



AGENDA REPORT

Meeting Date: July 16, 2013
Item Number: E-1
To: Honorable Mayor & City Council
From: Mahdi Aluzri, Assistant City Manager
Subject: A RESOLUTION OF THE COUNCIL OF THE CITY OF BEVERLY HILLS STATING THE CITY'S POSITION CONCERNING THE ACCELERATION OF ISSUANCE OF ADDITIONAL MEASURE E BONDS BY THE BEVERLY HILLS UNIFIED SCHOOL DISTRICT

Attachments:

1. Resolution
2. Overview of AB 182 (Buchanan) and Related Articles from Shaw/Yoder/Antwih
3. Letter to the School District dated July 11, 2013
4. City Attorney Memo dated July 12, 2013

RECOMMENDATION

Adoption of the resolution is recommended if the City Council agrees with the position stated in the resolution.

INTRODUCTION

After discussion of this item at its July 2, 2103 meeting the City Council requested that a resolution be brought forth for consideration. The resolution was requested in response to concerns expressed by the City Council and members of the public over the change to tax rates which was considered and approved by the Beverly Hills Unified School District (BHUSD) Board in order to pay for the anticipated issuance of additional Measure E bonds.

The Board, at its meeting on June 25, 2013, adopted a resolution asking the County to increase the tax rates to facilitate the sale of up to \$95m of Measure E bonds for 2013-2014. At the same time, the Board directed its staff to place a new replacement bond measure on the ballot in November or March 2014.

DISCUSSION

Concerns over the Board's decision to accelerate the issuance of Measure E bonds and increase the taxes rates were raised by members of the public at the June 18, 2013 City Council meeting. At the request of the Mayor the item was placed on the July 2, 2013 Study Session agenda and the City Council discussed the Board decision as well as the analysis by the City Attorney's Office of the City's ability to itself place a measure on the ballot to formally address these concerns. As previously stated the City may place an advisory measure on the ballot but has no jurisdiction over the School District's ability to advance and implement a bond measure. There were several questions raised by members of the Council related to the Board's decision and whether the decision can be reversed and what that might result in terms of the County's process to carry out the original request to raise the tax rates. The attached list of questions was prepared and forwarded to the office of the School Superintendent as was suggested in the meeting.

As stated in the attached resolution, Measure E was passed by the voters in 2008 and it authorized the issuance of up to \$334m in bonds intended for upgrades of school facilities to provide a safe, secure and technologically updated environment for the students. When the measure was passed anticipated tax rates were projected to be close to \$50 per \$100,000 of assessed value.

The Board at its June 25, 2013 meeting requested that the County Board of Supervisors adjust the tax rates for FY13-14 and increase it to facilitate the issuance of up to \$95m in Measure E bonds. This rate would be in addition to the tax rates currently being assessed to pay bonds issued under Measures K and S.

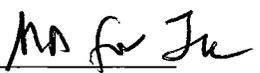
The attached resolution states that the City Council does not support the Board's decision to accelerate the issuance of the bonds without voter approval. The resolution also urges the Board to rescind its request for adjusting the tax rate until such time as the voters decide on a replacement bond measure anticipated to be placed on the ballot in November 2013 or March 2104.

In addition, the City Council requested an update on the proposed bill (AB 182) currently being considered by the state legislature to impose limitations on the School Districts' ability to issue and finance Capital Appreciation Bonds. The attached memo provided by the City's State lobbyist, Andrew K. Antwih gives an update on the status of the bill.

Finally, the City Council requested that the City Attorney's Office provide a memorandum explaining the potential options available to the City and residents who wish to challenge the School Board's decision. That memorandum is also attached.

FISCAL IMPACT

No fiscal impacts are anticipated.

Jeffrey Kolin 
Approved By

Attachment 1

A RESOLUTION OF THE COUNCIL OF THE CITY OF BEVERLY HILLS
STATING THE CITY'S POSITION CONCERNING THE
ACCELERATION OF ISSUANCE OF ADDITIONAL MEASURE E BONDS
BY THE BEVELRY HILLS UNIFIED SCHOOL DISTRICT

RECITALS

WHEREAS, in November 2008, voters in the Beverly Hills Unified School District (the "School District") approved Measure E, which authorized the School District to issue up to "\$334 million in bonds at legal interest rates subject to mandatory audits, independent citizens' oversight without an estimated increase in tax rates".

WHEREAS, in 2009, the School District issued its first series of bonds under the Measure E authorization in the amount of \$72,044,664, leaving \$261,955,336 authorized but unissued.

WHEREAS, subject to a future vote of the Board of Education of the School District (the "Board"), the School District intends to issue a second series of Measure E bonds during fiscal year 2013-14 in an estimated amount of up to \$95 million.

WHEREAS, at its recent June 25, 2013 meeting, the Board adopted a resolution requesting the County to adopt a tax rate sufficient to pay the debt service on up to \$95 million additional Measure E bonds expected to be issued in Fiscal Year 2013-14.

WHEREAS, the tax rate is expected to increase in order to pay the additional Measure E bonds. This rate is in addition to the tax rates currently assessed for Measure K and Measure S indebtedness.

WHEREAS, the School District Board directed staff to place a new bond measure on the ballot to replace the Measure E authorization in the upcoming November or March elections.

WHEREAS, the City Council desires to state the City of Beverly Hills' position regarding the acceleration of the issuance of additional Measure E Bonds which would have the effect of increasing property tax rates.

NOW THEREFORE, the City Council of the City of Beverly Hills hereby finds, determines and resolves as follows:

Section 1. The City Council declares that the City Council does not support the acceleration of the issuance of additional Measure E bonds which would have the effect of increasing property tax rates until such time as the voters approve such acceleration through an advisory election or otherwise authorize the issuance of additional or replacement bonds. The City Council further urges the Board to rescind their direction to the County Board of Supervisors to adjust the tax rates for 2013-2014 until such time as the voters approve the upcoming new bond measure.

Section 2. The City Clerk shall certify to the adoption of this Resolution and shall cause this Resolution and his certification to be entered in the Book of Resolutions of the Council of the City.

Adopted:

JOHN A. MIRISCH
Mayor of the City of
Beverly Hills, California

ATTEST:

_____ (SEAL)
BYRON POPE
City Clerk

Attachment 2



SHAW/YODER/ANTWIH, inc.
LEGISLATIVE ADVOCACY • ASSOCIATION MANAGEMENT

To: Cheryl Friedling,
Deputy City Manager
City of Beverly Hills

From: Andrew K. Antwih, Partner,
Chris Castrillo, Legislative Assistant
Shaw / Yoder / Antwih, Inc.

Re: Overview of AB 182 (Buchanan) – Bonds: school districts and community college districts

Synopsis:

AB 182 establishes restrictions on the use of capital appreciation bonds (CABs) and requires the governing boards of local school districts and community college districts to obtain specific, detailed information about financing and interest impacts regarding the issuance of CABs.

Background:

School districts and California Community College Districts have authority to issue local education bonds for the construction and modernization of school and higher education facilities. Once voters approve the bonds, school districts and local community college districts can issue the bonds, paid for by a tax levy. In 2000, voters passed Proposition 39, which lowered the threshold of local bond approvals to 55%. Current law also establishes a limit on the amount of tax that can be assessed against local property for a Proposition 39 bond: \$30 per \$100,000 of assessed property value for an elementary or high school district, \$60 per \$100,000 of assessed property value for a unified school district, and \$25 per \$100,000 of assessed property value for community college districts.

Under a traditional bond, a current interest bond (CIB), the issuer pays principal and interest from the outset, similar to traditional home mortgage payments. Under a CAB, principal and interest payments are delayed, sometimes for decades. The issuer is banking on substantial increases in property values in two to four decades. The price for the delayed payments can be huge. For example, in the Central Valley, a school district that issued a \$6.5 million bond will ultimately pay \$97 million in principal and interest – 10 times the amount borrowed – while a California Community College District that issued a \$350,000 bond will pay \$5.8 million – 16 times the amount borrowed.

