by a school or college district may result in higher rent.

### **Technical Definitions of Bonds**

Notice that the common term in all of these definitions is debt. When a school or college district sells bonds, it borrows money from investors and must pay them the money back over time, *with interest*.

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## Capital Appreciation Bonds: Disturbing Repayment Terms

In 1993, California law was changed so that school and college districts could use an innovative form of debt finance called zero-coupon bonds, also known as Capital Appreciation Bonds. These bonds allow school and college districts to borrow now for construction and pay it back — with compounded interest — many years later. The borrowing strategy has been a tempting and dangerous lure for elected school and college boards.

Some people think Capital Appreciation Bonds are a “ticking time bomb” or the “creation of a toxic waste dump.” Others regard critics as uninformed and contend that these debt finance instruments are beneficial for school and college districts. Since the people who will be paying off many of these Capital Appreciation Bonds are now children or not even born yet, there isn’t much incentive to stop the flow of borrowed money that doesn’t need to be paid back for a generation or two.

### **Capital Appreciation Bonds Get Attention: Some Welcomed It, Some Didn’t**

There was a brief time in the last half of 2012 when California news media and even national news media alerted the public to a neglected but long-festering problem involving municipal bonds sold by many California school districts and community college districts. These educational districts chose to borrow money for construction using an unconventional debt finance instrument called a Capital Appreciation Bond.

Capital Appreciation Bonds allow school and college districts to circumvent state laws that limit taxes and debt relative to the total value of property in the districts. But they also subject future generations of Californians to potentially burdensome taxes and debt.

### **Explaining and Contrasting Current Interest Bonds and Capital Appreciation Bonds**

The traditional Current Interest Bonds (also called Fixed Rate Bonds) are relatively easy to understand. If someone buys a Current Interest Bond and holds it until it matures (reaches the end of its time period for borrowing), that buyer receives interest on a regular basis (usually semi-annually). The buyer gets the original principal paid back when the bond reaches the end of its term of maturity.

Here’s an example of how a Current Interest Bond works:

- An entity buys a \$1000 Current Interest Bond issued by a school district at face value (also known as par value) with a 25-year term to maturity at a 2.5 percent interest rate.
- Each year, for 25 years, the buyer gets \$25 in interest from the school district, because 2.5% of \$1000 is \$25.
- When the bond matures, the buyer gets the principal of \$1000 back from the school district.
- The total interest earned over 25 years is \$625, because \$25 times 25 is \$625.
- Although the \$625 is income, the buyer will never have to pay tax on that interest if the bond is tax-exempt, as is typical with municipal bonds.

Obviously the school district must levy taxes on property owners each year throughout the 25-year term to maturity so that it has enough money to pay interest each year (and ultimately pay back the principal at the maturity date).

Capital Appreciation Bonds (also called Zero Coupon Bonds) are more difficult to understand. Someone who buys a Capital Appreciation Bond pays for it at a price deeply discounted from the face value (par value) of the bond. The buyer does not receive interest payments until the bond reaches maturity, at which point the buyer is paid the face value of the bond, which is the deeply-discounted price (the principal) plus all of the interest earned during the term to maturity.

During the term to maturity period of the Capital Appreciation Bond, interest accumulates over time. The interest is compounded, meaning interest for a time period is earned on the original amount of money and also earned on any of the interest that has already been accumulated up to that time period.

Compound interest that accumulates as a Capital Appreciation Bond grows in value is called “accreted interest.” “Accreted” (a word derived from the Latin *accrescere*, to increase) means accumulated over time.

Here’s an example of how a Capital Appreciation Bond works:

- An entity buys a \$5000 Capital Appreciation Bond with a 25-year term to maturity at an interest rate of 5 percent.
- The discounted price of the bond is \$1477.
- When the bond matures, the buyer gets \$5000 back from the school district.

- The total earned over 25 years is \$3,523.
- Although the \$3,523 is income, the buyer will never have to pay tax on that interest if the bond is tax-exempt, as is typical with municipal bonds.

The school district benefits because for many years it does not need to levy taxes on property owners in order to make interest payments. It can borrow much more money through bond sales without being restricted by tax and debt limits established in state law. The community can enjoy the benefits of the bond sales without having to pay for them — at least for a while.

And although the buyer does not get a regular interest payment, the accumulated (“accreted”) interest is compounded over many years, making the wait a worthwhile investment. The cliché about “the power of compound interest” for an investor is accurate.

### **Why Did Capital Appreciation Bonds Become Popular?**

The public first became aware of Capital Appreciation Bonds in 2012 when news media reported on a 2011 debt financing arrangement at the Poway Unified School District. Most reports insinuated that limits on taxes and debt established by the legislature in 2000 in conjunction with Proposition 39 had forced schools and community colleges to borrow money by selling Capital Appreciation Bonds. Allegedly these limits were constraining school and college districts from implementing necessary construction programs at a time of plummeting property values. Educational districts saw Capital Appreciation Bonds as the only debt financing option available to alleviate school overcrowding and ensure children’s safety.

But in reality, Capital Appreciation Bonds have been a component of bond issues by California educational districts for over twenty years. Signed into law in 1993, Senate Bill 872 authorized school and college districts to sell them. Voters in the Windsor Unified School District approved a bond measure on April 12, 1994, and the district proceeded to sell \$5,054,761 in Capital Appreciation Bonds in its first series of bond sales. The Old Adobe Unified School District and the Oakland Unified School District soon followed.

### **Capital Appreciation Bond Origins**

The first sentence in a 1982 article in the *New York Times* declared, “Give Wall Street a headache like double-digit interest rates, and someone will invent an aspirin like the zero-coupon bond.” According to this article, in 1981 J.C. Penney became the first corporation to issue Capital Appreciation Bonds. In 1982, E.F. Hutton became the first bond broker to underwrite Capital Appreciation Bonds for municipal governments.

A survey of news coverage on Capital Appreciation Bonds during the 1980s reveals that the focus of journalistic concern for this new form of municipal debt finance was the risk to investors. Needless to say, Capital Appreciation Bonds endured past the era of high interest rates, and the aspirin for investors became a headache for taxpayers.

### **Who Buys Capital Appreciation Bonds?**

Capital Appreciation Bonds are not necessarily a wise decision for an investor, so who sees an investment advantage in buying them? James Estes, Professor of Finance at California State University, San Bernardino tried to answer this question and reported the results of his investigation in a 2013 paper. After observing that Charles Schwab & Co, Inc. does not offer or sell Capital Appreciation Bonds, he contacted twelve companies that offer municipal bond funds. All twelve claimed they don't market funds featuring Capital Appreciation Bonds. Company representatives told Estes that Capital Appreciation Bonds were undesirable to their investors because of their lack of current interest payments, their poor yield, and their high risk.

Estes also investigated rumors on the web that CalPERS might be holding many municipal Capital Appreciation Bonds. CalPERS spokesperson Danny Brown denied that CalPERS holds them and cited their risk. Finally, Estes mentions the claim of a finance reporter that international banks hold Capital Appreciation Bonds in a trust administered by Bank of America.

In response to a Twitter inquiry from the author of this report, a former reporter for *Voice of San Diego* tweeted that he never learned who held the district's Capital Appreciation Bonds during his 2½ years reporting on Poway Unified School District's Capital Appreciation Bond fiasco: "The word was that the debt had likely been sold and resold and resold. Also no repository for that info...I always wanted to know."

In 2014, a municipal bond advisor named Dale Scott of Dale Scott & Company presented a plan to Poway Unified School District for the district to buy back some of its Capital Appreciation Bonds using funds from a property tax increase. One challenge for this district is identifying who owns the bonds so offers can be made to buy them back. Scott pointed out that he had managed to find owners of Capital Appreciation Bonds issued by the Stockton Unified School District and buy back about 30 percent of them. According to an August 20, 2014 article in the *San Diego Union-Tribune*, "Scott said there is a myth that capital appreciation bonds are impossible to acquire once they are sold, but the reality is the bond holder may have many reasons for selling bonds that may take decades to mature."

## **Tax and Debt Limits Meant to Assure Property Owners that a 55% Approval Threshold for School Bond Measures Wouldn't Crush Them**

From a school district's perspective, Capital Appreciation Bonds are attractive because they enable the district to borrow more within its tax and debt limits. California Education Code Sections 15268-15270 sets the current limits. The state has not changed the limits since the enactment of Assembly Bill 1908 in conjunction with Proposition 39 in 2000, although Governor Brown proposed increasing them in his 2015-16 budget. (See Section 2 for background.)

Opponents of Proposition 39 in 2000 pointed out in their ballot arguments that these tax and debt limits were not part of the constitutional amendment enacted through Proposition 39 and therefore could be amended or repealed by the state legislature at any time. This is true.

Districts can set a lower tax or debt limit in the ballot statement for a bond measure. And K-12 school districts can get waivers from State Board of Education to impose higher tax or debt limits. (See Section 6 for background on waivers.)

