Presenters

- John Patterson, Senior Finance Analyst
  Treasurer and Tax Collector - Public Finance Branch

- Jackie Guevarra, CPA, Chief Accountant
  Auditor-Controller - Accounting Division

- Rachelene Rosario, Principal Accountant
  Auditor-Controller – Accounting Division
  Financial Analysis/Bond Accounting/Property Tax
Agenda

- Welcome/Introductions
- Treasurer and Tax Collector Presentation
- Department of Auditor-Controller Presentation
- Questions
Los Angeles County Treasurer and Tax Collector (TTC)

After the economic downturn in 2008, the TTC’s Public Finance Branch noticed an increase in school district utilization of high-cost Capital Appreciation Bonds (CABs)

- Recession caused negative assessed valuation (AV) growth or significantly less than projected AV growth
- Created pressure on Proposition 39 statutory tax limit constraints and artificial tax rate limits promised to voters
- Resulted in many school districts issuing long-dated CAB structures

TTC established process in 2010 for reviewing all school district GO bond transactions

- New money transactions approved by the Board of Supervisors pursuant to section 15140 (b) of the Education Code

The Los Angeles County Treasurer and Tax Collector (TTC) is a recognized statewide authority on school district financings

On May 16, 2011, the previous TTC issued the School District General Obligation Bonds - White Paper (Appendix A) on problematic school district financing practices

- Long-dated CABs
- Misuse of Proposition 39 tax rate limits
- Use of JPA Structures to issue GO bonds
- Borrowing from bond project funds

State legislation in 2013 (AB 182) significantly limited and restricted the use of CABs

- Final maturity of CABs cannot exceed 25 years
- Limited payback ratio of total debt service to principal to not exceed 4:1
Recommendation 6.7:

The Los Angeles County Office of Education, the Los Angeles County Auditor Controller, and the Los Angeles County Treasurer and Tax Collector, should monitor the use of school bond debt in Los Angeles County, including review of (a) proposed debt service schedules in advance of bond pricing, and (b) realistic forecasts of assessed value.
Response to Recommendation 6.7:

- In 2010, TTC developed and implemented a robust review process for school district GO bond financings.

- TTC Public Finance Branch works closely with County Counsel and the County Auditor-Controller to ensure that all school district GO bonds are issued in accordance with State law and County requirements.

- TTC’s process includes a review of the following:
  - Ballot measure approved by the voters
  - Assessed valuation growth/tax rate schedule
  - Preliminary bond structuring report
  - Sources and uses of bond proceeds (including costs of issuance)
  - Can the tax base of the school district support the issuance of GO bonds at cost effective rates to property owners?
  - TTC works with County Counsel to review bond documents and obtain Board of Supervisors approval of tax levy resolution
  - TTC participates in the pricing process to help ensure districts receive fair market pricing for its GO bonds
  - After the pricing of the bonds, TTC works with the County Auditor-Controller to ensure the transaction is properly accounted for and debt service requirements are included on the annual Secured Property Tax Roll.
Los Angeles County
Department of Auditor-Controller
(A-C)
Department of Auditor-Controller
Objectives

■ Grand Jury Report Recommendations

■ A-C Process Overview:

A. Election
B. Issuance
C. Pricing/Closing
D. Debt Service Schedule
E. Tax Rates

F. Audit Confirmations
Response to Recommendation 6.7:

- We concur with the recommendation. The Los Angeles County Auditor-Controller (A-C) will continue to work with the Treasurer and Tax Collector (TTC), and County Counsel in conjunction with School General Obligation Bonds. The A-C will continue to perform the following roles associated with the School District general obligation bonds:
  - Monitor bond measure election results and the amounts approved by the voters
  - Provide valuation information and prepare requisite documents (e.g., bond certificate) to meet statutory requirements prior to bond closing
  - Establish County tax accounts and debt service funds for the collection of tax levies and the payment of debt service for all GO bonds
  - Track approximately 600 bond issuances and transfer funds for payments throughout various maturity dates
  - Provide bond information to each school district for budget and financial reporting purposes
  - Calculate the annual tax rate for each bond issued and prepare the annual Tax Rate Resolution for Board approval
  - Provide monthly payment reports to TTC in anticipation of scheduled debt service payments

9/30/2016
Department of Auditor-Controller
Process Overview

A-C Process Overview:

A. Election
   — Monitor outstanding balance of authorized amount

B. Issuance
   — Distribution List
   — Request for information (e.g., cash balance, assessed valuation, estimated tax rate, etc.)