Over the last several years, due to the downturn in the housing market, and consequently low assessed property valuations, school districts and California Community College Districts have resorted to the use of CABs to generate adequate bond dollars.

Specific provisions:

AB 182 would require the following:

- The ratio of total debt service to principal for each school bond series to not exceed 4 to 1.
- Each Capital Appreciation Bonds (CABs) maturing more than 10 years after its date of issuance to be subject to redemption before its fixed maturity rate, beginning no later than the 10th anniversary of the date the capital appreciation bond was issued.
- Interest rates for CABs would be capped at 8%, issuance costs at 2% and would carry a maximum discount rate of 5%. CABs would be restricted to a term of 25 years.
- Amend the Government Code to cap, at 30 years, down from 40, the term of any bond issued by a school or community college district.
- This bill would also alter the information required, prior to the sale authorization of a CAB, to include:
 - An analysis of overall costs of the CAB
 - A comparison of costs to Current Interest Bonds (CIBs)
 - A statement on why the CAB is being recommended
 - Disclosure of the financing term, maturity time, repayment ratios and the estimated change in assessed valuation of local property.

AB 182 recently passed the Senate Governance and Finance committee on a 7-0 vote on July 2nd. It has received no "No" votes in its prior committees and on the Assembly Floor. The bill will now head to the Senate Floor for a vote.

According to most recent bill analysis, the author argues that because CAB's allow higher levels of borrowing by deferring payment of principal and interest for up to 40 years, much higher interest costs are incurred than more traditional Current Interest Bonds (CIBs). In some cases, debts to principal ratios of CABs have been over 15-1. The author believes that the using the CAB mechanism is risky, stating that there is no guarantee that the projected assessed valuations will be realized and that the tax payers living in the districts may have to "foot the bill" 20-40 years down the road.

The analysis states that the author "does not want to prohibit CABs, but establish parameters for the issuances of bonds to ensure that the costs of bonds are not excessive." By limiting the terms of CABs to 25 years and CIBs to a maximum of 30 years, along with the framework for maximum debt service ratios, the author believes that this will lower the overall costs of issuing bonds.

Those in opposition raise a couple of different arguments. There is an issue of local control at play here and opponents argue that this bill limits a local authority's discretion with respect to what's best for their schools and communities when it comes to bond issuance.

Others argue that the provisions from AB 182 are simply too restrictive. The bill analysis highlights a few specific concerns:

- The 4-1 debt ratio applies to the individual series of bonds sold, not the "total authorization." Critics argue that this restriction prevents them issuing a bond series that is sufficient to meet their needs. Application to the "total authorization" would give districts greater flexibility in meeting this requirement.

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Sacramento, CA 95814

- Critics believe that the reduction to 30 years from 40 years with respect to CIBs is unwarranted, since they don't lead to higher debt costs that CABs may incur.
- Capping the interest rates and setting the 4-1 interest rate ratio. Opponents argue that interest rates are currently low and stand to rise, which could mean districts are unable to meet the ratio requirements should interest rates rise in the future. They would like to see a mechanism that adjusts for this.
- There are also cost concerns associated with the new information required prior to authorizing the sale of CABs.

This bill was recently amended on July 1st to require that the information required to be disclosed prior to the bond sale authorization to be publicly noticed on at least two executive meetings; first as an information item and second as an action item.

The amendments also clarify, within the Government Code, that the number of years the whole or any part of the general obligation bond issued by a school or community college district shall not exceed 30 years and that any school or community college district that intends to issue a capital appreciation bond must comply with the provisions of the education code altered by this bill.

The amendment also states that "a school district or community college district that intends to issue a capital appreciation bond pursuant to its authority to issue bonds or refunding bonds by resolution to conform to the capital appreciation bond issuance to certain requirements otherwise applicable to bond issued by a school district or community district pursuant to an election. "

(Attachments)

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Assembly Bill 182 – Capital Appreciation Bonds

Assemblymember Joan Buchanan and Senator Ben Hueso

LEGISLATIVE INTENT

AB 182 establishes restrictions on the use of capital appreciation bonds (CABs) and requires local governing boards to be provided specified information regarding the issuance of CABs.

PROBLEM

According to the California Debt and Investment Advisory Commission, almost 500 general obligation CABs have been issued since 2007, the majority of which were by K-12 school districts (85.5%), with California Community College Districts a distant second (12.7%). The terms of CABs are commonly up to 40 years and can cost more than ten times the amount borrowed, putting a financial burden on tax payers and school districts for years to come.

BACKGROUND

School districts and California Community College Districts have authority to issue local education bonds for the construction and modernization of school and higher education facilities. Once voters approve the bonds, school districts and California Community College Districts can issue the bonds, paid for by a tax levy. In 2000, voters passed Proposition 39, which lowered the threshold of local bond approvals to 55%. A limitation on the amount of tax that can be assessed for a Proposition 39 bond was also passed by the Legislature that year as follows: \$30 per \$100,000 of assessed property value for an elementary or high school district, \$60 per \$100,000 of assessed property value for a unified school district, and \$25 per \$100,000 of assessed property value.

Over the last several years, due to the downturn in the housing market, and consequently low assessed property valuations, school districts and California Community College Districts have resorted to the use of CABs to generate adequate bond dollars.

Under a traditional bond, a current interest bond (CIB), the issuer pays principal and interest from the outset, similar to traditional home mortgage payments. Under a CAB, principal and interest payments are delayed, sometimes for decades. The issuer is banking on substantial increases in property values in two to four decades. The price for the delayed payments is huge. For example, in the Central Valley, a school district that issued a \$6.5 million bond will ultimately pay \$97 million in principal and interest – 10 times the amount borrowed – while a California Community College District that issued a \$350,000 bond will pay \$5.8 million – 16 times the amount borrowed.

In order to attract investors, the majority of the CABs do not allow the CABs to be refinanced. A school district or California Community College District is forced to keep the structure of the CAB until it is paid.

Using this mechanism is risky. There is no guarantee that the projected assessed valuations will be realized. Tax payers living in those districts 20 to 40 years later will have the burden of paying the debt.

The term of a bond issuance should be aligned with the life cycle of the structure. Buildings require rehabilitation at about 25 years. Under the state education bond program, school districts are eligible for modernization funds when buildings are 25 years old. Before issuing more bonds for modernization purposes, it is fiscally prudent to first pay off the bond that constructed the building before issuing more bonds to modernize the building.

AB 182 does not prohibit CABs. Rather, the bill establishes limitations on bond issuances to ensure that tax payers and districts are not saddled with future large payments.

BILL SUMMARY

- Limits the terms of CABs to 25 years and reduces the terms of CIBs issued under the Government Code from 40 to 30 years, beginning January 1, 2019.
- Prohibits the ratio of the total debt service (principal and interest) to principal for each bond series from exceeding four to one under the Education Code.
- Requires a CAB with a term longer than 10 years to have a refinancing mechanism beginning no later than the tenth year from the date the bond was issued, at the discretion of the issuer.
- Requires a local governing board agenda to indicate that a CAB is proposed, and requires the governing board to first hold an informational hearing prior to taking action to approve a CAB at a subsequent meeting.
- Requires specified information to be provided to governing boards regarding proposed CABs:
 - An analysis of the overall cost of the CAB, including the term of the financing, the time of maturity, the repayment ratio, and the projected change in assessed valuations.
 - A comparison of the CAB to the overall cost of a CIB.
 - The reason a CAB is recommended.
 - A copy of the disclosure regarding the role of underwriters as required by the regulatory agency overseeing underwriters and financial advisors.