## **Tax and Debt Limits Make Funding of Construction Programs Highly Dependent on Assessed Property Valuation**

Because tax and debt limits are based on annual assessed property valuation in a district, the limits change yearly as a reflection of the real estate market. If property values increase compared to the previous year, the amount of money that can be borrowed increases relative to the previous year. If property values decline compared to the previous year, the amount of money that can be borrowed that year decreases. Educational districts hope (and usually project) property value to increase at a respectable rate for many years to come.

If the substantial increase in home prices during the mid-2000s gave school and college districts several years to borrow a lot more than perhaps originally anticipated, the dramatic drop in the following years hindered school and college districts, especially those with ongoing construction programs. From 2007 to 2011, assessed property valuation in some regions of California declined by as much as 50%, especially in exurban areas of California that grew rapidly in population during the 2000s as young families sought home ownership at prices they could afford.

Not surprisingly, these same regions needed new school construction to accommodate the children in these young families. Because of tax and debt limits, educational districts

could not raise tax rates or borrow more money using traditional Current Interest Bonds to compensate for the loss in revenue resulting from the decline in property values.

Capital Appreciation Bonds are a clever way to circumvent the debt limits. A school or college district can take on a long-term debt obligation of \$5000 by selling a bond but declare the debt to be \$1300 because the bond was sold at the deeply discounted “principal” of \$1300. And by deferring payment to bond investors until the bonds mature, the district can borrow money without exceeding the tax limit.

### **Hoping for the Best with Capital Appreciation Bonds**

Of course, school districts will eventually have to collect a lot of money through levying taxes on property owners to pay principal and accreted interest to the buyers of Capital Appreciation Bonds. Essentially, Capital Appreciation Bonds represent a district’s gamble that assessed values will climb rapidly enough to produce sufficient tax revenue to allow issuers to pay off the bonds when they become due. If the anticipated increase in assessed property valuation fails to occur during the term of maturity, the district cannot pay principal and interest owed in future years.

There is little political disincentive for elected board members to borrow money today for school construction and impose a commitment on future generations to pay it off in 25, 30, or even 40 years. Only the elected board members of the Poway Unified School District have suffered political consequences from approving this kind of debt finance. But future school and college board members (who are children today) may be unjustly subjected to voter ire when the bill on Capital Appreciation Bonds is finally due.

### **2013: An Incomplete Fix for the Excesses of Capital Appreciation Bonds**

Assembly Bill 182 was an attempt to restrain the worst excesses of Capital Appreciation Bonds while still allowing school and college districts to use them as a debt finance tool. It developed out of a proposal from San Diego County Treasurer-Tax Collector Dan McAllister as a response to high-profile Capital Appreciation Bond sales by school districts in his county.

Supporters of this bill were prominent critics of unrestrained Capital Appreciation Bond sales: California State Treasurer Bill Lockyer, the aforementioned San Diego County Treasurer-Tax Collector Dan McAllister, the California Association of County Treasurers and Tax Collectors, the California League of Bond Oversight Committees, the Howard Jarvis Taxpayers Association, and the California Taxpayers Association. Several rural county boards of supervisors supported the bill, as well as the board of supervisors for Contra Costa County, where the West Contra Costa Unified School District, the Mt. Diablo Unified

School District, and the Acalanes Union High School District received local attention for risky bond finance schemes, including Capital Appreciation Bonds.

California State Treasurer Bill Lockyer wrote the following in support of Assembly Bill 182:

...many districts face a critical need to build or modernize facilities for their children, and I recognize that falling property tax assessments, revenue losses, and statutory debt service limits have all combined to reduce districts' debt financing options, at least at the present time. However, we cannot continue to use debt financing tools, such as CABs, that force tax payers to pay, at times, more than 10 times the principal to retire these bonds. In too many cases, these transactions have been structured with 40-year terms that delay interest and principal payments for decades, resulting in huge balloon payments. Moreover, school board members and the public have not always been fully informed about the total costs and risks associated with issuing capital appreciation bonds. As a result of such CAB deals and lack of transparency, our future generations in many California school districts will be burdened with heavy taxes for years and years to come.

But there was also significant opposition to the bill from groups heavily involved in promoting bond measures for school construction, including California's Coalition for Adequate School Housing (C.A.S.H.), the Association of California School Administrators, the California Association of School Business Officials, and the Small School Districts' Association. The first legislative analysis written for a committee about AB 182 described the basis for the opposition:

All of the opposition letters submitted to the Committee have an "oppose unless amended" position. Generally, the opposition supports more transparency, but is concerned that the bill will inhibit school districts' ability to secure funding to house students and provide for renovations as promised to voters through their bond initiatives. While some of the opponents do recognize the need to establish some parameters to prevent extreme CABs, they argue that CABs, if done appropriately and in a limited way, are effective. The requested amendments vary from organization to organization. They include expanding the term of CABs to 30 years, restoring the term of 40 years for CIBs, increasing the total debt service to principal ratio to 6 to 1 and applying the ratio to bond authorization, grandfathering in bonds that are already approved but not issued, and allowing districts to seek a waiver from the SBE to increase the tax rates.

In the end, the bill passed the State Senate 36-0 and passed the State Assembly 78-0. Soon after the bill was signed into law, governing boards of school and college districts were already initiating the sale of more Capital Appreciation Bonds under the new guidelines. This method of debt finance for school and college construction is not going away.

## **Case Study: Poway Unified School District's Egregious Debt Finance**

Poway Unified School District created a special School Facilities Improvement District in 2007 and asked voters in February 2008 to authorize \$179 million in bonds to finance capital improvements. The bond measure passed with 63.9% support, as it qualified under Proposition 39 for a 55% voter approval threshold.

As a campaign strategy, the district promised voters that the bond measure would not require a tax increase, supposedly because assessed property values would rise enough over time to bring in more tax revenue and pay off the debt service. To keep this promise, the school board subsequently adopted some excessive debt financing schemes.

From 2008 through 2011, the district borrowed the \$179 million by issuing four series of bonds, including Current Interest Bonds and non-callable Capital Appreciation Bonds, with some bonds issued to refund earlier bond issues. It even sold some 40-year bonds at the maximum legally allowed interest rate of 8 percent. It used numerous controversial debt finance practices, such as selling bonds at a 20 percent premium over face value, and ended up incurring issuance fees totaling more than \$6.7 million.

Perhaps people in the Poway Unified School District did not comprehend the dangers at the time, but the school board realized the district was doing something questionable. In 2010 it filed a validation lawsuit to subvert future lawsuits against their next bond finance deal. This provoked a warning letter from the California Attorney General, but in the end no party chose to be a defendant, thus giving the district legal cover to proceed.

Property owners in the School Facilities Improvement District now have the burden of paying \$1.27 billion in debt service through 2051 for the privilege of borrowing \$179 million. Poway Unified School District was described in the news media as having "shot to fame" as a "poster child for an era of reckless and risky school bond borrowing" through bond sales that have "reached legendary status." And it became a rare example of voters making school board members accountable for its decisions on bond finance.

Three of the five board members who voted for the Capital Appreciation Bond deal in 2011 have lost their reelection campaigns, and a fourth chose not to run for re-election. The only remaining board member from 2011 may still be in office because only three candidates (two incumbents and a challenger) ran to fill two seats in the 2012 election. Seeing the popular demand for change, eight candidates ran for three seats in 2014.

## **Michigan Banned Capital Appreciation Bonds When California Legalized Them**

On April 27, 2012, a former reporter for the *Detroit Free Press* newspaper named Joel Thurtell published a post on his blog entitled “Muni Bomb Ticks in California.” Thurtell wrote about the popularity of Capital Appreciation Bond sales by California educational districts.

Thurtell revealed that the practice was not new; in fact it was common at Michigan school districts in the late 1980s and early 1990s:

There’s a school bond scandal brewing as California schools load taxpayers with horrendous debt for the next generation of taxpayers. The blight is called CABs — short for Capital Appreciation Bonds. It hit Michigan in 1988. Within four years of the first CAB issue, Michigan public school debt had doubled to reach more than \$4 billion. That was just principal. The interest on the CABs amounted to 200 percent — 300 percent — even 575 percent of principal, depending on the terms of the individual bond issue. Nineteen years ago, I delved into this fascinating but arcane world with its private argot strewn with obscure words like “zeroes” and “basis points” describing fairly simple things in language you need a special dictionary to comprehend. It’s an industry with specialized documents that seem encrypted so that people like you and I will have trouble understanding them.

Thurtell had spent many days of difficult, tedious research at the Michigan State Treasurer’s office scrutinizing paper copies of “Official Statements” produced for Michigan school districts. He produced a “Big Chart” that quantified the prevalence of Capital Appreciation Bond sales and accumulated debt service. On April 5, 1993 the *Free Press* published the first of a series of Thurtell’s articles about how Michigan school districts were borrowing their money for school construction. The articles changed public policy in Michigan:

Because of my *Free Press* stories...the state Legislature banned future issues of Capital Appreciation Bonds and ordered that future bond issues be competitively bid rather than rigged through a process the underwriters euphemistically termed “negotiation.” It was huge that CABs were banned, because as you will read in these stories, schools were piling up enormous debt to be paid by future taxpayers. Imagine the predicament schools would have found themselves in had such debt been allowed to continue accumulating into today’s depressed economy. Debt payback was predicated on rosy assumptions called “present value” that predicted large increases in real estate valuation *ad infinitum*.

