SAN DIEGO COUNTY OFFICE OF EDUCATION
6401 LINDA VISTA ROAD, SAN DIEGO, CALIFORNIA 92111-7399 (858) 292-3500

Superintendent of Schools
Randolph E. Ward, Ed.D.

February 27, 2013

Dr. Edward Brand
Superintendent
Sweetwater Union High School District
1130 Fifth Avenue
Chula Vista, CA 91911-2896

Dear Dr. Brand:

Re: BAN Issuance

On October 26th, 2012 the District submitted a notice to the San Diego County Office of Education regarding the proposed issuance of General Obligation Bond Anticipation Notes (BAN). The BANs would be used to provide funds for construction of a new gymnasium and other projects until such time that General Obligation (GO) bonds can be sold. Once that's done, the GO bonds will be used to retire the BAN issuance. The Board approved the BAN issuance at its November 13, 2012 Board meeting prior to comment by our office.

Education Code Section 17150.1 requires the District notify the County Superintendent and County Auditor 30 days prior to approval by the District Governing Board. The code states that the District must provide the following information for review:

"The Superintendent of the school district shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, evidence of the ability of the school district to repay that obligation, and the issuance costs"

Our office contracted with Government Financial Strategies (GFS) to perform an independent review of the Information that was provided by the District. Their report is attached.

To summarize the analysis, the assumptions used by the district appear reasonable. Assuming that the tax base continues to grow, interest rates remain low and the law allows Districts to utilize Capital Appreciation Bonds as part of the bond structure, the District should be capable of repaying the Bond Anticipation Notes from the issuance of Proposition O Obligation Bonds.

Sincerely,

Brent Watson
Executive Director, District Financial Services
San Diego County Office of Education

BR: SR

Attachment

cc: Albert Alt, Chief Financial Officer, Sweetwater Union High School District
Lora Duzyk, Assistant Superintendent, Business Services, San Diego County Office of Education

Review of Proposed Debt

Sweetwater Union School District
2013 Bond Anticipation Notes

February 19, 2013

Introduction

The purpose of this report is to assist the County Superintendent of Schools in fulfilling its responsibilities under Education Code 17150.1. As always, we invite corrections and perspective to improve this report.

Education Code 17150.1 requires a notification 30 days prior to governing board approval to the County Office of Education and County Auditor of certain types of debt proposed to be issued and specifies their public comment to the governing board "regarding the capability of the school district to repay that debt obligation."

Education Code 17150.1 states what must be provided as part of this notice as follows:

> The superintendent of the school district shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, evidence of the ability of the school district to repay that obligation, and the issuance costs, to the county auditor, the county superintendent, the governing board, and the public.

On October 26, 2012 the District submitted a notice to the County Office of Education regarding the proposed issuance of General Obligation Bond Anticipation Notes, Election 2006, Series 2012.

The notice stated that the "Sweetwater Union High School District Board of Trustees will approve the issuance of the GO BANs on Tuesday, November 13, 2012." Shortly thereafter, the District communicated to the County Office of Education that there would be a delay in proceeding. In fact, the Board did take action on November 13 and we believe the Notes were issued in January.

The October submission included a summary of the financing which indicated the par amount of notes, net note proceeds, final maturity, date of optional redemption, coupon, yield, true interest cost, debt service schedule, and estimated construction fund earnings. The District also included a table showing various Proposition O facilities projects, funding sources, and budget information. The submission did not include "evidence of the ability of the school district to repay that obligation" as required by Education Code 17150.1.

This report addresses key questions that relate to the proposed financing, the affordability, and potential risks. The questions are:

1. Why is the District borrowing?
2. What will the District's annual obligation be, including debt service payments and administrative costs?
3. What is the risk that the annual obligation will vary from year to year and by how much?
4. What are the planned repayment sources?
5. What is the likelihood the planned repayment sources will be sufficient?
6. What is the cost of funds and is this reasonable?

Because the notification from the District did not include all items required by statute, we reviewed other information, including correspondence from District staff, the November 13, 2012 Board agenda items, the Preliminary Official Statement draft as of January 14, 2013, the Note

Indenture draft as of January 9, 2013, in order to perform an independent analysis of the District's ability to repay the bond anticipation notes by issuing general obligation bonds.