SUPPORT

- Bill Lockyer, California State Treasurer
- California Association of County Treasurers and Tax Collectors

- California League of Bond Oversight Committees
- California Taxpayers Association
- Contra Costa County Board of Supervisors
- Dan McAllister, San Diego County Treasurer-Tax Collector
- Howard Jarvis Taxpayers Association
- Humboldt County Board of Supervisors
- Humboldt Taxpayer's League
- Mark Luce, Napa County Board of Supervisors
- Sierra County Board of Supervisors
- Siskiyou County Board of Supervisors

OPPOSITION (BASED ON PRIOR VERSIONS OF BILL)

- Association of California School Administrators (Oppose unless amended)
- Beverly Hills Unified School District
- California Association of School Business Officials (Oppose unless amended)
- California School Boards Association (Oppose unless amended)
- Coalition for Adequate School Housing (Oppose unless amended)
- Community College League of California (Oppose unless amended)
- Fresno Unified School District (Oppose unless amended)
- Oceanside Unified School District (Oppose unless amended)
- Riverside County Superintendent of Schools (Oppose unless amended)
- San Diego Unified School District (Oppose unless amended)
- Small School Districts' Association (Oppose unless amended)

STATUS

- Will be amended in August

FOR MORE INFORMATION

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Lourdes Jimenez (Senator Hueso's office)
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Risky bonds tie schools to huge debt

About 200 districts in California may have to pay as much as 10 to 20 times the amount borrowed.

November 29, 2012 | Dan Weikel

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

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

For The Record

Los Angeles Times Wednesday, December 05, 2012 Home Edition Main News Part A Page 4 News Desk 2 inches; 73 words Type of Material: Correction

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In Los Angeles County, 29 districts have issued \$556 million in long-term CABs with repayment obligations totaling \$2.3 billion. Pay-back ratios range from \$2.40 for every dollar borrowed in the El Camino Community College District near Torrance to \$9.20 per dollar borrowed in the Westside Union School District in the Antelope Valley.

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

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

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

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

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

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

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

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

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

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

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

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dan.weikel@latimes.com

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

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(BEGIN TEXT OF INFOBOX)

BOND REPAYMENT

Two hundred school and community college districts throughout California have issued long-term capital appreciation bonds, many of them with high repayment rates. Here is a sample:

-- District Bonds issued Maturity date Principal and interest paid Westside Union School \$11.5 million 2050 \$106.1 District in Los Angeles County \$9.20 for every \$1 borrowed San Bernardino \$56.5 million 2048 \$492.5 Community College million or District \$8.72 for every \$1 borrowed San Diego \$88.8 million 2047 \$630.4 UnifiedSchool million or District \$7.09 for every \$1 borrowed Oceanside Unified \$30 million 2049 \$279.7 School District in million or San Diego County \$9.32 for every \$1 borrowed *--*

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Source: California treasurer's office



California treasurer, schools chief urge moratorium on CABs

Thu, Jan 17 2013

SAN FRANCISCO, Jan 17 (Reuters) - California's treasurer and schools chief asked local school officials on Thursday to avoid issuing capital appreciation bonds, which have prompted concerns after one school district took on nearly \$1 billion in debt for a \$105 million initial loan.

State Treasurer Bill Lockyer and State Superintendent of Public Instruction Tom Torlakson urged school district officials to stop issuing the bonds until reform legislation is fully considered.

"In too many cases, CAB deals have forced taxpayers to pay more than 10 times the principal to retire the bonds," they said in a letter.

CABs, which have been popular with school districts in states with fast-growing student enrollments, defer payments while interest compounds, swelling payments when they start.

"Also, the transactions have been structured with 40-year terms that delay interest and principal payments for decades, resulting in huge balloon payments and burdens on future taxpayers that cannot be justified," the letter said.

GOVERNOR ALSO WANTS REFORM

California officials grew concerned about capital appreciation bonds last year due to controversy hanging over the Poway Unified School District. It faces a bill of \$981 million for capital appreciation bonds it sold in 2011.

The San Diego-region school district will pay off the debt from 2033 through 2051. The bonds cannot be repaid sooner.

Poway district officials have defended issuing the debt, but its terms and cost stunned Republican state lawmakers from the San Diego area and concern Lockyer and Torlakson, both Democrats.

Governor Jerry Brown, a Democrat, also is keen on the matter.

"The governor has told us he wants reforms. Key lawmakers and legislative leaders have made clear they agree statutory changes are needed," the letter said.

Nearly \$92.8 billion of the debt has been issued since 1980, and a large amount of it remains unpaid. Around a third of the outstanding volume is on the books of issuers in California, according to Thomson Reuters data.

Capital appreciation bonds have also been popular in Texas and Illinois.

<http://www.reuters.com/assets/print?aid=USL1E9CHG7D20130117>

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THE BOND BUYER

Thursday, April 18, 2013 | as of 2:14 PM ET

Lawsuit Says FA 'Duped' School District into Overpaying

by: [Randall Jensen](#)

Tuesday, April 16, 2013

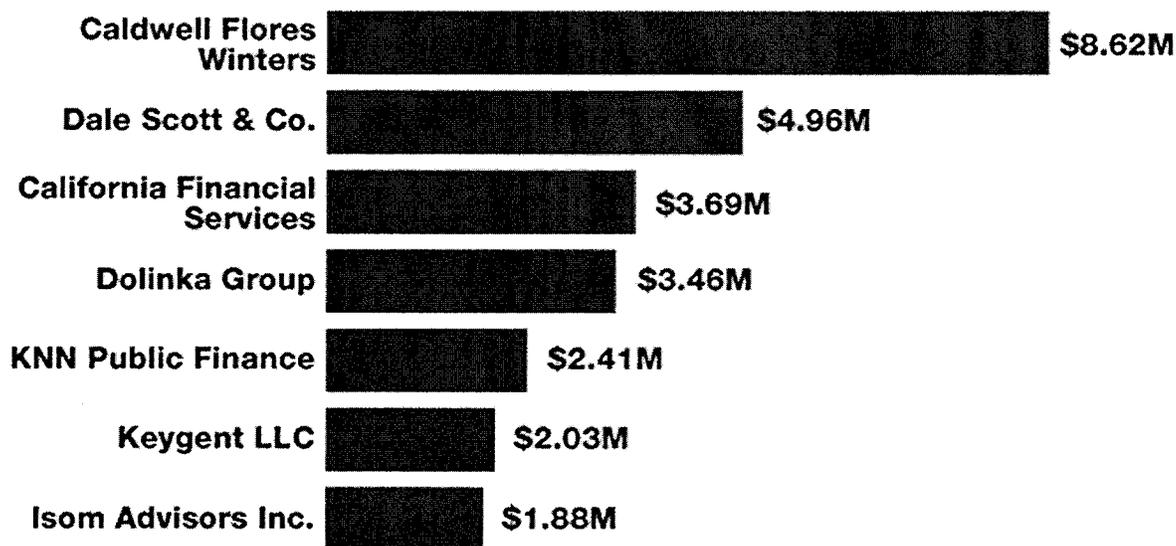
SAN FRANCISCO — A small California school district said its financial advisor "duped" it into overpaying hundreds of thousands of dollars for services in a lawsuit that is playing out amid controversy in the state over school bond election and borrowing practices.

Advisory firm Caldwell Flores Winters, Inc. sued Willits Unified School District for breach of contract, resulting in a counter-complaint from the Mendocino County district with 1,800 students.

Critics say the legal dispute has uncovered questionable, if not illegal, practices.

Questionable Practices

Fees in school bond sales with capital appreciation bonds: 2007-Nov., 2012



Source: California Debt and Investment Advisory Commission

"To me it is just outrageous, forget about fiduciary duties, that any advisor would ask to be compensated in this manner," said Timothy Schaefer, owner of Magis Advisors, an independent municipal financial adviser in Newport Beach, Calif. "I am struggling to find words because it is so over the top."

In April 2012, Caldwell Flores Winters sued Willits Unified for failing to pay the financial advisor \$278,961.

The district in December filed a cross-complaint against CFW that alleged violation of state conflict of interest laws, the state political reform act and breach of fiduciary duty.