At the May 2012 annual conference of the California League of Bond Oversight Committees, the Los Angeles County Treasurer-Tax Collector Mark Saladino and Alicia Minyen, a school bond expert and certified fraud examiner, made presentations that included discussion of Capital Appreciation Bonds. Saladino had written a May 16, 2011 white paper about risky municipal debt finance that referenced school districts issuing Capital Appreciation Bonds. Minyen was a prominent critic of a few school districts in Contra Costa County that had issued Capital Appreciation Bonds in irresponsible ways.

Minyen referenced Joel Thurtell's articles and blog posts. The author of this report then wrote articles for his personal blog about the Capital Appreciation Bond presentations, and local taxpayer activists throughout the state began contacting him with questions and concerns about Capital Appreciation Bond sales going on in their local school and college districts. Californians who paid close attention to tax and government finance issues from a critical perspective were confused — and suspicious.

### **Graphic Depictions of Poway Unified School District Bond Debt Inspire Limited Reforms**

Finally a breakthrough in bringing public awareness to the issue occurred in August 2012, when a journalistic web publication called *Voice of San Diego* published a series of investigative pieces written by reporter Will Carless about the 2011 Poway Unified School District bond sales. The first article hit on August 6, 2012: "Where Borrowing \$105 Million Will Cost \$1 Billion: Poway Schools."

It's possible that *Voice of San Diego* was successful in bringing sudden and dramatic attention to the practice because of the simple and colorful graphics produced by Keegan Kyle and included with the articles. These graphics portrayed the deals in a way much easier to understand than the analytical writing of policy experts.

These articles and the associated graphics were the catalyst for intense statewide public criticism. *Voice of San Diego* created a spreadsheet, the *Los Angeles Times* created a database, and other news media outlets compiled information revealing that a couple hundred community college and K-12 school districts in California had issued Capital Appreciation Bonds, with many starting long before property values began to decline in 2007.

California and national news media, state and local taxpayer organizations, and many state and local politicians spent the next year criticizing California educational districts for poor decisions about borrowing money via bond sales for school construction. About a dozen educational districts received a disproportionate amount of negative attention for their

Capital Appreciation Bond sales. Criticism ebbed but did not disappear after Governor Brown signed Assembly Bill 182 in October 2013 to put limits and new oversight on Capital Appreciation Bonds.

### **Backers of Capital Appreciation Bonds Stubbornly Defend Them**

Throughout the state and even at the Poway Unified School District, elected district officials and administrators defended their decisions to sell Capital Appreciation Bonds. Their response to criticism was common and consistent:

1. Voters wanted school construction done as soon as possible.
2. Capital Appreciation Bonds were the only way available to get the money.
3. We didn't do anything wrong.
4. Look at the complete program instead of focusing on individual bond issues.

These claims generally echoed the arguments of parties involved in the preparation and sale of those bonds. These bond experts knew the obscure and complicated business of municipal bonds, but they also had a financial interest in seeing these bond sales continue.

Tables A-5 and A-6 are comprehensive lists of arguments for and against Capital Appreciation Bonds, with rebuttals.

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### Tricks of the Trade: Questionable Behavior with Bonds

Californians who want more spending on educational construction often express their resentment of a 2000 law limiting taxes and debt resulting from bond sales. It was passed in order to strengthen campaign arguments to voters in support of Proposition 39, which lowered the approval threshold for local bond measures from two-thirds to 55%. (See Table 11 in Section 5 for the limits.)

School districts have adopted several strategies to get around these limits in state law. One of them is very obscure but 100% successful: obtaining waivers from the State Board of Education.

Meanwhile, some districts are stretching legal definitions to use proceeds from bond sales to pay for items that resemble instructional material more than construction. One example is personal portable electronics such as iPads. Some of the state’s largest districts are purchasing this kind of technology while giving little assurance to the public that long term bonds aren’t the source of the money. This equipment may be obsolete well before the bonds mature, meaning that future generations will pay for these devices long after they are outdated and discarded.

### **Debt and Tax Limits Waived When School Districts Want to Borrow More Money**

Research by the California Policy Center now allows the People of California to see — for the first time — a chart listing all California K-12 school district requests to the state for waivers to sell bonds for school construction. These waivers allow school districts to circumvent state laws enacted in conjunction with Proposition 39 and meant to set limits on taxes and debt burdens imposed on property owners.

State law (California Education Code Sections 3050-33053) allows the California Board of Education to grant waivers from numerous sections of the California Education Code, including bond indebtedness limitations. This power is obscure but significant, and until now a compilation of the history of bond indebtedness waivers has not been available to the public.

Out of the 51 waiver requests from 2000 through 2014, only one received notable public attention. In 2013, the fourth waiver request since 2002 from the West Contra Costa Unified School District became controversial when some local taxpayer activists and a columnist for the *Contra Costa Times* criticized the district for repeatedly seeking waivers to borrow yet more money for construction through bond sales.

To develop a bond indebtedness waiver chart and provide the public with comprehensive information about the waivers, the California Policy Center obtained a document from the California Department of Education listing school district requests since 2000 to the California Board of Education for bond indebtedness waivers. Staff indicated that this listing was an “internal working file and has not been reviewed or validated for accuracy.”

California Policy Center researchers checked the data, corrected inaccuracies, and expanded on the data using meeting agendas, staff reports, and meeting minutes. Now the public has a useful resource for considering public policy related to bond indebtedness waivers.

Table A-3 provides complete history of school district requests to the California Board of Education for waivers from tax and debt limits to borrow more money for school construction by selling bonds to investors. Preliminary activity in the first three months of 2015 is also included.

### **Request a Waiver, Get a Waiver**

From 2000 through 2014, California K-12 school districts requested 51 waivers from sections of the California Education Code that do one or both of the following:

1. Prohibit the total amount of bonds issued (the total amount of principal) from exceeding 1.25 percent or 2.50 percent of the most recent assessed aggregate value of taxable property in the district. (Elementary and high school districts have a 1.25% limit; unified school districts a 2.5% limit.)
2. Prohibit the total amount of bonds issued as authorized by one bond measure from requiring a property tax that exceeded \$30 or \$60 per year per one hundred thousand dollars (\$100,000) of taxable property. (Elementary and high school districts have a \$30 limit; unified school districts a \$60 limit.)

Out of these 51 waiver requests, school districts ended up withdrawing three of them. The State Board of Education approved all 48 other waiver requests, without one dissenting board vote.

The 100% approval rate for waiver requests is not surprising. In 2013, the State Board of Education took action on 518 waiver requests for all sections of the California Education Code and approved 97% of them. Under state law, the California Board of Education is generally obligated to grant such waivers as long as the request is submitted correctly and the waiver doesn't violate seven criteria specifically listed in state law:

1. The educational needs of the pupils are not adequately addressed.
2. The waiver affects a program that requires the existence of a schoolsite council and the schoolsite council did not approve the request.
3. The appropriate councils or advisory committees, including bilingual advisory committees, did not have an adequate opportunity to review the request and the request did not include a written summary of any objections to the request by the councils or advisory committees.
4. Pupil or school personnel protections are jeopardized.
5. Guarantees of parental involvement are jeopardized.
6. The request would substantially increase state costs.
7. The exclusive representative of employees, if any...was not a participant in the development of the waiver.

None of those seven criteria relate to local fiscal policies, meaning there is no obvious justification in state law for the Board of Education to deny a waiver from state laws related to bond indebtedness. Nonetheless, the Board of Education has chosen to impose conditions on bond indebtedness waivers and sometimes incorporated changes from the original requests at the recommendation of California Department of Education personnel. But the Board of Education has also rejected recommendations from the Department of Education, most notably in 2013 when the board repeatedly rejected a staff recommendation that school districts applying for waivers should not be permitted to sell Capital Appreciation Bonds.

### **Case Study: West Contra Costa Unified School District**

This school district based in Richmond is perhaps the most egregious example in California of unrestrained bond finance for a construction program. One individual was disproportionately responsible for leading the district to almost \$2 billion in debt service. It

remains to be seen if his legacy will be as a hero for disadvantaged students in dilapidated schools or as a politician who undermined the district's always-tenuous fiscal stability.

During his time on the West Contra Costa Unified School District board of trustees from 1993 to 2014, Charles Ramsey claimed to work for the interests of students in this district. Ramsey played a leading role in the political deals and fundraising (through a Political Action Committee named "For the Children of West County") needed to win voter approval of six out of eight bond measures proposed from 1998 through 2014. Those six successful bond measures authorized the district to borrow a total of \$1.63 billion via bond sales.

