



San Diego Unified
SCHOOL DISTRICT

Office of the Superintendent
EUGENE BRUCKER EDUCATION CENTER
4100 Normal Street, Room 2219
San Diego, CA 92103-2682
Phone: (619) 725-5506
Fax: (619) 291-7182

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SAN DIEGO
COUNTY GRAND JURY

August 2, 2013

Honorable Judge Robert J. Trentacosta
Presiding Judge of the Superior Court
220 W. Broadway
San Diego, CA 92101

RE: AMENDED Grand Jury Report: "School District Dilemma-Bonds or Bondage?"

Dear Judge Trentacosta:

The San Diego Unified School District ("District") has reviewed the Facts, Findings and Recommendations in the Grand Jury Report "School District Dilemma-Bonds or Bondage" filed on May 22, 2013. Pursuant to California Penal Code section 933(c), the filed a response dated June 21, 2013. Unfortunately, a response to Recommendation 13-82 was inadvertently not included in that response. Therefore, the following constitutes the response of the District and its Governing Board ("Board") to Recommendation 13-82 pertaining to matters under the control of the District. This response should be reviewed in conjunction with our previous response on this report. For your convenience, a copy of our previous response is attached.

RESPONSE TO RECOMMENDATIONS

Recommendation 13-82: For all future bond proposals encourage the PTA or similar organizations to educate their membership in school board policies and procedures. Suggested featured speakers could be school board members or financial experts who can answer questions and share relevant bond information.

Response: This recommendation has been implemented in part, as explained below. (Penal Code § 933.05(b)(1).) This recommendation will not be implemented in part, because it is not warranted or is not reasonable, as explained below. (Penal Code § 933.05(b)(4).)

Explanation: The District has no authority over PTAs, school foundations and similar organizations since they are separate legal entities. As a practical matter, however, the district usually works closely with outside organizations on issues which are important to education. In the past, the PTA has sponsored forums at which candidates may speak and political groups may provide information about ballot measures and issues. In addition, we believe that PTA newsletters regularly provide information to their membership about many issues, including upcoming ballot measures. To the extent we are able, we can encourage the PTA to continue to educate their membership regarding school board policies and procedures and future proposed bond information.



Honorable Judge Robert J. Trentacosta
Presiding Judge of the Superior Court
RE: Grand Jury Report: "Bonds or Bondage?" - AMENDMENT

Conclusion

On behalf of the Board of Education and its staff of the San Diego Unified School District, we appreciate your concern for our District.

Sincerely,



Cynthia Marten
Superintendent of Public Education

CM/AMD/dmh

Enclosure



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June 21, 2013

Honorable Judge Robert J. Trentacosta
Presiding Judge of the Superior Court
220 W. Broadway
San Diego, CA 92101

RE: Grand Jury Report: "School District Dilemma-Bonds or Bondage?"

Dear Judge Trentacosta:

The San Diego Unified School District ("District") has reviewed the Facts, Findings and Recommendations in the Grand Jury Report "School District Dilemma-Bonds or Bondage" filed on May 22, 2013. Pursuant to California Penal Code section 933(c), the following constitutes the response of the District and its Governing Board ("Board") to the findings and recommendations pertaining to matters under the control of the District. This response has been prepared with the assistance of our financial advisor and bond counsel.

RESPONSE TO SUMMARY AND OTHER PRELIMINARY STATEMENTS

Initially, I must say that the District takes its stewardship of the schools and the taxpayers' money very seriously, approves all issuances in open meetings with disclosure of the plan of finance, and strives to obtain the best value for its issuances by employment of experienced and knowledgeable financial advisors and other professionals.

The District operates within San Diego County 109 elementary schools, 24 middle/junior high schools, 26 senior high schools, 12 atypical schools, 4 alternative schools, 45 State preschool sites, 14 child development centers, 4 special education centers and is the sponsoring agency for 44 charter schools. The District has been authorized by the voters to issue General Obligation Bonds on a number of occasions as follows:

Proposition MM. In November 1998, over 2/3 of District voters authorized \$1.510 billion in general obligation bonds of the District pursuant to Proposition MM ("Proposition MM"). With the issuance of the 2005 General Obligation Bonds (Election of 1998, Series G) on September 8, 2005, all of the Proposition MM bonds have been issued, and the District has also effected the refunding of a number of its Proposition MM bond issues. Proposition MM proceeds were applied to fund the modernization of 161 existing schools and construction of 12 new and three rebuilt schools. In addition to the repair of aging schools, Proposition MM projects included ensuring the health and safety of school playground equipment, access to the physically disabled, fire alarm/security systems and climate controls, upgrading electrical systems for technology, building libraries, science classrooms and outdoor lunch court shelters, maintaining school buildings and grounds and improving the teaching and learning environment.