C. Pricing/Closing
   — Establish debt service fund
   — Establish tax account
   — Prepare assessed valuation certification (signed by the Auditor-Controller
   — Post-Issuance
     • Bond Accounting System (Data Entry)
     • Monitor payment dates
D. Debt Service Schedule (Payments)

- Monthly - Transfer money from debt service funds for scheduled debt service payments
  - 48 = Unified School Districts
  - 20 = School Districts
  - 5 = High School Districts
  - 13 = Community College Districts

*Approximately 600 bond issuances (as of September 2016)*

- Monthly - Send report to TTC for reconciliation to invoices from paying agent
- TTC staff prepares and processes the actual wire transfer
E. Tax Rates

- Annually - Request anticipated issuances from school districts for the upcoming fiscal year
  - Send out Authorized Unissued Bonds letter to school districts (March 1st)
  - Perform statutory limit test on (new) bonds—per Education Code 15268-70
    - $30 – School Districts/High School
    - $25 – Community College Districts
    - $60 – Unified School District

  **per $100,000 of assessed valuation**
E. Tax Rates (continued)

- Annually – calculate tax rates for levy (July/August)

(Note: The annual tax rate resolution is approved by the County Board of Supervisors on the first Tuesday of September every year.)

<table>
<thead>
<tr>
<th>BOND REQUIREMENTS (Principal + Interest)</th>
<th>AVAILABLE FUNDS (1)</th>
<th>ASSESSED VALUATION (2)</th>
<th>TAX RATE</th>
<th>TAX AMOUNT PER $100,000 AV</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>b</td>
<td>c</td>
<td>d = (a - b) / c x 100</td>
<td>e = d / 100 x 100,000</td>
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</tbody>
</table>

(1) Note: Available Funds (b) includes June 30th cash balance and estimated unsecured taxes.

(2) Assessed Valuation information is available around early August.

- Tax rate resolution reports available at:
  
  http://auditor.lacounty.gov/wps/portal/ac/reports
F. Audit Confirmations

- Annually – Send out a packet of audit confirmations to each school district’s auditors (see sample letter in Appendix C):
  - Statement of Receipts and Disbursements
    - Revenues, Expenses, Cash Balance (June 30th)
  - Outstanding bond debt (by issuance)
    - Principal and interest
  - Secured Taxes (current and prior year)
  - Unsecured Taxes (current and prior year)
Contact Information

County of Los Angeles

**Treasurer and Tax Collector**
500 W. Temple Street HOA 437, Los Angeles, CA 90012

**Joseph Kelly**
Treasurer and Tax Collector

**Antoinette Chandler**
Assistant Treasurer and Tax Collector

**Teresa Gee**
Chief Public Finance Officer
Phone: 213-974-8359
Email: tgee@ttc.lacounty.gov

**John Patterson**
Senior Finance Analyst
Phone: 213-974-2310
Email: jpatterson@ttc.lacounty.gov

**Department of Auditor-Controller**
500 W. Temple Street HOA 603, Los Angeles, CA 90012

**John Naimo**
Auditor-Controller

**Connie Yee**
Division Chief

**Jackie Guevarra**
Chief Accountant
Phone: (213) 974-8309
E-Mail: jguevarra@auditor.lacounty.gov

**Rachelle Rosario**
Principal Accountant
Phone: 213-974-2871
Email: rrosario@auditor.lacounty.gov
Appendices

Appendix A: TTC White Paper

Appendix B: Civil Grand Jury Report Recommendations & TTC responses (6.8 to 6.10)

Appendix C: A-C Sample Audit Confirmation Letter
Appendices

Appendix A: TTC White Paper

Appendix B: Civil Grand Jury Report Recommendations & TTC responses (6.8 to 6.10)