His emailed reaction after the school district received its fourth tax and debt waiver from the State Board of Education was typical:

...I did all I could to change the attitudes that constantly plague our community and tried to make the world a better place. No longer can people sit back and point fingers about us and now I can proudly say that WE DID IT!!!! Once again and now we can add Measure E to the list of successes with the debt limit waiver now applied to this phenomenal bond program. And once again, a loud and boisterous THANK YOU. For all of us and in the end it is all about the West Contra Costa Unified School District kids!!!

The district has debt service of \$1.83 billion and continues in 2015 to issue bonds that don't mature for 40 years. It has issued Capital Appreciation Bonds. It has requested four waivers from the State Board of Education to exceed tax and debt limits, even earning attention from local news media for abuse of this obscure process. In the context of reporting on the district's fourth waiver request, *Contra Costa Times* columnist Dan Borenstein asserted the following:

The West Contra Costa school district should slow its deceptive school construction program because it's pushing too much debt onto property owners and will soon exceed tax limits it promised voters...In their quest to rebuild or replace every school, district officials are moving too fast, behaving irresponsibly and overtaxing poor and working-class residents...District officials need to start thinking about property owners who foot the bill. New schools are nice, but they must also be affordable.

Borenstein also suggested that the campaigns for the bond measures were deceptive, both in general and in specifics: "Each time they went to the ballot, district officials presented that particular bond measure to voters as if it were the only one. They never mentioned the outstanding debt taxpayers already owed from prior measures." He also criticized a "buried" reference in a three-page long paragraph in a fourteen-page ballot statement

stating that the district would have authority to seek a waiver from tax and debt limits cited elsewhere in the ballot material.

The US Securities and Exchange Commission has investigated financing of the district's bond program, and the Federal Bureau of Investigation has also made inquiries. A grand jury questioned Charles Ramsey about his relationship to corrupt officials involved with the bond-funded construction program at the Sweetwater Union High School District in Chula Vista.

There have been continual questions about the district's management of its construction program over its history. Frequent change orders, cost overruns, and unusually high construction costs per square foot have attracted many critics over the years. In addition, enrollment at the West Contra Costa Unified School District is expected to decline.

Finally, one corporation – Chevron – owns 11.62% of the assessed valuation of property in the district. Chevron’s refinery operation in Richmond is perpetually targeted by environmental and social justice groups, some of which hope to close it down. Although the district is vulnerable to a future drop in assessed valuations, the closing of the Chevron refinery would be a financial disaster to the district (and the City of Richmond).

### **Borrowing Money for Technology Using Bonds**

California community college districts and school districts continually claim funding shortfalls for operating expenses. Yet it’s easier for an educational district to get voter

authorization to borrow money for construction than it is to get voter approval to impose a parcel tax to obtain supplemental revenue.

This tempts some districts to stretch credulity and declare that voters authorized bond proceeds to be spent on items tenuously related to building a school and providing it with furniture and equipment. And despite the many protections in Proposition 39, sometimes the application of bond funds to operating expenses cannot be prevented.

The Los Angeles Unified School District and the San Diego Unified School District have borrowed money through bond sales and used the proceeds to buy portable electronic tablets for students. These districts rationalize the practice by claiming that voters consented to it when they approved Proposition 39 in 2000 and then subsequently approved local district bond measures.

Recently several districts have asked voters to approve Ed-Tech Bonds<sup>®</sup>, a trademarked arrangement of bond sales marketed by Dale Scott & Company that permit a district to issue an ongoing series of new short-term bond issues to pay for technology that becomes outdated after a few years. Voters seem to support the idea of using money borrowed from short-term bonds for technology, as long as the district explains the concept openly and establishes reasonable limits.

But the Los Angeles Unified School District and the San Diego Unified School District have used construction bond proceeds to buy iPads for students to use in the classroom and even take home. Because the useful life of these devices is limited, these school boards may be making a fiscally irresponsible policy decision when financing their purchases with borrowed money from bond sales.

### **Why Any Educational District Can Borrow Money Via Bond Sales and Use It to Buy iPads**

No group or individual has put forward a strong legal argument for the idea that school districts cannot use Proposition 39 bond proceeds to buy personal portable electronic devices. In contrast, the arguments are strong for the idea that voters gave educational districts the authority to do this, as long as the districts don't stray too far from the purposes of Proposition 39.

Perhaps the most notorious example of questionable use of bond funds is the ill-fated Common Core Technology Project Plan at the Los Angeles Unified School District (LAUSD). The former superintendent proposed that funds from Measure R and Measure Y would be used for the first phase of a program to buy electronic tablets (specifically, iPads produced

by Apple, Inc.) for students to take home. The iPads would come with software developed by another company.

On September 7, 2012, a law firm provided the superintendent with a memorandum entitled “Use of Los Angeles Unified School District Measures R, Y and Q General Obligation Bond Proceeds for Certain Costs Related to the District’s Common Core Technology Project Plan.” It asserted that borrowed money from bond sales authorized by measures that comply with Proposition 39 could be used for (1) costs of acquiring electronic tablets, (2) costs of acquiring hardware and installing software, and even (3) costs of hiring “technology specialists who will train the District’s internal technology support teams to operate and maintain the Common Core Technology project, and technology adoption trainers who will train other school site trainers.”

The memo also exposed a oversight in the Proposition 39 language:

There is no statutory definition of many of the terms used in Proposition 39, such as what constitutes the construction, replacement or furnishing and equipping of school facilities for Proposition 39 purposes. Thus, there is no controlling legal authority expressly stating whether costs related to the Common Core Technology Project would constitute the construction, replacement or furnishing and equipping of school facilities for purposes of Proposition 39...the District should remain aware that there is no controlling legal authority expressly stating what constitutes the “equipping of school facilities” for purposes of Proposition 39. The provisions of Proposition 39 relating to the expenditure of general obligation bond proceeds for equipping of school facilities have not been interpreted by any court or other legal authority and, to our knowledge, are not pending before any court.

In practice, educational districts and their bond financial advisers were setting the standards:

Broad agreement, however exists among issuers of general obligation bonds and their advisors that costs directly connected to the construction, acquisition, equipping and furnishing of school facilities may properly be paid from proceeds from the sale of Proposition 39 Bonds, if such costs (i) are “capitalizable” under generally accepted accounting principles applied in accordance with the policies and procedures of the California School Accounting Manual, and (ii) constitute construction, reconstruction, rehabilitation, replacement, furnishing or equipping costs of a project listed on one or more bond measures passed pursuant to Proposition 39.

In effect, the parties getting the borrowed money and getting the transaction fees for the bond sales have determined how that money should be properly spent.

## **Los Angeles Unified School District Defies Criticism, Pushes Forward**

Despite this memo, the LAUSD superintendent's plan to use borrowed money to buy iPads with installed software generated controversy across the political spectrum. For example, both the United Teachers of Los Angeles (the teachers' union) and the Howard Jarvis Taxpayers Association objected to it. Opponents claimed that voters never had an expectation that the bond measures would allow LAUSD to borrow money to buy personal student iPads with software. In addition, a rumor spread that LAUSD would use the proceeds of long-term bonds to buy technology only useful for a few years at most.

While LAUSD officials denied that they were going to sell long-term bonds for iPads, this argument gained attention from news media and inspired ridicule among critics. The same criticism also gained a following against the San Diego Unified School District. And the critics had a point: there was nothing in state law to prevent a school district from selling a 40-year Capital Appreciation Bond to buy an iPad with a lifespan of three years.

A major force in slowing down the rush to adopt this Common Core Technology Project at LAUSD was the district's Citizens Bond Oversight Committee, established at LAUSD even before Proposition 39 was enacted. After significant deliberation and disagreement, this committee expressed numerous concerns but concluded that the district could legally buy portable electronic devices using funds that voters approved the district to borrow via bond sales authorized in a ballot measure that complied with Proposition 39.

This conclusion was stated in a November 18, 2013 letter from the Bond Oversight Committee Information Technology Task Force to the LAUSD School Construction Bond Citizens' Oversight Committee:

On November 15, 2013, after months of discussions with the Office of the General Counsel ("OGC") and many requests for a legal opinion supporting the District's use of bond funds to pay for the majority of costs associated with the CCTP, the OGC issued a written reasoned memorandum opinion stating, among other things, that after performing its due diligence, including, but not limited to, conducting several telephone meetings with and reviewing past communications from the District's bond counsel, in the OGC's opinion there is legal support for the use of bond funds to purchase devices such as tablets for the purpose of equipping schools with those devices, to purchase the software packages to be used on the devices, and to allow students, teachers and staff to take the devices home. We find this opinion acceptable.

