
MEMORANDUM

TO: WHOM IT MAY CONCERN
FROM: LYNNE ESSELSTEIN, BOARD PRESIDENT AND ANTHONY RANII, SUPERINTENDENT
SUBJECT: JULY 11, 2013 GRAND JURY REPORT ON CAPITAL APPRECIATION BONDS
DATE: 7/19/2013

CAPITAL APPRECIATION BONDS

Introduction:

You may have read one of several articles that appeared recently in conjunction with a report from the San Mateo County Civil Grand Jury regarding Capital Appreciation Bonds (CABs). You can read the full report at http://www.sanmateocourt.org/documents/grand_jury/2012/bonds.pdf . As some of the articles mentioned, the report contains numerous factual errors. The report also fails to give a balanced picture of our use of this debt instrument.

Stewardship of public funds is one of the District's most important responsibilities, and one we take seriously. We regret that the Grand Jury did not give the District an opportunity to provide comments and information that would have resulted in a more accurate and complete report to the public. This memorandum will present information that will give a fuller picture to the public.

What is the San Mateo County Civil Grand Jury?

The Civil Grand Jury is a judicial body composed of 19 citizens. According to its website, it is meant to be a "watchdog for citizens of the county." The Grand Jury is a volunteer body that is tasked with suggesting meaningful solutions to a wide range of problems. From time to time, this body issues a report and respondents

must respond to the findings and the recommendations in the report. The recommendations are not binding.

What were the main points of this Grand Jury Report?

The thrust of the Grand Jury report is to spotlight aspects of CABs that, if inadequately addressed in a public debt financing, may result in unnecessary and excess public expense. Lack of transparency or public understanding of the debt obligation; issues structured with massive balloon payments at or near maturity dates; and inability to refinance (or “call”) CABs make them a potentially fraught debt instrument for public finance.

The report paints all CABs the same and fails to identify issuances, such as the District’s CABS, where these concerns have been addressed or are non-existent. In addition, the report contains numerous data errors that significantly misstate and misrepresent the District’s debt service obligation (interest) and debt ratio (proportion of principal borrowed to interest owed).

The District takes strong exception to any implication that its practices are irresponsible or harmful to taxpayers.

History of Measure B:

In order to paint a fuller picture, one has to become familiar with Measure B. The citizens of Hillsborough passed Measure B in November 2002 which authorized the issuance of \$66.8 million of bonds for capital improvement projects at our schools. This enormously successful program has allowed us to build a new building on each campus and fully renovate all of our learning spaces. Our Board of Trustees made every decision in an open, public meeting, and our Citizens’ Oversight Committee (required by State Law) was fully transparent and ensured that all bond funds had been properly spent and accounted for.

We are proud to note that we have never had an audit finding or exception in the history of the Measure B Bond Program either from our independent auditors or county and state regulators. The District’s Measure B Bond program has been a model of government fiscal management and transparency. Indeed, we worked hard to educate our taxpayers about every aspect of the program and have provided the public with numerous opportunities to be heard on this subject, all those legally required plus more.

In order to fund the Measure B projects, taxpayers are assessed an annual tax of up to \$30 per \$100,000 of assessed valuation. The District issued a series of bonds spaced several years apart in order to accomplish this. Each series of bonds is structured differently and is attuned to the market conditions and building and renovation needs at the time of its issuance. The voters themselves authorized this tax by passing Measure B. Four series of bonds were issued to fund \$66.8 million in projects. Roughly two million dollars of authorized capacity has not yet been used or financed.

The full story of Capital Appreciation Bonds in the District:

The Grand Jury report indicates that CABs “don’t require any payment (principal or interest) until they are due...creating massive balloon-type payments at or near the CABs’ maturity dates.” While this could be true, it is not the case for our District. The District’s January, 2011 issuance of CABs featured in the Grand Jury report actually included a mix of CABs and Current Interest Bonds (CIBs) which were issued with principal being paid in nearly every year over the life of the bonds. CABs are placed in selected years with CIB maturities on either side of the CAB maturities to accomplish an uninterrupted pattern of annual payments, thus amortizing the debt more evenly. In other words, there will be no balloon payment in Hillsborough.

The report goes on to discuss proposed legislation which would, among other things, require that CABs longer than 10 years contain a callable feature to pay the debt early or refinance the debt in the event that future interest rates are lower than they were at the time the bonds were originally sold. Had the Grand Jury consulted with the District before issuing the report, we would have explained that the District incorporated this very feature into our program. We insisted on it in order for us to continue to protect our taxpayers through refunding opportunities for the bonds. We have a proven record of refinancing the District’s debt in order to produce savings for Hillsborough taxpayers by reducing bond debt service payments. We have already completed one refinancing which saved the taxpayers more than \$2 million. This callable feature allows us to continue to refinance CABs, along with other types of bonds.

The Grand Jury Report also contained many factual errors:

First, the Hillsborough issuance referenced in the report included both CABs and CIBs, which was not reported in their chart.

Second, the “Bond Amount” does not just include the CABs, as the chart seems to indicate, but includes the previously mentioned CIBs as well.

Third, the “Total Amount Due at Maturity” is inaccurate because it erroneously adds the bond principal twice in the calculation.

Fourth, the table fails to indicate whether the CABs are callable, leaving the impression that they are not.

There was an overriding reason why CABs were required in the 2011 issuance. That bond issue, which included both current interest bonds (much like your home mortgage) and CABs, was required in order to retire an earlier shorter-term obligation called a bond anticipation notes (BANs), which the District issued in 2008 in order to obtain funds to commence projects and avoid construction cost inflation, which was ballooning at the time. The BANs had a limited duration, and when property values began to taper off, the District retired that instrument early to capture interest rate savings and ensure a successful refunding of that obligation. A mixture of CABs and CIBs was proposed and ultimately utilized as a vehicle to allow the District to maintain the annual property tax limitation required by California law for the Measure B bonds (\$30 per \$100,000 of assessed valuation). Were CABs not utilized, it is likely the District would have had to repay part of the bond anticipation note through its general funds, placing the District’s programs and educational initiatives at risk.

The Grand Jury looked at a single Hillsborough issuance rather than at the entire history of our Measure B Bond Program to date. Had they looked at all of issuances, they would see our total debt ratio is projected to be 3.29:1, well below the Grand Jury’s recommendation that debt ratios be below 4:1.

We have been prudent in our handling of the taxpayers’ money in the bond program. We have obtained local input and guidance from citizens knowledgeable in the municipal finance arena, and our Citizen’s Oversight Committee has been complimented on its transparency. Each decision on bond financing occurred at a public Board Meeting and only after an in-depth discussion and debate, including comments from the public.

The Grand Jury’s intent was laudable. Unfortunately, they were wrong on the facts and unclear about the big picture in Hillsborough. If you have any questions or comments, please contact Superintendent Anthony Ranii at 342-5193.

We continue to be thankful to the residents of Hillsborough for passing Measure B, and continue to work to safeguard the money you provide us.