Los Angeles County Warns of Bad Deals

Treasurer: Schools 'Getting Hosed'

Monday, May 23, 2011

By Randall Jensen

SAN FRANCISCO — The Los Angeles County treasurer has fired a warning shot at bond attorneys, underwriters and advisers in a bid to stop school bond practices that he says hurt taxpayers.

"The use of general obligation bonds to solve budget problems can pose a serious risk to school and community college districts," Mark Saladino, Los Angeles County treasurer and tax collector, **said in a letter** to a list of prominent California bond finance firms. "My office has observed several new financing practices that may place the issuing district at risk of both state and federal scrutiny."

Saladino said several types of recent general obligation bond sales used by districts will be rejected by his office, some of which resemble a "cash-out" financing structure declared illegal by the state attorney general in 2009.

The treasurer's office sent out the warning because officials began to see schools using bond proceeds to pay for cash-flow needs and using "exotic" debt structures, said assistant county treasurer Glenn Byers.

Byers said the new deals began to appear after districts discovered that lower assessed property values limited their ability to fund debt service within tax rates set before the housing collapse.

"Some of the structures are illegal, but most of them are not," Byers said. "We felt that there was nobody looking out for the best interests of the taxpayer — we felt they were getting hosed."

Two of the practices in question include using a joint-powers authority structure to generate bond proceeds beyond the amount approved by voters. Voters must approve local GO bonds in California in elections that authorize special property taxes to back the debt.

The treasurer also highlighted potential tax violations from the use of federal subsidies from Build America Bonds or qualified school construction bonds for anything other than to offset debt service.

Saladino also called into question the use of capital appreciation bonds with 40-year maturities. Byers said they can cost taxpayers more than $10 for each dollar borrowed, compared to costs of around $3 per dollar for more standard deals that extend out 25 years.

The reaction to the letter has so far been positive with many firms saying they have been disadvantaged by a rogue element, according to Byers.

"We have chosen at this point not to name names," Byers said, adding that they will stop any bad deals that come through the county. "If it continues, we are going to name names."

In Los Angeles County, the county government issues school district GO bonds sold under the state education code and the treasurer may act as an adviser on the deals. The county has 93 school districts.

Districts can also go to market under the state government code, circumventing the county's treasurer's role.

Karen Adams, Merced County treasurer and president of the California Association of County Treasurers and Tax Collectors, said Saladino's letter outlines some common problems with school district debt structures.

"What has happened in Merced County as we've inserted ourselves into the process to add value for the school districts and become what [underwriters] consider a hindrance, they cut us out," Adams said. "Recently, in the last three four years, I won't know if a school district is going to sale until a day before the pricing. That is a shame, an outrage in my book."

Adams said treasurers must be a part of the process to make sure general bond issuances benefit both school districts and taxpayers. She said it's important to reach out to school superintendents — who she said she doesn't blame — to make sure they know that treasurers want to help with the issuance process.

Earlier this year, California Attorney General Kamala Harris warned school bond financiers not to use premium bond structures to pay for issuance costs. Bond industry professionals said that practice had been routine for years, even decades.

In January, Saladino spurred the county's withdrawal from the California Statewide Communities Development Authority, a conduit issuer, in an effort to retain local control of issuances.