Willits Board of Trustees members said they felt "duped" by CFW as the district teetered on insolvency, according to meeting minutes.

Neither school district officials nor their lawyer returned calls for comment.

The advisory firm convinced district officials to seek a bond authorization well beyond what the district would legally be able to issue because the larger figure would generate more fees for Caldwell Flores Winters, the district argues in its lawsuit.

CFW was hired in 2009 to advise the school district on the bond program that led to the issuance of four series of bonds totaling \$18.87 million in July 2010, which will cost \$38.6 million in debt service. The sale included \$3.78 million of capital appreciation bonds that will cost \$21.9 million at maturity, the official statement said.

That series also included a \$4.97 million bond anticipation note with 5% interest due July 2014, which the district has been scrambling to figure out how to pay. It has considered further borrowing to pay off the debt.

Willits alleges in the suit that CFW recommended the highest amount of bond authorization for which to ask district voters out of four options, with the lowest being \$28 million.

This, Willits Unified argues, represented a conflict of interest because CFW influenced a decision that directly affected its compensation, which is generally banned by state law. The contract also represented a breach of fiduciary duty.

The district's complaint said CFW initially assumed a \$29 tax rate per \$100,000 of assessed valuation in the district, which would have supported \$23 million of bonding. Even though it was aware that assessed values had dropped in the district after the election, CFW charged Willits a 2.5% fee for the \$43 million capital program it advised the district to adopt even though only \$18 million was available to fund school construction, according to the cross-complaint.

That fee — \$1.075 million — was due in 36 monthly installments after the bond election passed. CFW sued after Willits cancelled the contract, seeking six months of payments plus a \$108,993 cancellation fee for a total of \$278,961, according to CFW's complaint.

Neither CFW nor its lawyers returned calls for comment.

Even if the district eventually can issue the full \$43 million authorization for its construction projects, it would be long after the contract with CFW would have expired, the district argued.

The fee for advising on the capital program was based on a \$43 million program that was impossible to achieve, the district argues in its cross-complaint, the district is not obligated to pay the full sum. "CFW knew it could perform program implementation services for only approximately \$18 million of the bond projects during the five year term of the contract," the cross-complaint said.

CFW was paid more than \$200,000 for financial advisory services and another \$185,000 for the implementation of bond projects, the district said.

CFW was also paid \$15,000 for conducting voter surveys.

The complaint also alleged that CFW did not advise that the district needed to hold competitive process to select CFW to provide construction management project services.

"CFW performed acts herein alleged with the intent to deceive the district so as to engage in self-dealing and to generate extraordinary and unwarranted fees," the district's lawyer, William Ayres, said in its complaint.

Mendocino County Superintendent of Schools Paul Tichinin, who has advised the Willits district on its troubled finances, said in a phone interview that Willits has suffered from declining assessed valuations, lower property values and a terrible economy.

Tichinin said the district is trying to find ways to pay for bond anticipation notes that are due next year amid falling tax revenues.

"The fiscal status of the district is independent from the bonds other than causing worry and concern," Tichinin said.

In March, the Willits district was one of 117 in the state to receive a "qualified certification" from the California Department of Education meaning that based upon current projections, the district is in danger of failing to meet its financial obligations in the next three fiscal years. An additional seven districts received the more serious "negative certification."

California Treasurer Bill Lockyer's office said he is troubled because CFW had a financial interest in recommending the highest bond authorization.

"If that doesn't violate conflict of interest laws, it should," said Tom Dresslar, Lockyer's spokesman. "This is the kind of stuff that is giving school bond finance a bad name."

Lockyer has been trying to limit schools' ability to issue capital appreciation bonds, arguing that they cost taxpayers too much for too long.

According to the treasurer, from 2007 to November 2012, CFW made far more money from California school bond sales that included capital appreciation bonds than any other financial advisor firm.

Dresslar also pointed out that it was questionable that the district paid CFW \$15,000 for pre-election voter surveys.

Lockyer sent letters in March to Attorney General Kamala Harris asking her to give an opinion on the roles of underwriters, financial advisors and bond counsels in school bond elections.

The SEC's office of compliance inspections and examinations is also conducting an investigation that may be looking at the involvement of some muni advisors in bond ballot campaigns that could violate the fiduciary duty standard and fair-dealing rule.

Caldwell Flores Winters was also paid thousands of dollars as a campaign consultant by the election committee in support of the \$43 million of bond authorization. The committee also received donations from the underwriter on the bond sale, Stone & Youngberg, and the bond counsel Jones Hall, according to county election filings.

CFW also negotiated the bond sale fees with the underwriter, as outlined in the contract included in court documents.

Last year The Bond Buyer reported some advisors were helping California school districts by serving as consultants to bond ballot campaigns, and then as financial advisors on the bond deals approved by voters.

State Assemblyman Don Wagner, R-Irvine, has proposed legislation that would prohibit a local agency from working with an individual or firm on any bond deal if they provide services to the bond election campaign.

Similar bills have been put forward and failed in the last few years. Wagner said he hopes the new attention on the subject will help get more support this year. Maybe this is the year.



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http://www.bondbuyer.com/issues/122_73/lawsuit-says-fa-duped-school-district-into-overpaying-1050712-1.html

Lawmakers to end excessive bond practice

By [Michael Gardner \(/staff/michael-gardner/\)](#) noon July 6, 2013 Updated 10:16 a.m. July 8, 2013

SACRAMENTO — California lawmakers are on the verge of passing sweeping legislation to rein in school districts that raise money for construction projects by using an expensive and once-obscure financing tool.

These loans obtained through what are called capital appreciation bonds, brought to light in Poway last summer, promise no payments for decades but later hit taxpayers with high-interest balloon payments that can wind up costing as much as 10 times the original principal, if not more.

“The poster child” is the Poway Unified School District, says Assemblywoman Joan Buchanan, D-Alamo, who is carrying the measure.

Poway has a bond contract that will force property owners to eventually pay nearly \$1 billion in return for \$105 million worth of construction.

Poway is not alone. For example, San Diego Unified, which opposes the bill, in 2010 issued \$88.9 million in bonds that will cost taxpayers \$630.4 million by the 2047 maturity date. There is no prepayment option. And San Ysidro School District in 2011 issued \$15.6 million with a total cost of \$228.9 million in 2050. But the district can pay it off in 2023.

Across San Diego County, schools and community colleges have signed 20 bond deals that will require their taxpayers to pay back \$13.8 billion for \$513 million worth of construction, according to the treasurer-tax collector's office.

Buchanan is working on the crackdown with Sen. Ben Hueso, D-San Diego, that would impose strict controls on issuing those types of bonds, known as CABs, in the future.

Among the provisions: a ceiling on interest, a cap on total debt service, shorter bond terms, a no-penalty prepayment option and complete public disclosure of the long-term costs before a contract is signed.

“We want more taxpayer dollars to be used on building the actual facilities and not on paying interest,” Hueso said.

After months of negotiations, the measure has cleared two key committees with bipartisan — and unanimous — support. The full Senate is expected to take it up in August, after a summer recess. Passage is expected.

Capital appreciation bonds generally work this way: A district needing quick cash to build but with little in the bank works out what amounts to a long-term loan by selling bonds that do not mature for up to 40 years. Voters are then sold on approving the deal with the promise of no immediate increases in the property tax because the first payment is often pushed out for as long as 20 years.

But what voters usually do not realize is that the terms include balloon payments and interest rates far higher than those charged for more conventional school construction bonds. That's because investors are willing to forego profits for two decades in return for reaping big returns in the future.

“The longer-term pay downs are going to hit people down the road,” said Dan McAllister, treasurer-tax collector of San Diego County, who has been in the thick of negotiations trying to constrain the controversial bonds.

Defenders of the bonds, including San Diego Unified, concede some limits may be called for. But they say the measure is an overreach. They counter that trustees are often placed in a no-win position because of growing demand for facilities but little access to immediate cash. Districts also must convince tax-wary voters to pay more.