This memo is once again referenced in a letter from the head of the Bond Oversight Committee to a retired superintendent of the Los Angeles Unified School District:

Our own review of the CCTP has led us to conclude that the District's actions to date are legal and not imprudent, and we have been assured by the District that the repayment period for the bonds used to finance this project will be reasonably related to the expected life of the assets purchased...we had requested, received, and closely reviewed a letter from the Office of the General Counsel to the District ("OGC") setting out the reasoned basis for its opinion that bond funds may be used to purchase devices such as tablets for the purpose of equipping schools with those devices, to purchase the software packages to be used on the devices, and to allow students, teachers and staff to take the devices home.

The letter from the head of the Bond Oversight Committee to the retired LAUSD superintendent also anticipated arguments soon to be advanced by the California Legislative Counsel:

1. Measure Q did not mention iPads as something that bond proceeds would buy because the ballot measure was passed in November 2008 and iPads were not available to the public until April 2010. It is not possible for a bond measure to anticipate specific technological devices before they are available.
2. The Measure Q bond project list states that bond funds may be used for computer and communications projects, including, but not limited to "hardware and software for information-technology applications" undertaken at some or all of the District's schools and associated facilities.
3. LAUSD has been using bond funds for technology, including computers in the classroom, since after voters approved Proposition BB in 1997. In addition, voters were aware from the language in the ballot statements that bond proceeds would be used for technology.

On April 19, 2015, the *Los Angeles Times* reported that the Securities and Exchange Commission has opened an informal inquiry into LAUSD practices because the district did not mention in its Official Statements that bond proceeds would be used to purchase iPads.

### **The California Legislature Turns Its Attention to the Practice**

In 2014, Assemblyman Curt Hagman introduced Assembly Bill 1754 in response to public criticism about using bond proceeds for personal portable technology. Under his bill, educational districts would have been prohibited from borrowing money from the sale of bonds authorized by measures passed under the criteria of Proposition 39 to purchase portable electronic devices, including laptops and tablets, unless the technology was

closely connected to instruction within the classroom, was not assigned to individual students, and was not permitted to leave the school site for more than one school day.

AB 1754 also would have prohibited educational districts from using bond proceeds to buy basic or supplemental instructional materials. To supplement his bill, Hagman asked the Joint Legislative Audit Committee to hold an oversight hearing to review the LAUSD iPad program. In his letter to the committee asking for an audit, Hagman wrote that “there have been discussions on the legality of using 25-year construction bond money to purchase the iPads (which have a lifespan of only 3-5 years).”

The audit committee hearing did not happen. And the bill failed to pass out of committee despite no opposition votes. Three committee members voted for it and four others did not vote.

While this bill was under consideration, the California Legislative Counsel produced a letter defending the use of Proposition 39 bond money to buy laptops and tablets. It asserted that Proposition 39 generally allows an educational district to buy portable electronic devices using funds that voters approved the district to borrow via bond sales authorized in a ballot measure that complied with Proposition 39.

The letter provided three major reasons why educational districts can do this:

1. Language in Proposition 39 states that bond proceeds may be used to provide access to information technology and specifically cites computers and the Internet. In addition, the argument in favor of Proposition 39 contained in the ballot pamphlet shows that voters were aware that bond proceeds would give schools access to information technology.
2. “Furnishing and equipping” cited in Proposition 39 includes the purchase of goods that satisfy the broad purposes of the law. It is incorrect to narrowly interpret Proposition 39 as authorizing the sale of bonds only for construction activities that support information technology access.
3. Courts reasonably regard laws as somewhat flexible to reflect changing conditions over time. Under this principle, a court would likely construe Proposition 39 to authorize the use of bond proceeds to purchase technological devices not in existence or wide use at the time of its passage, such as laptops and electronic tablets, so long as the intended use of those devices is similar to the use of desktop computers and is otherwise consistent with the purposes of the proposition. It is incorrect to narrowly interpret Proposition 39 rigidly limiting purchases of

technology to desktop computers because that's what voters recognized as technology when they approved the ballot measure in 2000.

### **Even Defenders of the Practice Admit There Needs to Be Limits**

Are laptops and tablets analogous to desktop computers that were the prevalent technology in schools when voters approved Proposition 39 in 2000? Some would argue that laptops and tablets are more like textbooks than furniture or equipment.

Even more questionable is the software installed in the laptops or tablets. Can software be defined as "equipment" if it is bought together as a package with the hardware?

Another question: Is it proper to use bond proceeds to pay for personnel who train others to use the laptops or tablets and the software that comes installed in them?

Finally, does federal law allow a local government to issue long-term tax-exempt bonds to buy or replace items with an approximate three-year lifespan?

In 2015, Assemblyman Scott Wilk introduced Assembly Bill 882, which was originally a similar effort to Assemblyman Hagman's Assembly Bill 1754 (in 2014) to stamp out the use of bond proceeds for portable electronic devices. But unlike Hagman's bill, Wilk's bill passed out of its first committee and moved through the Assembly. The bill was approved after Assemblyman Wilk agreed to an amendment requested by California's Coalition for Adequate School Housing (C.A.S.H.), a primary backer of educational construction bonds.

As of July 14, 2015, Assembly Bill 882 declares that the term of a bond used for the purposes of furnishing and equipping classrooms, including purchasing electronic equipment, shall not exceed 120 percent of the average reasonably expected economic life of the furnishings and equipment. CASH says this provision conforms the practice to federal tax rules.

Assembly Bill 882 also clarifies that portable electronic devices, including laptops and tablets, may be purchased with Proposition 39 bond funds only for the equipping of school facilities and be used for instruction-related purposes in school facilities. Those devices cannot be assigned to individual pupils or removed from the school site on a daily basis.

Even if Assembly Bill 882 is enacted into law, it would only apply to bonds approved by voters after January 1, 2016. LAUSD and the San Diego Unified School District would still be able to fund their programs with bond proceeds, as long as voters allowed them to continue it.

## Clarifying the Definition of “Furnishing and Equipment” in Proposition 39

Technology is not the only ambiguous aspect of “furnishings and equipment.” Board meeting agendas at the West Contra Costa Unified School District routinely include consent items to spend money to move equipment and furniture with proceeds of bond sales. Is this a prudent way to spend borrowed money that must be paid back over years, with interest? It’s another example of a school or college district taking advantage of a vague provision in state law.

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## The System Is Skewed to Pass Bond Measures

Considering the advantages that supporters have in preparing and campaigning for a bond measure, perhaps it’s noteworthy that voters reject about 20% of local bond measures for educational construction. At every stage of the process, interests that will benefit from bond sales can take advantage of a system that favors passage of a bond measure. Some issues of concern include use of public funds to develop campaigns to pass bond

measures, significant political contributions to campaigns from interests likely to benefit from construction, involvement of college foundations as intermediaries for campaign contributions, and conflicts of interest and alleged pay-to-play contracts.

### **It's Not "Tough" Anymore to Pass Local Bond Measures for School and College Districts**

Voters in 2000 who read the ballot argument in favor of Proposition 39 would have seen supporters claim that it would "require bonds to be passed by a tough 55% super-majority vote." Perhaps a 55% threshold could be described as "tough" compared to approval by a simple majority of 50% plus one, but it certainly hasn't meant passage is difficult to achieve in practice. Four out of five bond measures proposed under the criteria of Proposition 39 win voter approval. (See Section 3 for more information.)

Supporters might argue that the 80% voter approval rate for construction bond measures qualified under Proposition 39 simply reflects the view of a substantial percentage of Californians that school and community college districts need new and modernized facilities. But these views don't develop in a vacuum.

An industry of campaign consultants helps educational districts to convince voters to approve bond measures. They have developed a formula that generally results in victory. Here are some of the most obvious tactics used to achieve that success rate of 80 percent.

### **Using Public Funds to Hire a Consultant for Voter Research That Is Subsequently Useful in the Election Campaign to Pass the Bond Measure**

Many Californians would be astonished to learn that school and community college districts can use funds from their operating budget to develop a strategy to pass a bond measure. Yet this practice is common — and legal.

California law prohibits community college districts and K-12 school districts from using public funds or resources to campaign in support or opposition to bond measures. Education Code Section 7054 states "No school district or community college district funds, services, supplies, or equipment shall be used for the purpose of urging the support or defeat of any ballot measure..."

However, these same public resources CAN be used to provide information to the public about the possible effects of any bond issue or other ballot measure, as long as that information constitutes a fair and impartial presentation of relevant facts to aid the electorate in reaching an informed judgment regarding the bond issue or ballot measure.

A 2005 opinion from California Attorney General Bill Lockyer confirmed that it is legal for a college district (and a school district) to use district funds to hire a consultant to conduct surveys and establish focus groups to assess the following important conditions for a campaign:

1. The potential support and opposition to a bond measure, by gathering information and evaluating the potential for the adoption of a bond measure by the electorate.
2. The public's awareness of the district's financial needs.
3. The overall feasibility of developing a bond measure that could win voter approval.

According to the Attorney General, this is not “partisan campaigning.”

Of course, this professional research and analysis — paid for by taxpayers — puts a school or college district at a significant advantage for a bond measure campaign. Consultants determine which words and arguments are most effective in motivating various demographic groups in the district to vote for a bond measure. Consultants also determine which arguments would be most effective for opponents of a bond measure and how the school district can neutralize those arguments.