Questions Addressed

Why Is The District Borrowing?

It appears that the District is issuing bond anticipation notes because it cannot issue additional general obligation bonds at this time. Despite having ample *bonding capacity*, Proposition O bonds cannot be issued at this time because 1) tax rates are currently projected to continue to be higher than originally anticipated and 2) there's no room for additional debt service to be addressed for many years without resulting projected tax rates attributable to Proposition O higher than $30. Sometimes this is referred to as "taxing capacity".

Education Code 15268, applicable to union school districts, requires that:

> The bonds may only be issued if the tax rate levied to meet the requirements of Section 18 of Article XVI of the California Constitution in the case of indebtedness incurred by a school district pursuant to this chapter, at a single election, would not exceed thirty dollars ($30) per year per one hundred thousand dollars ($100,000) of taxable property when assessed valuation is projected by the district to increase in accordance with Article XIIIA of the California Constitution.

The 2012-13 tax levy attributable to Proposition O exceeds $30 and given significant declines in the tax base since 2008, the District has presumably concluded that it cannot meet the tax levy projection requirements via State statute and local commitment.[1]

Proposition O authorized $644 million of general obligation bonds. In 2008, the District issued $180 million of bonds, leaving $464 million in remaining *authorization*.

The District's 2012-13 total assessed value as provided by the County of San Diego is $35,997,987,502[2]. Thus, 1.25% x $35,997,987,502[3] = $449,974,844, the District's total *bonding capacity* for all bonds outstanding (in the case of the District, this includes Proposition BB and Proposition O). The District's outstanding bonds as of June 30, 2012 were equal to $350,778,339[4], leaving $99,196,505 in available bonding capacity.[5]

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[1] The District's Proposition O Tax Rate Statement, which was part of the ballot pamphlet, stated among other information, that:

> The best estimate from official sources of the highest tax rate which would be required to be levied to fund the bond issue during the term of the bond issue based on assessed valuations available at the time of the election or a projection based on experience within the same jurisdiction or other demonstrable factors is $0.027 per $100 ($27.00 per $100,000) of assessed valuation. It s estimated that the highest tax rate would apply in the 2018-2019 tax year based on assessed valuations available at the time of the election or a projection based on experience within the same jurisdiction or other demonstrable factors.

In meetings in the summer of 2012, District staff emphasized the importance of the $27 maximum Proposition O tax rate promised to the voters. Also mentioned was the Proposition BB (2000) promise of a $26.92 maximum tax rate, which also appears to have been exceeded.

[2] A table on Page 16 of the Preliminary Official Statement draft as of 1/14/13, states that the 2012-13 total assessed value is $34,652,969,485 although this differs with the text on Page 9 of the same document which states that the 2012-13 assessed valuation is $32,931,271,910

[3] As per Education Code 15102, "The total amount of bonds issued pursuant to this chapter and Chapter 1.5 (commencing with Section 15264) shall not exceed 1.25 percent of the taxable property of the school district . . ."