Appendix C: A-C Sample Audit Confirmation Letter
Appendix A: TTC White Paper
May 16, 2011

To School Finance Professionals:

COUNTY OF LOS ANGELES
SCHOOL DISTRICT GENERAL OBLIGATION BONDS - WHITE PAPER

The recent economic downturn in California has placed a significant financial burden on school and community college districts. This burden has been augmented by budget deficits at the State of California and the continuation of funding cuts and apportionment deferrals aimed at schools. To help manage the current fiscal challenges, many districts have sought to issue debt as one means of meeting their financial needs. While debt issuance can be part of a larger fiscal plan, the use of general obligation (GO) bonds to solve budget problems can pose a serious risk to school and community college districts. We recommend that districts take a conservative approach when issuing GO bonds in order to avoid any violations of State or Federal Law, and to ensure compliance with all tax and regulatory guidelines.

Through our participation in numerous GO bond financings, my office has observed several new financing practices that may place the issuing district at risk of both State and Federal scrutiny. Regardless of whether the GO bonds are issued under the California Education Code or Government Code, my office will not support any of the following practices:

1. **JPA Structure and QSCBs.** The use of a Joint Powers Authority (JPA) to augment a Qualified School Construction Bond (QSCB) issuance provides bond proceeds beyond the amount approved by voters in a GO bond measure. This results in taxpayers being charged a significantly higher rate of interest than the actual market rate for the QSCBs (net of the direct-pay subsidy). The JPA structure with QSCBs resembles the "cash-out" refunding method that in January 2009 was declared by the California Attorney General to be in violation of State Law. The use of this structure exposes the district to potential litigation on the part of local residents and could cause the Internal Revenue Service (IRS) to revoke the district's direct-pay subsidy from the U.S. Treasury.

2. **JPA Structure (Marks-Roos).** Issuing GO bonds through a Marks-Roos structure is generally used to augment construction fund proceeds beyond the amount approved by voters. This increases the cost to local taxpayers and is another example of a "cash-out" financing structure that was declared illegal by the Attorney General in 2009.
3. **Use of Federal Subsidy for District Operations.** In a taxable GO bond financing, the Build America Bond (BAB) or QSCB subsidy must be used as an offset to debt service. Any application of this subsidy to fund district operations will significantly increase the cost to local taxpayers and may result in enforcement actions by the IRS.

4. **Proposition 39 Tax Limits.** If a school district has already exceeded its Proposition 39 tax rate limit of $30/$100,000 or $60/$100,000, it cannot issue additional debt under that ballot measure. A district cannot avoid the Proposition 39 tax rate limits by issuing GO bonds in only those maturities that do not currently exceed the $30 or $60 limitations. Such structures are contrary to the original intent of Proposition 39 and pose a legal risk to the issuing district.

5. **Bond Premium to Pay Costs of Issuance.** A March 1, 2011 letter from the California Attorney General stated that "the law is clear that any premium, even if legitimate, must be deposited into a special fund, applied to pay debt service, and therefore cannot be diverted to pay costs of issuance." The views expressed in this letter from the Attorney General provide clear guidance that Government Code Section 23903 and Education Code Section 15146(f) do not allow for costs of issuance, including underwriter's discount and bond insurance, to be paid from bond premium.

6. **Borrowing from Bond Project Funds.** GO bond proceeds are statutorily limited to qualified capital expenditures and cannot be used to fund operating expenses or payroll disbursements. Borrowing from a GO bond project fund to finance working capital needs is in direct violation of both State Law and Federal Tax Law.