In Poway's case, the district in the summer of 2011 approved issuing a 40-year bond deal to raise \$105 million. It was the first bond contract coming out of Proposition C, a \$179 million measure approved by voters in 2008 to remodel 24 of its oldest schools.

The disclosure of the terms of Poway's contract months later sparked outrage. But an independent investigation by ESI International commissioned by the district found no wrongdoing on the part of trustees, although some members of the community have contended the board was not provided sufficient information about the deal and that the private financial advisers may have pressed a CAB so they could profit.

The bond program was first reported by a Michigan blogger last year and then gained wide attention after it was examined by the news website Voice of San Diego.

Poway Unified did not respond to a request for comment on the legislation.

Assembly Bill 182, if signed into law, will come too late to provide Poway taxpayers with relief. The district cannot pay off the loan until 2051 because there is no prepayment clause.

"Unfortunately, Poway isn't the only district to use and abuse this type of financing," said state Treasurer Bill Lockyer.

For example, a legislative review found that a San Bernardino County district will pay \$6.6 million over 29 years for a \$283,000 bond. Taxpayers in a Kern County district will be responsible for paying \$15.5 million to close out a \$1 million bond in 38 years.

School districts say the growth in popularity of capital appreciation bonds can be traced to the collapse of the housing market and subsequent plunge in assessed valuations. Those factors — coupled with a shrinking pool of state construction bond money and a state law capping developer fees — have left some districts with little choice.

"They cannot fail the communities that rely on them," said Paul Jessup, Riverside County's deputy superintendent of schools.

Particularly hard hit are districts with rapid enrollment growth and a declining tax base. Jessup said. Some went to year-round schools and brought in portables.

The proposed tighter borrowing limits will put poorer districts at a disadvantage, Jessup said. "This is a fundamental equity issue," he said.

Critics of the bonds, though, say it's the low-income property owners paying the higher-rate bonds who will be hurt the most.

"The logic defies me that there is some wisdom in saying poor people ought to be burdened with more debt in order to finance facilities. I don't get that," Lockyer said.

Even the most conventional of tools, called a "Current Interest Bond," can carry an interest-to-principal debt service of up to 3-1, compared to the mostly 2-1 for a typical home mortgage, according to a state analysis.

Capital appreciation bonds, on the other hand, can run as high as 23-1 in the worst examples found by a state review. Of the 648 CABs issued since 2007, 349 carry a debt-to-principal ratio higher than 3.5 to 1.

Critics say these bond terms that last for decades unjustifiably bind future generations to higher property tax bills even though they may not benefit.

Districts dispute that. "Do you know of any school building that isn't getting used after 30 or 40 years? The useful life of the building far outlives the mortgage," Dennis Meyers, an assistant executive director of the California School Boards Association said. He uses the example of a house with a mortgage. Just because it will need repairs, perhaps a new roof, buyers still take out a 30-year loan.

Meyers is also opposed to a provision in the bill that would impose the conditions on only K-12 schools and community colleges — the predominant users of the bonds.

If CABs are bad for districts they are just as costly for other public agencies, Meyers said.

School districts also oppose the firm 4-1 debt service ratio restriction and shorter length, saying they should be allowed to use averages to meet caps. That way, one in a series of issuances could be over the limit for flexibility reasons, but another could be lower.

San Diego's McAllister calls them unjustified loopholes that will cost taxpayers too much.

Districts also want to delete provisions that would levy new conditions on their use of the fairly noncontroversial capital improvement bonds.

"The bill casts too wide of a net," Meyers said.

District arguments do not sway David Wolfe, the legislative director for the Howard Jarvis Taxpayers Association who supports the bill.

"Nobody cares about the property owners who will have to pay the bills," he said.

Wolfe said the new public disclosure rules could help wake up voters, who are sold on the no-tax-increase pledge for 20 years without considering longer term consequences.

"People think bonds are free money," he said.

Attachment 3



Jeffrey Kolin, City Manager

July 11, 2013

Dr. Gary Woods
School Superintendent
Beverly Hills Unified School District
255 South Lasky Drive
Beverly Hills, CA 90212

Re: Questions raised by the City Council at its July 2, 2013 meeting

Dear Gary,

During the July 2, 2013, when the City Council was discussing concerns raised by the public over the School Board's decision to accelerate the issuance of Measure E bonds, several questions were raised some of which we feel are best addressed by your office as staff to the Board. Board Vice President Margo was present at the meeting and suggested the list of relevant questions be forwarded to your office so the Board can provide responses as appropriate. The following is the list of relevant questions raised during the meeting:

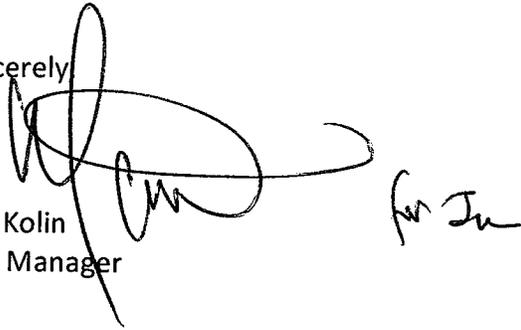
1. Has the County acted on the Board's request to adjust the rates? Will that be done at a County Board meeting and if so when is that anticipated to happen?
2. Is the District willing to rescind its request to the County to increase the tax rate and not issue additional Measure E bonds until the outcome of the election is known?
3. Is the county obligated to proceed with the original request if the Board withdraws its request?
4. How much of the \$95m in potential bond funds is the Board expecting to issue before the replacement ballot measure is considered by the voters?
5. How will the new State law (AB 182) if passed impact the remainder of the bonds to be issued.
6. What will the District's position be on the acceleration and issuance of additional Measure E bonds if the measure placed before the voters does not pass?

Please note that the City Council will again be discussing this issue at their July 16 formal meeting starting at 7pm. They will also be considering adoption of a resolution they requested stating that they do not support accelerating the issuance of additional Measure E bonds without voter approval and urging the Board to rescind their request to the County to increase tax rates.

I appreciate your prompt attention to this and look forward to responses to the questions. Please do not hesitate to contact me if you have any questions or concerns.

Sincerely

Jeff Kolin
City Manager

A handwritten signature in black ink, appearing to read "Jeff Kolin", with a long horizontal flourish extending to the right.

Attachment 4



RICHARDS | WATSON | GERSHON

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MEMORANDUM

TO: Honorable Mayor and Members of the City Council
FROM: Lolly A. Enriquez, Chief Assistant City Attorney
DATE: July 12, 2013
SUBJECT: Beverly Hills Unified School District Measure E Bonds

INTRODUCTION

In November 2008, voters in the Beverly Hills Unified School District (the “School District”) approved Measure E, which authorized the School District to issue up to “\$334 million in bonds at legal interest rates subject to mandatory audits, independent citizens’ oversight without an estimated increase in tax rates”. In 2009, the School District issued its first series of bonds under the Measure E authorization in the amount of \$72,044,664, leaving \$261,955,336 authorized but unissued. Subject to a future vote of the Board of Education of the School District (the “Board”), the School District intends to issue a second series of Measure E bonds during fiscal year 2013-14 in an estimated amount of up to \$95 million.

At its recent June 25, 2013 meeting, the Board adopted a resolution requesting the County to adopt a tax rate sufficient to pay the debt service on up to \$95 million of additional Measure E bonds expected to be issued in Fiscal Year 2013-14. This increased tax rate is in addition to the tax rates currently assessed for Measure K and Measure S indebtedness. In addition, the School District Board directed staff to place a new bond measure on the ballot to replace the Measure E authorization in the upcoming November or March elections.

At the June 18 and July 2 City Council meetings, some residents expressed concern over the Board’s proposal to accelerate the issuance of additional series of Measure E bonds and increase property taxes. Pursuant to the request of the City Council at the July 2 meeting, this memorandum analyzes the remedies available to the City and residents (including whether the City can assist residents) who object to the School District’s decision to increase taxes and the potential acceleration of the issuance of additional series of Measure E Bonds.