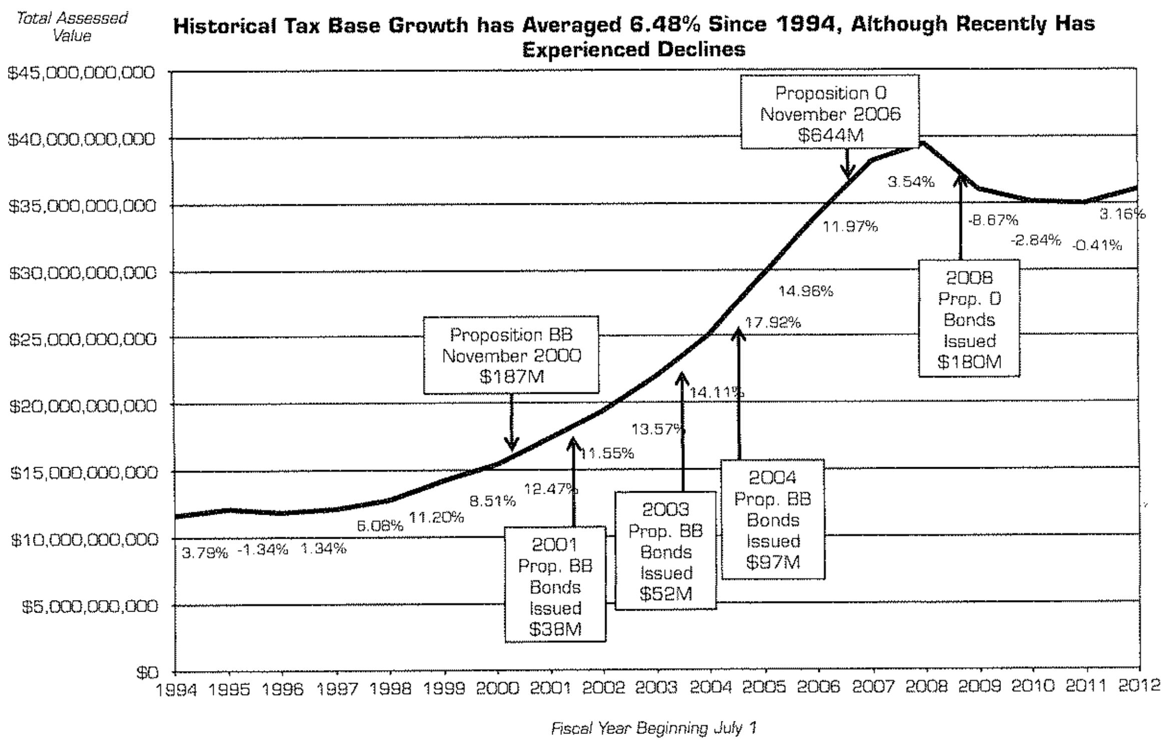
[4] A table on Page 25, Preliminary Official Statement draft as of 1/14/13 states outstanding bonds of $328,479,415 as of 11/1/12. The difference appears to be attributable to not including the Series 2011-A Refunding.

[5] The MDA included in the District's June 30, 2012 Audit Report (Page 9) states:

It is noteworthy that while Proposition O authorized $644 million of bonds to be issued, the District has thus far only been able to issue $180 million six years after the passage of Proposition O, less than 30% of the authorization.

Presumably, the implementation of Proposition O has been hampered by the recent loss in the District's tax base. See graph below.

Historical Tax Base Growth has Averaged 6.48% Since 1994, Although Recently Has Experienced Declines



Notes: assessed value data from 2003-04 onward per San Diego County Auditor-Controller's Office. Assessed value data prior to 2003-04 from District's Official Statements, sourced as California Municipal Statistics. Overlapping years of data were cross-checked for consistency.

The District's 2012-13 tax base reflects an increase which recovers almost all of the loss of the last two years, which bodes well for the ability to issue Proposition O bonds in the future.

Based on projections performed by the financial advisor, the estimated 2013 and 2018 general obligation bond debt service capacity is limited to $20,485,000 and $77,495,000, respectively. District's management will continue to monitor it's (sic) bonding capacity, and will ensure fiscally prudent decisions are made with respect to future bond issuance.

While bonding capacity and debt service capacity are two different calculations governed by different statutes, they are related. It would be helpful to see the District's financial advisor's calculation.

What Will The District's Annual Obligation Be, Including Debt Service Payments And Administrative Costs?

Debt Service

The District's submission to the County Office of Education included a debt service schedule which called for annual debt service of $728,300 (2% interest) each year on a par amount of notes of $36,415,000, with a final payment of principal and interest in 2018. Due to the delay, there's less interest to be incurred as the payment dates were kept constant, according to the Preliminary Official Statement draft as of January 14, 2013, which indicated that the first payment date will be July 1, 2013, with interest payments each January and July until maturity on January 1, 2018.

It should be noted that the November 13, 2012 Board action approved a not to exceed amount for the Notes of $38,000,000. As the Preliminary Official Statement draft did not indicate an amount to be borrowed, nor debt service table, we have prepared the one below, based on the October submission to the County Office of Education which indicated a par amount of $36,415,000.