In addition to the above practices, we also wish to highlight a common type of GO bond financing that is exceedingly costly for both school districts and local taxpayers. My office will not support transactions that rely on the following bond structure:

**Long-Dated CABs.** The issuance of capital appreciation bonds (CABs) with maturities greater than 25 years will result in a significantly higher debt burden for GO bond issuers. A 40-year CAB will generate debt service more than ten times (10x) greater than the principal amount of bonds being issued. Unless a district is certain to exceed its Proposition 39 tax rate limits, it should not consider the issuance of CABs. Furthermore, reasonable assumptions for growth in assessed value must always be utilized when sizing a GO bond financing with CABs. If a district elects to issue bond anticipation notes (BANs) as an alternative to a CAB structure, a similarly conservative approach to assessed value must be used. BANs should never serve as a vehicle to extend the total years of debt service beyond the limits set forth in the Education Code and Government Code.
In order to mitigate the use of those practices referenced in this letter, my department will work directly with local school districts on the structuring and sale of all GO bonds issued in the County of Los Angeles. If you have any questions regarding this letter, please contact Glenn Byers, Assistant Treasurer and Tax Collector, at (213) 974-7175.

Very truly yours,

MARK J. SALADINO
Treasurer and Tax Collector
Appendix B: Civil Grand Jury Report Recommendations & TTC responses (6.8 to 6.10)
Civil Grand Jury Report Recommendation & TTC Response

**Recommendation 6.8:**

- Los Angeles County should form a committee consisting of representation of the Los Angeles County Office of Education, the Los Angeles County Auditor Controller, the Los Angeles County Treasurer, and Tax Collector and at least four or five members of the public, to support Los Angeles County school districts in restructuring existing bond indebtedness and reducing the debt burden.

**Response to Recommendation 6.8:**

- TTC agrees with the spirit of the recommendation to support school districts in restructuring (i.e., refunding) existing bond indebtedness, but disagrees with the committee structure as the mechanism to accomplish that.

- TTC recommends that the Public Finance staff, working collaboratively with the Auditor-Controller and the Los Angeles County Office of Education (LACOE) educate school district officials on evaluating refunding opportunities for CABs, and to work with external financial professionals (financial advisors, underwriters and bond counsel) to develop a process or program that would enable school districts to refund non-callable CAB structures.

- TTC Public Finance works closely with County Counsel and County Auditor-Controller to ensure that all school district general obligation bonds are issued in accordance with State law and County requirements.
Civil Grand Jury Report Recommendation & TTC Response

**Recommendation 6.9:**

Los Angeles County should authorize the committee formed in Recommendation 6.8, to evaluate and make appropriate recommendations to the Los Angeles County Board of Supervisors and affected school districts about school bond indebtedness

**Response to Recommendation 6.9:**

- TTC advises against the establishment of a committee
- TTC recommends the establishment of an ongoing fiscal forum to educate, inform and make recommendations to school district officials
- Beginning in the fall of 2016, the fiscal forums would be conducted by staff twice per year
- The leadership committee would be comprised of the TTC, Auditor-Controller, and LACOE
- County personnel would present various/rotating topics to school district staff including the following
  - The essentials of school district bond issuance
  - Recommendations and best practices from the State Controller’s Bond Accountability Task Force
  - Recommendations and best practices from the GFOA
Recommendation 6.10:

Los Angeles County should authorize the committee formed in Recommendation 6.8, to ensure that Government Finance Officers Association financing best practices are instituted throughout Los Angeles County school districts.

Response to Recommendation 6.10:

TTC agrees with the concept of developing ongoing training programs to educate school district officials on the best practices related to debt issuance.

TTC advises against the establishment of a formal committee to achieve the objectives of Recommendation 6.10.

As noted in response to recommendation 6.9, training is to be incorporated as a standing component of the twice per year fiscal forum.

The TTC recommends that the County work closely with the Office of Education to ensure that school district business officials receive training on California school district GO bonds and are properly educated and informed on the County’s review and approval process.
Appendix C: A-C Sample Audit Confirmation Letter
July 28, 2016

Dear Auditors:

«Agency_Name_1»

The financial audits of school districts require certain information to be verified by the County Auditor-Controller. We have developed a standard report format to confirm amounts related to all school districts. For this reason, you may receive additional information, which may not be needed for your audit.

Attached are the schedules and a listing of the related contact persons. If you have any questions, please contact Huanling Lee at (213) 974-8346.

Very truly yours,

John Naimo
Auditor-Controller

Connie Yee, Division Chief
Accounting Division

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