QUESTIONS PRESENTED

What remedies are available to the City and its residents who object to the School District’s recent decision to increase property taxes based on an expected accelerated issuance of up to \$95 million in Measure E bonds during fiscal year 2013-14 despite the language in the 2008 ballot measure? In addition, what assistance can the City give to its residents regarding the same?

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SHORT ANSWER

I. LEGISLATIVE REMEDIES

- A) **City initiative or referendum** - The City is most likely preempted by State law from putting an initiative or referendum on the ballot preventing the School District from accelerating the issuance of additional series of Measure E bonds that would have the effect of increasing property tax rates. In addition, the City can only exercise its powers of initiative and referendum with respect to legislative acts, and not administrative or adjudicatory acts. The School District's actions with respect to the Measure E bonds are likely to be administrative acts and not legislative acts.
- B) **Resident (taxpayer) initiative or referendum** – Taxpayers most likely cannot exercise the powers of initiative or referendum regarding the School District's potential approval of the issuance of additional Measure E bonds as this action is most likely not a legislative act. Further, although Proposition 218 extends a taxpayer's initiative power to include the power to repeal or reduce any local tax, an initiative to repeal or reduce a tax pledged as security for bonded indebtedness is likely to be found unconstitutional in violation of the contract impairment clauses located in the state and federal constitutions.

II. JUDICIAL REMEDIES

- A) **City lawsuit on behalf of residents** – The City does not appear to have standing as an “interested person” to bring a reverse validation action to challenge the validity of the School District's accelerated issuance of Measure E bonds and the related increased property tax rate, either on its own behalf or on behalf of its residents.
- B) **Resident taxpayer lawsuit (and potential City assistance)** – Resident taxpayers have standing to bring a reverse validation lawsuit to challenge the accelerated issuance of Measure E bonds. The City's ability to assist in such litigation is questionable because such assistance may be considered a prohibited gift of public funds.

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III. POLITICAL REMEDIES

- A) **Advisory Election** –The City may hold an advisory election addressing its concerns. The Elections Code allows cities to hold advisory elections for the purposes of allowing voters to voice their opinion on substantive issues, or to indicate the approval or disapproval of a ballot proposal.
- B) **City Resolution** – The City Council can adopt a resolution stating the City’s position with regard to the proposed acceleration of the issuance of additional Measure E bonds and the increased property tax rates related thereto.

ANALYSIS

I. LEGISLATIVE REMEDIES

A) City initiative or referenda

Article II, Sections 8-11 of the California Constitution provide the basis for the powers of initiative and referenda in California. An initiative is defined as “the power of the electors to propose statutes and amendments to the Constitution and to adopt or reject them.” Cal. Const. Article II, § 8(a). Referendum is “the power of the electors to approve or reject statutes or parts of statutes except urgency statutes, statutes calling elections, and statutes providing for tax levies or appropriations for usual current expenses of the State.” Cal. Const. art II, § 9(a). The City Council may on its own submit an initiative or referendum for voter approval without a petition signed by the requisite number of voters. Elec. Code § 9222.

The powers of initiative and referendum extend only to legislative acts, as opposed to adjudicatory or administrative acts of a city. *DeVita v. County of Napa*, 9 C.4th 763 (1995), *Dye v. Council of the City of Compton*, 80 Cal. App. 2d 486 (1947). Legislative acts generally involve the formulation of rules to be applied in all future cases, whereas adjudicatory acts generally involve the application of a fixed rule to a specific set of existing facts. Examples of legislative acts include zoning and rezoning ordinances, general and specific plans, road abandonment and fixing compensation of local officials. Examples of adjudicatory and administrative acts include conditional use permits, variances, employee discipline and appeals and subdivision map approvals. Since the School Board’s actions related to the accelerated issuance of Measure E bonds are specific actions implementing a voter approved legislative measure, it is likely that the actions are not legislative acts.

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In addition, an initiative or referendum may not regulate matters that have been preempted by the State. See, e.g., *Voters for Responsible Retirement v. Board of Supervisors*, 8 Cal. 4th 765 (1994); *Wiltshire v. Superior Court*, 172 Cal. App. 3d 296 (1985). Further, a city may not enact local laws that conflict with “general” or state laws. Cal. Const. art XI, § 7. Local legislation that conflicts with general laws of the state is void. A local law conflicts with state law if it either duplicates, contradicts, or enters a field which has been fully occupied by state law, whether expressly or by legislative implication. A local law contradicts state law when its purpose is inimical to the purpose of the state law, or prohibits what the legislature intends to authorize. *Sherwin-Williams Co. v. City of Los Angeles*, 4 Cal. 4th 893 (1993); *Northern Cal. Psychiatric Society v. City of Berkeley*, 178 Cal. App. 3d 90 (1986); *Big Creek Lumber Co. v. County of Santa Cruz*, 38 Cal. 4th 1139 (2006).

Article XIII A, Section 1 and Article XVI, Section 19 of the California Constitution provide the constitutional basis for the issuance of voter-approved general obligation bonds. Sections 15000 et seq. of the Education Code and Sections 53506 et seq. of the Government Code provide the statutory authority for the issuance of general obligation bonds by a school district. The California Constitution provides that the maximum amount of any ad valorem tax on real property shall not exceed one percent (1%) of the full cash value of such property. However, there is no limit on ad valorem taxes levied to pay bonded indebtedness incurred for the acquisition or improvement of real property approved on or after July 1, 1978, if approved by two-thirds of the voters. In addition, Proposition 39, which amended the Constitution in 2000, provides an additional exception to the 1% ad valorem tax limit for bonded indebtedness of a school district “incurred for the construction, reconstruction, rehabilitation or replacement of school facilities, ... or the acquisition or lease of real property for school facilities, approved by 55% of the voters of the district” if certain conditions are met. Cal. Const. art XIII A, § 1.

The Government Code provides that the School District can issue general obligation bonds secured by ad valorem property taxes. Gov’t. Code § 53506. In addition, the State legislature created the Strict Accountability in Local School Construction Bonds Act of 2000 which imposed additional requirements for School District general obligation bonds authorized by a 55% vote. Educ. Code §§ 15234 et seq. The Constitution read in conjunction with the State law allows school district indebtedness approved by a minimum of 55% of the voters to be payable from ad valorem property taxes up to \$60 per year per \$100,000 of assessed value. Any local law preventing the School District from issuing additional series of bonds or attempting to prevent an increase in property taxes securing bonds is likely to be in conflict with such federal

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and state authorization because it would prohibit what the legislature intended to authorize.¹ *Northern Cal. Psychiatric Society v. City of Berkeley*, 178 Cal. App. 3d 90 (1986).

In addition, a local law is preempted by state law if state law occupies the field, either expressly or by legislative implication. *Sherwin-Williams*, supra. In determining whether the legislature has impliedly occupied or preempted a field to the exclusion of local regulation, the court looks at the whole purpose and scope of the legislative scheme. *Candid Enterprises, Inc. v. Grossmont Union High School District*, 39 Cal. 3d 878 (1985). An intent to occupy the field will be found if: “(1) the subject matter has been so fully and completely covered by general law as to clearly indicate that it has become exclusively a matter of state concern; (2) the subject matter has been partially covered by general law couched in such terms as to indicate clearly that a paramount state concern will not tolerate further or additional local action; or (3) the subject matter has been partially covered by general law, and the subject is of such a nature that the adverse effect of a local ordinance on the transient citizens of the state outweighs the possible benefit to the municipality.” See *Western Oil & Gas Association v. Monterey Bay Unified Air Pollution Control District*, 49 Cal. 3d 408, 423 (1989).