Expected Debt Service

Par Amount of Notes $36,415,000.00
Coupon 2.00%

	Principal	*Interest*	*Total Debt Service*
January 1, 2013			$ -
July 1, 2013		$ 364,150.00	$ 364,150.00
January 1, 2014		$ 364,150.00	$ 364,150.00
July 1, 2014		$ 364,150.00	$ 364,150.00
January 1, 2015		$ 364,150.00	$ 364,150.00
July 1, 2015		$ 364,150.00	$ 364,150.00
January 1, 2016		$ 364,150.00	$ 364,150.00
July 1, 2016		$ 364,150.00	$ 364,150.00
January 1, 2017		$ 364,150.00	$ 364,150.00
July 1, 2017		$ 364,150.00	$ 364,150.00
January 1, 2018	$36,415,000.00	$ 364,150.00	$36,779,150.00
	$36,415,000.00	$3,641,500.00	$40,056,500.00

Administrative Costs

No information regarding on-going administrative costs was provided. The District is utilizing a Trustee rather than a Paying Agent, as was the case with the District's Series 2008A Proposition O general obligation bonds. Presumably, there is an annual administration fee. It is unclear from documents provided whether the District is intending for the interest payments due on the Notes to be paid from a deposit generated from the premium expected on the sale of the Notes or from annual tax levies. Should there be annual tax levies, there may be a County cost charged to the District.

What is the risk that the annual obligation will vary from year to year and by how much?

As shown above, the annual payment amounts vary, because of the interest-only payment structure for the first four years (2013-14 through 2016-17) and the final payment of principal and interest in 2017-18. However, the District appears to be planning a fixed interest rate. Therefore, once the financing is closed, the annual payments should not be different than the amounts known on the closing date.

What are the planned repayment sources?

The District stated in its October submission to the County Office of Education that the repayment source for the Bond Anticipation Notes is the issuance of Proposition O bonds, and that if the District is unable to issue Proposition O bonds, it will issue "a new five year BAN and roll the debt over". A subsequent communication from the County Office to the District confirmed that per Education Code 15150 (b), five years is the maximum term for bond anticipation notes including the term of renewal notes, so no "roll over" will be available.

The Note Indenture draft as of January 9, 2013 states, in Section 2.01 (b):

> The Notes shall be payable from the proceeds of the sale of General Obligation Bonds or any bond anticipation notes issued in renewal of the Notes pursuant to Section 15150 of the California Education Code or from other funds of the District lawfully available for the purpose of repaying the Notes, including State grant funds available for such purpose. Interest on the Notes shall be payable from the proceeds of the sale of General Obligation Bonds, from ad valorem taxes which may be lawfully levied pursuant to the Sate law (sic), or from other funds of the District lawfully available for the purpose of paying interest on the Notes as set forth herein.

This means that the should the District not be able to issue the general obligation bonds by January, 2018 in a sufficient amount to repay the Notes, the District will be obligated to repay the Notes from other sources including, but not limited to, the General Fund, other cash on hand, or the issuance of lease-purchase financing.

What Is The Likelihood The Planned Repayment Sources Will Be Sufficient?

