

April 9, 2013

To: Albert G. Ault, Ed.D., Chief Financial Officer
Sweetwater Union High School District

From: Nick Marinovich, Chair
Sweetwater Bond Oversight Committee

REVIEW OF BOND ANTICIPATION NOTE FINAL OFFICIAL STATEMENT (Draft for CBOC Review)

The purpose of this memo is to bring to your attention, on behalf of the Citizen's Bond Oversight Committee, concerns and questions we have regarding the Bond Anticipation Notes for the Montgomery High Gymnasium and National City Middle School Projects. This review was conducted subsequent to the release of the Final Official Statement on March 25, 2013 and posted on the <http://emma.msrb.org> web site.

Background

As you are aware, the California Education Code and California Constitution govern the purview of the Bond Oversight Committee. Section 15278 (b) gives the Committee a broad oversight role when it states:

"The purpose of the citizens' oversight committee shall be to inform the public concerning the expenditure of bond revenues. The citizens' oversight committee shall actively review and report on the proper expenditure of taxpayers' money for school construction."

The National City Middle School and Montgomery High Gymnasium Projects have been included in the long range planning for Proposition O Expenditures, have been incorporated in numerous status reports to the Board of Trustees relative to Proposition O matters, and as stated in the Bond Official Statement will eventually be paid for through a calling/paying off the notes with General Obligation Bonds secured by tax revenue approved by the voters. We had heard at several of our Bond Oversight Committee meetings about the intended use of BAN's for these two aforementioned projects.

Board of Trustees Actions

On November 13, 2012 (R-5) the Board Adopted "Resolution No. 4176, Authorizing the Issuance of Not To Exceed \$38,000,000 Aggregate Initial Principal Amount of Sweetwater Union High School District 2012 General Obligation Bond Anticipation Notes, and Approving Certain Other Matters Related Thereto (the "Resolution of Issuance")." Some key provisions of the Resolution were as follows:

- Authorizing the issuance of the Notes in a principal amount not to exceed \$38,000,000;
- The principal amount of the Notes shall not exceed the amount set forth above, the annual interest rate on the Notes shall not exceed 3.00% and the Underwriter's discount (excluding original issue discount) shall not exceed 0.25% of the aggregate principal amount of the Notes;
- Authorizing the President of the Board of Trustees, the Superintendent, the Chief Financial Officer or such other officer or employee of the District as the Superintendent may designate to

approve the final form of the above documents and to execute such documents for and on behalf of the District;

There are a number of questions and issues that have arisen that require your attention.

ISSUES

On behalf of the entire Bond Oversight Committee, our issues are as follows:

It is unclear who is paying the interest on the bonds. The staff analysis of Board of Trustee Item R-5 states under fiscal impact "there is no cost to the district." If the District is not paying the interest then it would be logical to assume that the taxpayer would be levied. Section 15150 of the Education Code deals with, among other matters, the required content of the Resolution authorizing the BAN's. Specifically Section 15150 d(2)(A) states:

"A resolution of the governing board of the school district or community college district authorized the levying of the tax. The tax for the payment of the interest on the notes is a tax authorized by law for payment of bonds is anticipation of which the notes are issued".

The Resolution No 1476 adopted by the Board is silent with respect to any levy. The facts as stated would seem to put the District in violation of Education Code Section 15150. Also the Bond Indenture does not authorize the levy, provide the stated interest rate or say how the bond anticipation notes will be repaid.

The first payment is due on July 1, 2013. Page 5 of the Final Official Statement says that the first interest payment is \$391,405.55. Subsequent years \$749,500.00 are due semi-annually. None of the disclosures clearly stated the source of funds that would make the interest payments. For example, one disclosure indicates that there is no levy against taxpayers to pay the interest unless the BAN is not paid off by maturity in 2018. Also, see page 12 of 216 of the Official Statement that says Interest on the Notes will be paid from the Sale of General Obligation Bonds, or from an available source of funds of the district. This would imply that the District is anticipating selling General Obligation Bonds in the near future. This runs counter to recent information from staff. Perhaps the District is intent on borrowing funds from Mello Roos to pay the BAN Interest? This also would be problematic. In short, the District must clarify how these Bond Anticipation Notes interest are to be paid.