Further research is needed to reveal how often a “feasibility study” concludes that a bond measure is *not* “feasible.” Considering that the firm evaluating the feasibility of a bond measure may often be seeking future contracts with the district or the campaign committee, there may be a conscious or subconscious inclination to manipulate the survey questions or the results to obtain a deceptively positive recommendation. In his book *Win Win: An Insider's Guide to School Bonds*, Dale Scott of Dale Scott & Company cites a case in which he suspects a consulting firm had self-interested motivations when it recommended that a school board place a bond measure on a June primary ballot rather than a November presidential ballot with an apparent better chance of passage. Voters rejected the bond measure.

Considering that voters approve about 80% of educational bond measures at the 55% voter approval threshold, cynics would argue the real purpose of surveys isn't to determine “feasibility” but to use public funds to develop election campaign strategy. Based on promotional material of firms that specialize in feasibility studies for bond measures, the argument is valid.

Here's an excerpt from a consulting firm's website about how information from taxpayer-funded surveys can be used to improve the chance of election victory:

...an initial baseline survey can determine the overall feasibility and voter acceptance of a bond or parcel tax measure at different funding levels. It can test how voters respond to different versions of the ballot title and summary, and – through analysis of respondent demographics and past voting patterns – it can help determine which election calendar promises the greatest likelihood of success. The same survey can also determine the effectiveness of the rationales and arguments that might be offered for and against a bond or parcel tax measure, thus helping shape the communications themes that will explain how the measure addresses voters’ concerns... works with its clients to perfect ballot language and voter pamphlet arguments, using our empirical data to guide our advice.

A second example:

Public opinion research is critical to packaging a revenue measure for success. School districts can maximize the dollars that they raise through general obligation bonds, Proposition 39 bonds, and parcel taxes by collecting pertinent voter opinion data and using this information to solicit support. can help maximize your measure’s potential by providing accurate and reliable results...We provide both qualitative and quantitative research services in the following areas:

- Assessing baseline support for revenue measures
- Identifying the highest achievable tax threshold and total bond amounts
- Determining the arguments and features of the measure that will increase support
- Evaluating the need and content for a public information campaign
- Determining the best election in which to place the measure on the ballot
- Packaging a measure for success

A third example:

understands that the research can be the first step not only in determining the feasibility of a potential revenue measure, but also in bringing together the various stakeholders and constituencies that will need to be involved and supportive in order for any ballot measure to be successful. We know that the issues facing the District do not exist in a vacuum and must be put into the context of the current political and cultural environment in the District. The voter opinion survey presents the District with an opportunity to hear from the administration, teachers, staff, Board, and other community stakeholders about their priorities. Involving key stakeholders in the research design leads to confidence in the

research findings and helps ensure that the parties who are integral to a ballot measure's success are on board and on the same page.

Even items scheduled on board meeting agendas to hire the consultant and then to review the survey results create a positive news opportunity for bond measure proponents. At this early stage in the process, potential opponents usually have not emerged to present a different perspective. And a finding of measurable strong support portrays a bond measure as something already broadly supported by community, thus convincing undecided individuals and organizations that the bond measure is worthy of support and discouraging individuals and organizations that might be inclined to oppose it.

### **Public Resources Used to Win a Bond Measure**

A consulting firm for school bond measures has developed a "Finance Measure Checklist for Success" (see Tables 14 and 15) that outlines five steps for victory. A school district can fund and coordinate four of the five steps with public resources. Only the fifth and final step requires the district to "step away" from explicit political campaigning and pass primary responsibility to a separate political entity, such as a Political Action Committee.

By the time the "partisan campaign" begins, the community college district or K-12 school district has spent a year or longer obtaining polling data, alerting voters directly and through the news media to the need for school construction, and refining campaign themes and messages. A taxpayer-funded effort to pass it has been well underway, without a cent of money raised or spent by a campaign committee. Already the proponents have an advantage over any opposition to the bond measure.

### **Comparing the Election Campaigns of Supporters and Opponents**

There is an existing network of professional political consultants who are experienced in establishing a campaign committee, collecting corporate campaign contributions, and communicating with voters using an effective message developed from the results of the district's feasibility study. Political campaigning is a business, and fierce competition forces consulting firms to build and maintain a reputation for winning. Meanwhile, professional campaign vendors are ready to design, print, and mail campaign material. Endorsements can be quickly obtained from political, business, and community leaders. Participants in phone banks and precinct walkers can be recruited and even paid if a financial incentive is necessary.

In addition, potential district contractors are able to promote school bond measures through California's Coalition for Adequate School Housing (C.A.S.H.), whose membership "contains over 1,500 school districts, county offices and private sector

businesses, including architects, attorneys, consultants, construction managers, financial institutions, modular building manufacturers, contractors, developers, and others that are in the school facilities industry...C.A.S.H. has sponsored or supported over \$52 billion in statewide school bonds to build and/or modernize thousands of schools.”

Contrast this to the typical opposition to a bond measure. Often there aren't any formal opponents. Sometimes the opposition consists of a few individuals known in the community as gadflies or anti-tax or libertarian activists. Opposition can gain more credibility if there is an existing local community or taxpayer organization that provides a formal forum for fiscal critics to meet and strategize. That organization is almost always more effective if it employs full-time professional staff responsible to a board of directors.

In rare cases there is a well-funded opposition campaign backed by local business leaders and interest groups and run by professional political consultants. One example of this was opposition to Measure Z for the San Diego Unified School District in the November 2012 election.

Potential opponents must regularly monitor local news sources and the meeting agendas of local educational districts to know when an elected governing board is considering a bond measure and passes a resolution putting a bond measure on the ballot. Sometimes the board does this immediately before the legal deadline, thus providing very little time for opponents to respond before the election.

Concerned parties must meet to consider the bond measure and determine an appropriate position. Someone needs to know or obtain the various laws concerning the submission of an opposing argument in the ballot pamphlet, and someone needs to write the opposing argument and go through the process of getting group approval of the text. It needs to be submitted on time and in compliance with often-technical legal requirements. A few people in the organization must volunteer to write commentaries or letters to the editor of the local newspaper, and then follow through with the promise. Some people may chip in some money from their small businesses or personal savings to order some lawn signs, which have to be designed, approved, printed, and distributed.

Nonetheless, bond measures do fail almost 20% of the time despite the organizational and financial advantages of supporters. A 2003 report from the Public Policy Institute of California noted that big urban school districts in the San Francisco Bay Area and the Los Angeles area with high numbers of registered Democrat voters tended to propose more bond measures and win voter approval of those bond measures more often than smaller districts in rural areas, such as the Central Valley. This pattern appears to continue through 2014.

In some large urban school districts in California, especially in the San Francisco Bay Area, bond measures always win easily and opposition seems futile. As long as these districts don't propose bonds too frequently, they rarely have to worry about opposition.

### **Top Donors Are Current or Potential Contractors for Finance and Construction**

Generally, the public has poor access to records concerning the contributions to and expenditures of campaigns to pass bond measures. In some counties the campaign forms must be obtained in person and are provided as photocopies. Other counties have electronic databases that simply link to scanned documents. Trying to compile or analyze campaign finance patterns would be a tedious undertaking.

Nevertheless, compilations of contributors to four campaigns to pass five bond measures in November 2012 suggest that what is commonly assumed is accurate: these campaigns are mostly funded by companies likely to earn money from the proceeds of those bond sales.

### **Community College Foundations Entangled in Controversy**

A 2005 opinion of the California Attorney General (also referenced above in relation to bond underwriters and campaigns) determined that a community college district's auxiliary organizations (such as foundations and student body associations) are legally able to contribute their own privately raised funds to a political action committee established specifically to advocate voter approval of a bond measure. It is routine to see community college foundations contributing to bond campaigns. Like any 501(c)3 non-profit, college foundations are permitted to spend up to 20% of expenditures for influencing legislation, and that includes bond measures.

Controversy arose about this practice in 2004 after the Sierra College Foundation contributed about \$100,000 to three bond measure campaigns for the Sierra Community College District. Neither the Political Action Committees nor the Sierra College Foundation reported the contributions to the California Fair Political Practices Commission.

At least two board members alleged that the college president, who estimated making 40 presentations to groups of prospective donors, had tried to hide the identities of contributors to the bond measure campaigns (including architects and engineering firms) using the Foundation as an intermediary. These board members also believed that people interested in contributing to the bond campaign were advised to make their contributions to the Foundation instead of the bond measure campaign committee in order to benefit from a tax deduction. The Placer County Civil Grand Jury ended up concluding there wasn't any reliable evidence to support these accusations against the college president, but the

incident exposed some of the potential problems with college foundations acting as a intermediary to fund campaigns to pass bond measures.