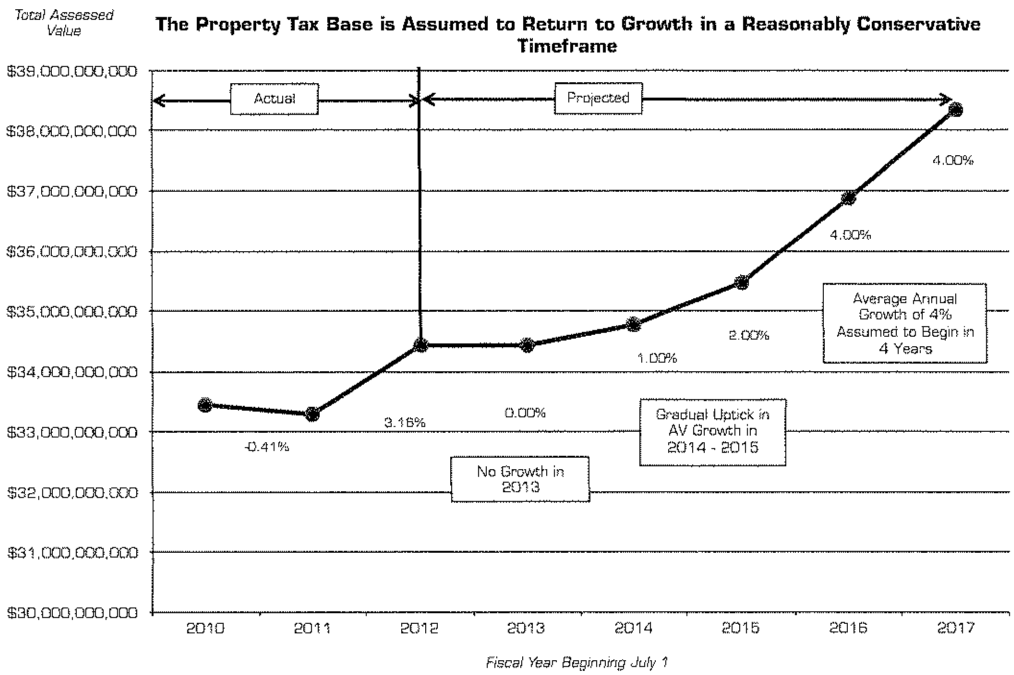
The District cannot currently issue general obligation bonds, based on the limitations on the tax rate projections previously discussed. The District will require sufficient growth in the tax base by fiscal year 2017-18 which will allow for the issuance of bonds which will produce net proceeds of at least $36,779,150 to repay the bond anticipation notes principal and interest due in January, 2018.

With respect to the interest payments due in fiscal years 2013-14 through 2017-18[6], we cannot ascertain from the information we have how the annual interest payments beginning July 1, 2013 will be addressed. If the interest payments are to be addressed from the deposit of a premium generated upon the sale of the notes, it would be good to see the relevant calculations. If the annual interest payments are to be made from tax levies for the purpose, it would be important to see evidence that the County will be levying this tax.

With respect to the principal and interest due in 2017-18, the question to be addressed is what level of tax base growth will be sufficient to allow for a sufficient bond issue by the maturity date of the notes on January 1, 2018, and what basis would there be for assuming that level will occur.

[6] leaving aside the final interest payment on January 1, 2018, which presumably would be paid along with the principal repayment due on that date

The calculation was not provided, therefore, we undertook an independent analysis. To do this, we developed some assumptions for future tax base growth through 2046-47, as shown in the graph below.



Over the next five years, these assumptions produce a five year compound annual growth rate of 2.63%. To understand whether these growth assumptions are sufficiently conservative, we looked at available historical data, since 1994. As shown in the table below, during the 15 five year periods since 1994, the five year compound annual growth rate has exceeded 2.63% 11 of 15 times, or 73% of the time.

Assessed Value - Historical 5-Year Growth

Fiscal Year Range	Beginning Total AV	Ending Total AV	5-Yr Compounded Annual Growth Rate
1994 - 1998	$11,631,730,271	$12,804,127,189	2.43%
1995 - 1999	$12,072,203,247	$14,238,339,474	4.21%
1996 - 2000	$11,910,926,894	$15,450,577,596	6.72%
1997 - 2001	$12,070,241,118	$17,377,514,004	9.54%
1998 - 2002	$12,804,127,189	$19,384,849,824	10.92%
1999 - 2003	$14,238,339,474	$22,015,279,928	11.51%
2000 - 2004	$15,450,577,596	$25,120,938,936	12.92%
2001 - 2005	$17,377,514,004	$29,622,748,242	14.26%
2002 - 2006	$19,384,849,824	$34,055,439,688	15.13%
2003 - 2007	$22,015,279,928	$38,133,567,981	14.72%
2004 - 2008	$25,120,938,936	$39,485,186,395	11.97%
2005 - 2009	$29,622,748,242	$36,061,582,254	5.04%
2006 - 2010	$34,055,439,688	$35,038,594,850	0.71%
2007 - 2011	$38,133,567,981	$34,895,757,663	-2.19%
2008 - 2012	$39,485,186,395	$35,997,987,502	-2.29%
2012 - 2016	$35,997,987,502	$39,931,311,615	2.63%
		Historical Average of 5 Year Growth Rates:	7.71%
% of 5 Year Periods That Exceed Assumed 5 Year Growth of 2.63%:			73.33%

During the four periods in which the 5 year compound growth rate was less than 2.63%, however, it missed by quite a bit. This is particularly true recently, during the last three five year periods. However, we've already seen an uptick of 3.16% in the District's total assessed value for 2012-13, as shown previously.