The interest rate on the BAN's exceeds the limit stated in the Board Resolution. Section 3 of Resolution 4176 states:

"principal amount of Notes in excess of \$38,000,000, shall not result in a final maturity date of the Notes later than five years from the date of the delivery of the Notes to the Underwriter, and shall not result in the Notes bearing interest at a rate in excess of 3.00% per annum." Page 2 of the Final Official Statement states that the interest rate on the \$25,720,000 BAN's maturing in January 1, 2018 have an interest rate of 5.0%.

It must be emphasized the Board adopted resolution does not say yield but interest rate.

The BAN Resolution should have included language on the use of Bond Premium for Project Expenses. If the district had not taken the bond premium of \$4.7 million and instead deposited it into the debt service fund, then the interest cost would have been 1.44%. This did not happen (See the Sources and Uses Schedule in the Official Bond Statement on page 12 of 216). The resolution fails to address the use of bond premium. This is disconcerting since the Board effectively did not approve that the bond premium be used for projects instead for debt service. Essentially, there is no way the Board would have known that the district would take the premium away from the taxpayer. The Note Indenture included an area for premium figures, but it is blank and no numbers were included in the Official Statement.

Several legal opinions indicate that the use of bond premiums should be deposited in a debt service fund rather than being used for project costs, contrary to the approach used by Sweetwater for its BANs. On March 1, 2011 Attorney General Kamala wrote a letter (Poway Unified School District v. All Persons Interested Superior Court of California, County of San Diego, Case No. 37-2010-00106255-CUMC-CTL) which states in part:

“As we understand it, the School District is offering to sell otherwise authorized bonds at a premium in exchange for additional upfront cash. This cash would then be used to pay the costs of bond issuance and interim financing. It is our Office's view that this proposed use of premium for costs of issuance as described in the complaint is not authorized by the law. 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. See Gov. Code, §29303; Ed. Code, § 15146, subd. (f). Further, the practice of artificially inflating the interest rate to generate premium for unauthorized uses translates into additional bond proceeds over and above what the voters authorized. Thus, by diverting premium to unauthorized uses and by artificially inflating interest rates to generate premium, the School District is not acting consistent with statutory law, and is also incurring debt beyond what the voters authorized in violation of the California Constitution.”

In Attorney General Opinion No. 06-1102o of January 9, 2009 for the Senator Joseph Smithian a number of questions were addressed relative to General Obligation Bonds and refunding of prior debt issued. While not identical to BAN's several of the key questions addressed in this Opinion are believed to apply the Sweetwater BAN's.

Specifically the question was asked:

“May a school district that has issued refunding general obligation bonds without a vote of the electorate spend proceeds from that bond sale to supplement funding for the original voter-authorized projects; to fund additional capital projects; or for other purposes unrelated to paying off the outstanding bonded indebtedness?”

The summary answer was:

“Without voter approval, a district may not use proceeds from a refunding general obligation bond to provide supplemental funding for unfinished projects, even if the projects were previously approved by the electorate, or for any other purpose except to pay off the designated outstanding bonds.”

Both of these opinions are attached for your reference.

NEXT STEPS

These are very serious issues regarding Bond Anticipation Notes issued by the Sweetwater Union High School District. In the interest of fairness and wanting to fully understand the District's perspective and response, it is requested that a full report be prepared for the Bond Oversight Committee meeting scheduled for May 8, 2013 regarding this matter. Myself and at least one other Committee member are available to meet with you to further discuss this matter in advance of the meeting.

Thank you for consideration of this matter.

Nick Marinovich, Chair
Bond Oversight Committee