The Government Code and the Education Code contain very specific terms regarding the issuance of school district bonds (i.e., the maximum interest rate, the security, the term, the form of the resolution authorizing the bonds, as well as the process involved in the issuance of bonds). It appears that the subject matter regarding school district bonds has been fully and completely covered by general law as to indicate it has become exclusively a matter of state concern. Therefore, it is likely that state law occupies the field of school district bonds by legislative implication.

Because a local initiative or referendum preventing an increase in property tax rates or preventing the issuance of additional bonds is likely to be in conflict with State law, and State law appears to fully occupy the field, the City likely cannot place such an initiative or referendum on the ballot.

¹ One series of Measure E bonds has already been issued and is secured by ad valorem property taxes up to \$60 per \$100,000 of assessed value. If there were to be a large dip in assessed values of property in the School District and property taxes needed to be increased to pay debt service on the outstanding Measure E bonds, there is nothing that can be done to prevent an increase so long as the \$60 per \$100,000 of assessed value is not exceeded. Otherwise, this would be deemed a default under the bond documents.

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B) Resident (taxpayer) initiative or referendum

For the reasons discussed above, residents are also likely prohibited from proposing an initiative or referendum on the issuance of Measure E bonds because the issuance of bonds is likely an administrative act, and not a legislative act.

Despite the general prohibition on initiative and referenda regarding administrative acts, taxpayers do have a separate constitutional right to place on the ballot a measure to repeal or reduce a tax. On November 5, 1996, an initiative to amend the California Constitution known as the “Right to Vote on Taxes Act” (“Proposition 218”) was approved by a majority of California voters. Proposition 218 added Articles XIIC and XIID to the State Constitution and requires, among other provisions, majority voter approval for the imposition, extension or increase of general taxes and 2/3 voter approval for the imposition, extension or increase of special taxes by a local government. Proposition 218 also extends the initiative power by stating that residents of California shall have the power to repeal or reduce any local tax, assessment, or fee. *See* California Constitution, Article XIIC, Section 3. Thus, even if residents cannot prevent the acceleration of the issuance of Measure E bonds through the initiative or referendum process, Proposition 218 raises the question of whether residents may place a matter on the ballot to reduce or repeal a property tax that is levied to pay bonds. However, the rights granted to voters by Proposition 218 are most likely limited by the contract impairment clauses in the federal and state constitutions.

The United States Constitution, Article I, Section 10, Clause 1, provides in part: “No state shall . . . pass any . . . law impairing the obligation of contracts” In addition, the California Constitution, Article I, Section 9 provides in part: “A . . . law impairing the obligation of contracts may not be passed.”

Public securities, like the Measure E bonds, constitute contracts that fall within the purview of these state and federal constitutional prohibitions against impairing the obligations of contract. Courts have consistently relied on the Contract Clauses to strike down changes in law that reduce or otherwise improperly alter the securities pledged as security under a contract.² In

² *United States Trust Co. v. New Jersey* (1977) 431 U.S. 1, 29-31 (“If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all [A] State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors.”); *Islais Co. v. Matheson* (1935) 3 Cal. 2d 657, 666 (retroactive California statute reducing penalties imposed on delinquent taxpayers in reclamation district impaired contracts of bondholders); *County of San Bernadino v. Way* (1941) 18 Cal.2d 647, 662.

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addition, a year after Proposition 218 was adopted, the legislature enacted the “Proposition 218 Omnibus Implementation Act,” which added Section 5854 to the Government Code. Section 5854 states the following:

Section 3 of Article XIII C of the California Constitution, as adopted at the November 5, 1996, general election, shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after that date, assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights protected by Section

Therefore, it appears unlikely that resident taxpayers can put a measure on the ballot to reduce or repeal an increase in property tax rates to pay additional Measure E bonds, at least after such bonds are issued, because it would impair the security pledged for payment of the bonds to the bondholders.

II. JUDICIAL REMEDIES

A) City Lawsuit on Behalf of Residents

1. Reverse Validation Action

In general, a validation action is a mechanism for a public agency to determine the validity of its own actions. Cal. Civ. Proc. Code § 860. Since validation statutes do not specify the matters to which they apply, and instead state that they apply to “any matter which under any other law is authorized to be determined [by a validation action],” courts look to other statutes and cases that have interpreted them to determine the scope of public agency actions that are subject to validation under validation statutes. *California Commerce Casino, Inc. v. Schwarzenegger* (App. 2 Dist. 2007) 53, Cal. Rptr. 3d 626. Section 15110 of the Education Code specifically allows for school districts to validate school district bonds. Section 15110 states that “[a]n action to determine the validity of bonds ... may be brought pursuant to Chapter 9 (commencing with Section 860) of the Code of Civil Procedure.” In addition, state law provides that “if no proceedings have been brought by the public agency pursuant to this chapter, any interested person” may bring an action to challenge the validity of a public agency action. Cal. Civ. Proc. Code § 863.³ This is called a “reverse validation action.” In this instance, any

³ A reverse validation action must be brought within 60 days of the action at issue. Cal. Civ. Proc. Code § 860. With respect to Measure E bonds, case law is not clear whether a taxpayer’s action would accrue beginning in 2008 when the Measure E bonds were originally authorized in an amount up to \$334 million (and is thus, barred by the

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“interested person” may bring a reverse validation action to determine the validity of the School District’s actions. The primary question, then, is whether the City constitutes an “interested person” for the purpose of bringing a reverse validation action.

2. Standing to Bring a Reverse Validation Action

Code of Civil Procedure Section 863 provides that “any interested person” may bring a reverse validation action. The statute does not define the term “interested person,” but case law suggests that an “interested person” includes taxpayers, residents, and persons who own property or have an interest that will be affected by the governmental action at issue. *Regus v. City of Baldwin Park* (1977) 70 Cal. App. 3d 968. The question here is whether the City would be an “interested person” for the purpose of bringing a reverse validation action under Section 863.

In general, reverse validation actions may be brought by individuals with a direct interest in property affected by the government action or by an organization representative of such individuals. See *Regus v. City of Baldwin Park* (1977) 70 Cal. App. 3d 968; *Citizens against Forced Annexation v. County of Santa Clara* (1984) 153 Cal. App. 3d 89. The City does not own property directly affected by the School Board’s decisions as the City does not pay property taxes on the property that it owns.

We found no published cases which address a city’s ability to bring a reverse validation action challenging the issuance of bonds by another agency that will impact the tax rates of its residents. We did, however, find two unpublished cases that may be instructive. In an unpublished case from 1988, the court held that the City of Compton did not have standing to sue on behalf of its residents in a challenge regarding the insurance industry’s “redlining practices.” *City of Compton v. Bunner* (Unpub. 1988) 243 Cal. Rptr. 100. The City of Compton sued “on its own behalf and as a representative of its residents” to challenge Farmers’ Insurance Company’s redlining practices. *Id.* at 105. The court held that the City of Compton did not have standing to sue the State, the Insurance Commissioner and Farmers because it did not belong to a class allegedly discriminated against by the defendants. *Id.* at 118. The court also held that the city did not have standing to sue in a representative capacity. *Id.* The court noted that the city was “attempting to litigate the personal claims of its residents alleged to be caused by redlining.” *Id.* at 119. Since the city was not a member of the class it sought to represent, the court concluded that the city did not have standing to sue as a representative of its residents. *Id.*

statute of limitations), or on the date the School District voted to notify the County to increase property taxes, or the date the School District votes to issue the additional Measure E bonds.

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In a reverse validation action regarding the validity of school district bonds, the court held that a plaintiff did not have standing because he did not own property or reside in the affected territory. *Katz v. Mountain View-Whisman School District*, 2006 Cal. App. Unpub. LEXIS 10295. In that case, the plaintiff owned a partial interest in a limited liability corporation that owned property in the areas that would be subject to the parcel tax imposed by the school district. The court stated that an “interested person” for the purpose of Section 863 “is a ‘citizen, resident and taxpayer’ of an affected geographical territory or a person who pays taxes to an affected entity.” *Id.* at 5-6 (citations omitted). The court rejected the plaintiff’s argument that “his indirect interest through the partnership is sufficient to give him standing” and held that Katz did not have standing to pursue the reverse validation action. *Id.* at 6.