### **Alleged “Pay-to-Play” by Some Bond Underwriters Gets Attention**

In the spring of 2012, there was a flurry of news media attention about some bond underwriters making contributions to campaigns for bond measures and subsequently making money through issuance fees as the underwriter for the bond sales. The news article that broke the story reported the following:

Leading financial firms over the past five years donated \$1.8 million to successful school bond measures in California, and in almost every instance, school district officials hired those same underwriters to sell the bonds for a profit, a *California Watch* review has found. The practice is especially pronounced in California, where underwriters gave 155 political contributions since 2007 to successful bond campaigns for school construction and repairs.

Under an amendment to Rule G-37, adopted in 2010, the Municipal Securities Rulemaking Board (MSRB) requires each broker, dealer or municipal securities dealer to send a form quarterly to the MSRB reporting their contributions to bond ballot campaigns if those contributions exceeded \$250. These contributions do not prohibit brokers from doing business with the entity proposing the bond measure, but the reporting requirements allow the public to identify these contributions as part of any effort to cross-reference them with contracts. Other rules prohibit brokers from doing business with entities if they have made campaign contributions to entity officials who make decisions related to selecting brokers for bond issues.

In 2009, the MSRB considered toughening Rule G-37 to prohibit brokers from doing business with government entities if those brokers contributed to campaigns to pass bond measures proposed by those government entities. California was cited as a particularly notorious location for the appearance of “pay-to-play” relationships. In the end, the MSRB declined to change the rule, citing constitutional First Amendment concerns.

*The Bond Buyer* reviewed broker contributions to 2010 campaigns to pass bond measures in California and identified “a nearly perfect correlation between broker-dealer contributions to California school bond efforts in 2010 and their underwriting subsequent bond sales.” A spokesperson for California State Treasurer Bill Lockyer responded to the review: “...it is probably time to end the days when underwriters, bond counsels or financial advisors fund, manage or provide other key support for local bond campaigns, then get paid to do work on the bond sales.” In 2013, the Los Angeles County Treasurer and Tax

Collector Mark Saladino adopted “a complete ban on cash and in-kind contributions from all firms in our underwriter pool starting no later than when we renew our pool for another year in January 2014.”

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## More Trouble with Bond Finance for Educational Construction

While compiling the comprehensive information provided in this study, California Policy Center researchers identified numerous other troubling aspects of bond finance. School and college districts are evading compliance with the law and making irresponsible decisions. Ordinary voters lack enough data to make an informed vote. Community activists who seek deeper understanding find themselves stymied.

### **Bad Government Behavior**

#### **1. Some School and College Districts Don’t Comply with Proposition 39**

Two examples of investigative reports on educational district compliance with Proposition 39 are the San Diego County Taxpayers Association 2015 School Bond Transparency Scorecard and a 2010 San Mateo County Civil Grand Jury report entitled “School Bond Citizens’ Oversight Committees, Prop 39.” These reports show some districts are close to

full compliance while others don't seem to be complying at all. It appears that two types of districts are broadly failing to comply: (1) small school districts, which may have limited capability to comply, and (2) large school districts routinely accused of fiscal irresponsibility and mismanagement.

## **2. Spend It Or Lose It? Districts Can Sell Bonds Decades After Voter Approval**

Some school and college districts ask voters to approve new authority to borrow additional money for facilities construction even though much of the authority from previous bond measures to borrow money has not been used. This is a strategy to circumvent tax and debt limits imposed by state law on individual bond measures, and it leaves millions (and sometimes billions) of dollars in borrowing authority dangling for future school boards to exercise long after voters have forgotten the election.

## **3. Districts Sell Bonds at a Premium and Use the Extra Money to Pay Fees Related to Selling the Bonds**

The California Attorney General's office is preparing a legal opinion (14-202) on whether school and college districts can use a premium to pay bond issuance fees. The question asked is "May the 'premium' generated from a school district bond sale be used to pay for expenses of issuance and other transaction costs?" (See Table 8 for a list of such fees.)

In 2011, the California Attorney General warned the Poway Unified School District that "artificially inflating the interest rate to generate premium" to pay for costs of issuance would be illegal.

The California State Treasurer or a state agency needs to compile a list of bond issues for which buyers paid a premium that the district then used to pay bond issuance fees. How rampant is the practice and how much has it cost California taxpayers?

## **4. Firms Get Contracts to Prepare a Bond Measure Before the Election and Then Get Contracts to Implement the Bond Measure After the Election**

The California Attorney General's office is preparing a legal opinion (13-304) on whether a party that gets a contract with a school or college district for surveying voters and preparing a bond measure can then get a contract as the bond underwriter (bond broker) for issuances approved by that same bond measure. The question asked is "In connection with a school or community college bond measure, does a district violate state law by contracting with a bond underwriter for both pre-election campaign services and post-election underwriting services?"

## **5. Is There Exaggeration, Deception, or Outright Fraud When Districts Assess Needs for Another Bond Measure?**

Some school and college districts seek to borrow more money for school construction even when their enrollment has been substantially declining for years and is projected to continue declining. Overcrowding would not seem to be a problem in such districts. Is the need legitimate?

A state agency should conduct random audits for several school or college districts to determine the credibility of their facilities plan based on their evaluations of safety, class size reduction and information technology needs. Numerous bond measures include the words “safety” and “security” in the ballot question and statement, insinuating to voters that students and teachers may be physically harmed unless the district can borrow money via bond sales for construction projects. Are there truly legitimate threats to safety and security in schools throughout the state?

## **6. A Handful of Voters in Future Development Areas Have Given School Districts Massive Authority to Sell Bonds and Put the Bills on Future Residents**

When researchers for the California Policy Center developed preliminary charts now in the appendix to this report and began circulating them publicly early in 2015, two bond measures received unexpected attention on the list of 1,147 considered since enactment of Proposition 39.

In both of these cases, a school district created the boundaries of a School Facilities Improvement District — carved out of the entire district — in a sparsely-populated where future development will occur and future schools will be built.

Apparently the Folsom-Cordova Unified School District compared this option to the establishment of a Community Facilities District funded by Mello-Roos fees and chose this financing option. Its Improvement District had a population in 2006 of about 330 persons.

### **Shortcomings That Hinder Voters**

The California legislature recognizes that some ballot statements for bond measures do not contain enough relevant information for voters. In 2014, Governor Brown signed into law Assembly Bill 2551, introduced by Assemblyman Scott Wilk, which requires each bond issue proposed by a local government to include estimates from official sources of tax rates for certain years, the maximum annual tax rate, and total debt service (the principal and interest that would be required to be repaid if all the bonds are issued and sold). The bill never received a vote in opposition. In 2015, Assemblyman Jay Obernolte introduced

Assembly Bill 809, which requires the ballot statement for local tax measures to include information on the amount of money to be raised annually and the rate and duration of the tax to be levied. As of July 13, 2015, the bill was moving through Senate committees after passing the Assembly 57-8 (with 15 not voting).

### **1. Ballot Questions and Statements Aren't Useful to the Ordinary Voter**

A 2009 Little Hoover Commission report on bond measures noticed the lack of “fundamental criteria for ballot measures” and recommended a “simple, easy-to-understand report card in the voter guide for all bond measures placed on the ballot.” The problem continues unabated today.

Bond measures tend to be presented to voters in a vacuum, with minimal context about the past history of the district's bond measures and construction programs. Voters can misinterpret proposed bond measures as a desperate response to a long-standing unaddressed crisis of unsafe, decrepit, and overcrowded classrooms, laboratories, and athletic facilities.

Voters need a chance to consider whether they should approve millions or even billions in new bond authority, even if millions or even billions of money has already been borrowed and millions or billions in existing authority still remains to be spent. This would reveal any history of foolish bond issues or debt acquisition.

### **2. Information Provided to Voters Needs More Pictures, Charts, and Tables**

As mentioned in Section 5 of this report, a possible reason why the public finally discovered the extreme Capital Appreciation Bond financing arrangements of the Poway Unified School District was the simple and colorful graphics in the *Voice of San Diego* articles about it. More than ever, American society depends on imagery, charts, and tables for information instead of prose.

### **3. Voters Need to See the Importance of Assessed Property Valuation and District Enrollment Projections**

Projections of the rate of change for assessed property valuation in the district should be among the most important elements in decisions concerning bond issues. Voters need to consider a history of wild swings in assessed property valuation in the district and decide whether projections are realistic or exaggerated.

A report on Capital Appreciation Bonds from the 2013-2014 Orange County Grand Jury recognized “there has been virtually no publicity concerning the implications of debt service repayment for CABs, specifically the magnitude of potentially higher taxes. There is

potential for some school districts, through the County, to increase property taxes well beyond what was presented when the bonds were issued in order to repay the CABs.” Results of the Grand Jury’s investigation were depicted in tables. At least three school districts in Orange County predicted assessed property valuation to grow at unrealistically high rates when they asked voters to approve bond measures. As a result, these districts will have to levy tax rates far beyond what was portrayed to voters in order to pay off the Capital Appreciation Bonds.