We believe the District will be able to issue additional Proposition O general obligation bonds by January 1, 2018 in a sufficient amount to address a January 1, 2018 liability of approximately $37,000,000. However, the District may have to rely on a capital appreciation bond structure. This raises a question about the risk of deferring the issuance of bonds with an expensive bond structure such as capital appreciation bonds to the future, given today's low interest rates, and proposed legislative changes which may affect the ability to utilize capital appreciation bonds.

What Is The Cost Of Funds And Is This Reasonable?

We analyze the cost of funds because high costs result in a financing being less affordable than it could be. Cost of funds includes the true interest cost and costs of issuance.

True Interest Cost

True interest cost ("TIC") takes into account interest rates and the underwriter's discount by looking at the cost of funds on a cash flow basis – dollars in and dollars out. In its submission to the County Office of Education, the District reported that its True Interest Cost would be 1.547% based on a coupon of 2% and net proceeds to the District of $37,130,090. We calculated the true interest cost at 1.59%, please see table below.[7]

[7] We don't know the expected closing date, so for ease of calculation, January 1 is used for the date of the first cash flow, recognizing that this causes the TIC to be slightly understated.

Cash Flow Analysis

Net Note Proceeds	$37,130,090
January 1, 2013	$37,130,090
July 1, 2013	($364,150)
January 1, 2014	($364,150)
July 1, 2014	($364,150)
January 1, 2015	($364,150)
July 1, 2015	($364,150)
January 1, 2016	($364,150)
July 1, 2016	($364,150)
January 1, 2017	($364,150)
July 1, 2017	($364,150)
January 1, 2018	($36,779,150)
True Interest Cost	1.59%

A true interest cost of 1.59% based on a coupon of 2% for an A+ rated general obligation bond issuer such as the District, seems high. It may be that the information provided to the County Office of Education in October has since been updated to reflect the current interest rate market, which has declined since October. The published[8] Municipal Market Data yield for A rated general obligation debt with a 2018 maturity is 1.27%. Without costs of issuance information or a sources and uses of funds table, it is hard to make a calculation, but assuming the same issuance size and net proceeds, a coupon of 1.70% would produce a true interest cost of 1.29%, more comparable to today's yields.[9]

Costs of Issuance

No costs of issuance information has been provided.

Other Items

Given that the District has indicated that it intends to repay the bond anticipation notes from the issuance of general obligation bonds only, consideration should be given to the removal of the covenant that it will use other sources of funds including the issuance of debt to be repaid by District budgeted sources (such as the General Fund), to reduce risk to the District's fiscal condition.

We highly recommend the District review the Government Finance Officers Association Best Practices for Debt Management. They can be found at:
http://www.gfoa.org/index.php?option=com_content&task=view&id=122&Itemid=135.
There are several recommended best practices which would likely benefit the District with its debt financing.

The Board's approval of Resolution 4176 authorizing the issuance of the 2012 Bond Anticipation Notes (we assume that legal counsel considers the change in the title to "2013" to be administrative) approved several documents which were not available as part of the Board's agenda packet and which have not been provided to the County Office of Education, including the Note Purchase Agreement, the Continuing Disclosure Certificate, and appointed several professional firms to assist with the issuance (bond counsel, disclosure counsel, and trustee).

[8] *The Bond Buyer*, January 28, 2013
[9] The difference between a 1.59% TIC and 1.29% TIC is approximately $500,000.

Conclusion

In conclusion, it appears that the District will be capable of repaying the bond anticipation notes from the issuance of Proposition O general obligation bonds, assuming that the tax base continues to grow, the law still allows for capital appreciation bonds at the time of bond issuance, and interest rates remain low.