As noted above, property owned by a local government is generally exempt from property taxes. Cal. Const. Art. XIII § 3(b). As such, the City does not pay the property taxes that would be affected by the School District’s actions in this case. Moreover, the City does not appear to have any other property or monetary interest that would be affected by the School District’s issuance of bonds and the related increase in the property tax rate in a manner that has traditionally been recognized as granting a person standing. The unpublished case law described above suggests that the City would not have standing to bring an action on its own behalf, nor would it have standing to bring an action on behalf of its residents.

In sum, the City does not appear to have standing to bring a reverse validation action to challenge the validity of the School District’s decision to increase property taxes and issue bonds. By virtue of their payment of the relevant taxes, however, the City’s *residents* have standing to bring a reverse validation action. Thus, the residents themselves may choose to bring a reverse validation action against the School District, as discussed below.

B) Resident taxpayer lawsuit (and potential City assistance)

As mentioned above, individuals with a direct interest in property affected by the government action or organizations representative of such individuals have standing to bring a reverse validation action. Thus, the resident taxpayers of Beverly Hills appear to be able to bring a reverse validation lawsuit concerning the issuance of bonds pursuant to Measure E.⁴

⁴ A reverse validation action must be brought within 60 days of the action at issue. Cal. Civ. Proc. Code § 860. With respect to Measure E bonds, case law is not clear whether a taxpayer’s action would accrue beginning in 2008 when the Measure E bonds were originally authorized in an amount up to \$334 million (and is thus, barred by the statute of limitations), or on the date the School District voted to notify the County to increase property taxes, or the date the School District votes to issue the additional Measure E bonds.

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Whether the City can assist resident taxpayers in a litigation effort will depend on if such assistance would constitute a gift of public funds. Article XVI, Section 6 of the California Constitution forbids cities from making “any gift ... of any public money or thing of value to any individual, municipal or other corporation....”

In determining whether an appropriation of public funds or property is considered a gift of public funds, the two primary questions are: 1) whether the funds are to be used for a public or private purpose, and 2) if used for a public purpose, whether the funds are to be used for a public purpose of the agency making the expenditure. If public funds are expended for a public purpose of the agency making the expenditure, then the expenditure is not a gift of public funds within the meaning of Article XVI, Section 6. *County of Alameda v. Janssen* (1940) 16 Cal. 2d 276.

A mere incidental benefit to an individual does not make a public purpose a private purpose. *American Co. v. City of Lakeport* (1934) 220 Cal. 548. Ultimately, the determination of what constitutes a public purpose is a matter for the legislature and its discretion will not be disturbed by the courts so long as the determination has a reasonable basis. *Board of Supervisors of City and County of San Francisco v. Dolan* (1975) 45 Cal. App. 3d 237.

Despite the judicial deference, the City’s financial support of a potential taxpayer lawsuit over the acceleration of Measure E bonds triggers concerns about whether such support would be a gift of public funds. Although courts afford great deference to a public agency’s stated public purpose, it may be difficult to articulate a public purpose of the City if the City expends funds for a lawsuit which it does not have standing to bring itself. A court may find a gift of public funds if it decides that the City is expending public moneys to litigate the claims of others. (See, *San Diego County Dept. of Social Services v. Superior Court* (2005) 134 Cal.App.4th 761, where the court held that a judicial order to use county funds to retain an attorney to investigate an indigent child’s civil claim for damages due to molestation at county group home was gift of public funds.) Therefore, there is risk involved if the City financially assists several of its resident taxpayers in litigation challenging the School District’s actions related to the accelerated issuance of Measure E bonds because such assistance may be considered a gift of public funds.

III. POLITICAL REMEDIES

A) Advisory Elections

Section 9603 of the California Elections Code allows cities to hold an advisory election for the purposes of allowing voters to voice their opinions on substantive issues, or to indicate to the local legislative body approval or disapproval of a ballot proposal. In contrast to initiatives

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and referenda, such an advisory ballot is not limited to legislative matters. In addition, the results of an advisory election are not binding and do not change any law.

An advisory election may be held within the City's jurisdiction, or a portion thereof. If there is a ballot proposal that also affects residents outside of the City, an advisory election may be held in such territory outside of the City's jurisdiction if all the following conditions are met:

- (1) A regular election or special election is to be held in that territory;
- (2) The advisory election would be consolidated with it; and
- (3) The board of supervisors of the county in which the outside territory is located approves the consolidation.⁵

Since the School District Board has already adopted a resolution directing the County to increase ad valorem taxes to pay debt service on an estimated future issuance of \$95 million of Measure E bonds, it may be too late to put an advisory measure on the ballot regarding whether or not to increase property taxes above the current levels. However, depending upon the timing of when the Board votes on whether to issue an additional \$95 million in Measure E bonds, there may be an opportunity for the City to hold an advisory election regarding such matter.⁶

B) City Resolution

Resolutions can be expressions of opinion or evidence of a decision made by the City Council. If the City wishes to do so, the City Council may adopt a resolution stating the City's position with regard to the accelerated issuance of additional Measure E bonds and the related increase in property tax rates.

CONCLUSION

I. LEGISLATIVE REMEDIES

- A) **City initiative or referendum** - The City is most likely preempted by State law from putting an initiative or referendum on the ballot preventing the School District from accelerating the issuance of additional series of Measure E bonds

⁵ An advisory election cannot be consolidated with an election if the ballot's capacity will be exceeded because of the addition of the advisory election. Elec. Code §9603.

⁶ If the School District decides not to issue additional Measure E bonds, the revenues from the increased taxes would go towards paying principal on current outstanding School District bonds coming due in fiscal year 2013-14.

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that would have the effect of increasing property tax rates. In addition, the City can only exercise its powers of referendum with respect to legislative acts, and not administrative or adjudicatory acts. The School District's actions with respect to the Measure E bonds are likely to be administrative acts and not legislative acts.

- B) **Resident (taxpayer) initiative or referendum** – Taxpayers most likely cannot exercise the powers of initiative or referendum regarding the School District's potential approval of the issuance of additional Measure E bonds as this action is most likely not a legislative act. Further, although Proposition 218 extends a taxpayer's initiative power to include the power to repeal or reduce any local tax, an initiative to repeal or reduce a tax pledged as security for bonded indebtedness is likely to be found unconstitutional in violation of the contract impairment clauses located in the state and federal constitutions.

II. JUDICIAL REMEDIES

- A) **City Lawsuit on behalf of Residents** – The City does not appear to have standing as an “interested person” to bring a reverse validation action to challenge the validity of the School District's accelerated issuance of Measure E bonds and the related increased property tax rate, either on its own behalf or on behalf of its residents. Further, case law suggests that cities cannot litigate the personal claims of its residents.
- B) **Resident taxpayer lawsuit (and potential City assistance)** – Resident taxpayers have standing to bring a reverse validation lawsuit to challenge the accelerated issuance of Measure E bonds which would have the effect of raising property taxes. There is risk involved if the City assists several of its resident taxpayers in a litigation challenging the School District's actions related to the accelerated issuance of Measure E bonds. It may be difficult to articulate a public purpose of the City if the City expends funds for a lawsuit which it does not have standing to bring itself. A court may find the City is making a prohibited gift of public funds if it decides the City is litigating the claims of others.

III. POLITICAL REMEDIES

- A) **Advisory Election** – The City may hold an advisory election addressing its concerns. The Elections Code allows cities to hold advisory elections for the purposes of

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allowing voters to voice their opinion on substantive issues, or to indicate the approval or disapproval of a ballot proposal.

B) **City Resolution** – The City Council may adopt a resolution stating the City's position with regard to the proposed acceleration of the issuance of additional Measure E bonds, and the increased property tax rates related thereto.