In addition, voters need to be aware if the school or college district asking to borrow money for construction is experiencing a long-term trend up or down in student enrollment. There are arguments for borrowing a lot of money for facilities construction during a time of dropping enrollment ([Wiseburn Unified School District is an example of this deliberate strategy](#)), but the message to voters needs to reflect actual circumstances.

#### **4. Ballot Questions for Bond Measures Deceive and Manipulate Voters**

Several ballot questions for proposed community college bond measures have specifically singled out veterans as beneficiaries. As noted in Section 2, polling shows that voters respond positively to the idea that a bond measure will help veterans. As a result, the possibility that veterans will be using facilities funded by bond proceeds gets prominent mention in ballot language.

On June 29, 2015, the Solano County Grand Jury issued a report highly critical of the ballot title and ballot statement for Measure Q, a November 2012 ballot measure that authorized the Solano Community College District to borrow \$348 million for construction by selling bonds to investors. The Grand Jury asserted that voters were duped into thinking that proceeds from selling bonds would directly provide classroom instruction and job training for veterans and other students. It suggested that future bond measures conform narrowly to Proposition 39 language and focus on construction of educational facilities:

##### *Finding 1*

The language of Measure Q was misleading. While Proposition 39 generally authorizes funding of buildings and land purchases even the name of the measure, “The Solano Community College District Student/Veterans’ Affordable Education Job Training, Classroom Repair Measure,” suggests otherwise.

##### *Recommendation 1*

Language used in future school bond proposals be limited to that which is stated in the authorizing statute.

References to veterans is an example of how campaign consultants have developed ballot titles, questions, and summaries that manipulate the emotions of uninformed voters who are looking at a ballot and deciding how to vote. Another example is the claim that “all funds stay local” or “all funds benefit neighborhood schools.” This statement ignores how taxpayers will pay the financial services industry for issuance fees and may end up providing more funds for interest payments to wealthy bond investors than for principal spent on design and construction of neighborhood schools.

These clever campaign tactics would probably withstand legal challenges based on California Elections Code Section 9509, which establishes a standard for a legitimate challenge to a title, question, or statement of a school or college district ballot measure. A complaint must have “clear and convincing proof that the material in question is false, misleading, or inconsistent” with state law.

### **Grassroots Activism on Bond Measures Is Difficult**

#### **1. Municipal Finance Is Confusing, Even for People Motivated to Understand It**

As stated in a 2013-14 Orange County Civil Grand Jury report on Capital Appreciation Bonds, “This topic required extensive research. Numerous newspaper articles were reviewed...An extensive Internet search was conducted to learn about the mechanics of bond financing and the related mathematics.” An ordinary person may have difficulty understanding concepts and jargon of municipal finance. It’s also a challenge for anyone without education or experience in accounting to identify and extract relevant information from financial audits and official statements.

In particular, Capital Appreciation Bonds are difficult to comprehend. To complicate matters, accreted interest for this type of debt instrument is portrayed differently depending on whether accounting is done on a “cash basis” or on an “accrual basis.” In the generally accepted accounting principles developed by the Financial Accounting Standards Board, each year’s interest payment is included as an expenditure for the year. This is accounting done on a cash basis. But in the generally accepted accounting standards for state and local governments developed by the Governmental Accounting Standards Board, accreted interest on Capital Appreciation Bonds is not recorded as a current expenditure until the bond matures. This is accounting done on an accrual basis.

Translating these concepts into something easy to understand is critical for the public to evaluate the wisdom of proposed bond issues.

#### **2. Centralized Data Isn’t Available to Compare Debt Finance Conditions of School and College Districts**

Where does the public go to find out how a school or college district funds facility construction and how it compares to other educational districts in the county or state?

In most cases, state law has not assigned any state or local agency with the responsibility to collect such information and provide it to the public in an accessible format. Even for information that state law requires to be collected and published — such as waivers from tax and debt limits — agencies are not providing the information in a way that alerts the public to existing or potential problems.

The California State Treasurer’s office has a “California Debt Issuance Database” administered by the California Debt and Investment Advisory Commission that allows the public to search for certain information about individual bond issues. School boards are required to submit certain information and reports regarding the sale or planned sale of bonds to the California Debt and Investment Advisory Commission. This database is better than nothing, but realistically it is not a useful tool for the ordinary citizen.

### **3. Basic Financial Information Is Inaccessible, Especially at Smaller School Districts**

Many school districts are not posting their state-mandated financial reports on their websites for public access. Useful documents that the public should be able to readily access include PDF versions of annual financial audits and bond program audits.

For cases in which financial reports are not available on the web, adequate response to public records requests is often elusive. E-mailed requests to educational districts to get these reports do not always result in a prompt response. In particular, officials in small rural school districts do not seem responsive to an outside individual or organization requesting the district’s financial information. Researchers for this project struggled to obtain financial audits that would reveal details of Capital Appreciation Bond sales with ratios of debt service to principal that are much worse than the Poway Unified School District.

### **4. “Private Placements” Sometimes Eliminate Official Statements as a Source of Data**

The Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) database was created and is maintained for the benefit of potential buyers of municipal bonds. Nevertheless, the Official Statements posted on the database are a valuable source of information for members of the general public who are interested in the debt finance and financial status of a state or local government agency.

Some school districts use “private placement” to sell bonds rather than using a more traditional method of selling bonds in the primary market to many investors. This is

supposed to allow for lower interest rates on the bonds and save money for taxpayers. Because the individual private investors are considered qualified to do their own research into the credit and financial status of a district, “private placements” for bond sales by educational districts are exempt from the federal requirement to post Official Statements.

Researchers were unable to determine current debt service for several small school districts for which Official Statements were not posted on EMMA. At least two of them (Exeter Union High School District and Columbia Union School District) used private placements for their most recent bond sales. It is likely that every school district missing an Official Statement on EMMA for its most recent bond issue used private placement.

## **5. Public Information About General Obligation Bonds Varies in Formats and Completeness**

In the annual Financial Audits for educational districts, information about general obligation bonds are presented in different ways. Some reports give details about each series of bonds that are issued, while some do not.

The same problem applies to the Official Statements on the EMMA database. Charts that indicate outstanding debt service are presented in different formats. Some charts provide details about principal and interest for each bond measure and some do not. A few Official Statements for educational districts that have substantial bond debt did not even add up the columns.

Official Statements are only produced when bonds are issued, so the most recent information available on the EMMA database can be more than a decade out of date. EMMA only became operational in the late 2000s, so information from the mid-1990s and earlier is often not available.

## **6. Refunding Bonds and Reauthorization Bonds Complicate Matters**

When a school district refunds some of its bonds with a new bond issue, the record becomes fuzzy about how much principal is still owed for each bond measure and bond issue. Some districts have repeatedly issued refunding bonds, thus creating confusion about what bond measures are responsible for creating current debt. Taxpayers in some educational districts are still paying for bond measures approved in the late 1980s and early 1990s, but that fact is now hidden behind more recent refunded bond issues.

Since 2000, sixteen school districts have asked voters to reauthorize previously-approved bond authority, thus complicating the reporting of bond authority and bond debt. When voters reauthorize bond authority in a new election, they trigger new capacity for the

district to levy taxes and accumulate debt. GO Reauthorization Bonds®, developed by the municipal debt financial advisory firm Dale Scott & Company, are marketed to districts that have reached their tax and debt limits, want to borrow more money for construction, but also want to avoid extensive sales of Capital Appreciation Bonds as the scheme to circumvent the tax and debt limits.

## **7. Critical Information Often Can Only Be Found in Old Board Meeting Packets Not Available for Easy Public Access**

Perhaps the most important information to evaluate when considering bond issues are the projections of assessed valuation. If such projections are even recorded, they are often only found in presentations that financial advisors make to the board of trustees. Those presentations might or might not be included in old board meeting packets that might or might not be posted on a district website.

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### Improving Oversight, Accountability, and Fiscal Responsibility

To help fix the many deficiencies identified in this report concerning school construction finance, the California legislature and the executive branch are urged to adopt 23 specific recommendations organized into these five goals:

Adoption of these 23 recommendations will help California voters to become more wary of borrowing billions more from wealthy investors for educational construction. Future generations will benefit when these five visions are advanced:

The introduction to a 2009 California Little Hoover Commission report entitled *Bond Spending: Expanding and Enhancing Oversight* claimed that government “must earn Californians’ confidence by demonstrating that it is providing oversight and accountability for the dollars put in their trust and delivering the promised value once a project is completed. Such confidence will be critical to the success of any future bond proposals.”

This warning was not heeded and the prediction was wrong. Oversight and accountability has not measurably improved, but Californians continue to vote for state and local bond measures.

The California Policy Center rejects the idea that additional oversight and accountability isn’t needed or desirable. Some legislative reforms and education programs (both public and private) can overcome voter cynicism, frustration, apathy, and ignorance. The following charts provide 23 recommendations for adoption by the California legislature, California executive branch agencies, and California local officials such as county treasurers.

Guide to all Tables and Appendices - Comprehensive Reference for Researchers