Proposition S. The District received authorization at a Proposition 39 election held on November 4, 2008, by more than 68% of the votes cast by eligible voters within the District (needing only 55% plus one vote to pass) on the measure to issue general obligation bonds in an amount not to exceed \$2,100,000,000 for the purposes summarized as follows: repairing

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RE: Grand Jury Report: "Bonds or Bondage?"

outdated student restrooms, deteriorated plumbing and roofs; upgrading career/vocational classrooms and labs; providing up-to-date classroom technology; improving school safety/security; replacing dilapidated portable classrooms; upgrading fire alarms; and removing hazardous substances ("Proposition S"). Pursuant to Proposition S, the District may only issue general obligation bonds if the tax rate projected to pay debt service on the proposed bonds, when combined with the tax rate necessary to pay debt service on the outstanding Proposition MM and Proposition S bonds of the District in each year, will not exceed \$66.70 per \$100,000 of assessed valuation, which was the tax rate levied to pay Proposition MM bonds at the time of the Proposition S election. Based on the assessed valuations of taxable property within the District that was projected at the time of the authorization of the Proposition S, the basic structure for issuance of Proposition S bonds was as Capital Appreciation Bonds ("CABs") in order for the debt service to be an extension of the Proposition MM levy. The Board of Education approved the financing plan reliant on CABs for the issuance of Proposition S bonds in open meetings, it being determined preferable to finance schools by not increasing the tax rate then being levied to pay the Proposition MM bonds. Due to the reduction in assessed value of property in the District and the tax rate limitation in the measure, the issuance of Proposition S bonds is difficult even with CABs, so the District returned to the voters.

Proposition Z. The District received authorization at a Proposition 39 election held on November 6, 2012, by more than 61% of the votes cast by eligible voters within the District on the measure to issue general obligation bonds in an amount not to exceed \$2,800,000,000 for the purposes summarized as follows: repairing deteriorating 60-year-old classrooms, libraries, wiring, plumbing, bathrooms and leaky roofs; removing hazardous mold, asbestos, and lead; upgrading fire safety systems/doors; upgrading classroom instructional technology, labs and vocational education classrooms ("Proposition Z"). Proposition Z was proposed by the District in order to continue to meet the modernization and facilities need of the District and is constrained only by the \$60 tax per \$100,000 AV projection limit contained in Proposition 39 legislation. The Board with respect to Proposition Z bonds adopted a policy of issuing such bonds as current interest bonds ("CIBs"). However, the Board cannot so limit its issuances of Proposition S bonds without delaying issuances for many years and has not adopted a policy to that effect.

The District has a duty to provide the facilities that the voters in the District have repeatedly approved by issuing the voter approved bonds within the tax levy constraints of the propositions and state law. It is this responsibility that the Grand Jury failed to take into account in some of its recommendations. The District uses CABs because without issuing CABs it is unable to issue bonds that legally meet such tax levy restrictions and to not issue CABs would deny the facilities that the voters approved for the school children.

RESPONSE TO FINDINGS

Finding #01: Bond initiatives and propositions typically do not provide information as to the cost of principal and interest payments. This amount can be exponentially larger than the original principal in bond measures that employ a CAB structure.

Response: The District disagrees partially with this finding. (Penal Code § 933.05(a)(2).)

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Explanation: Every bond measure authorizes a "principal" amount that is approved by the voters and specifies a maximum interest may be paid on such borrowed principal. The "principal" amount does not change from what the voters authorize just because the bond is issued as a CAB. What a CAB does is delay and compounds interest on such principal. Compounded interest usually is at a higher rate than current interest because the investor assumes a greater risk in receiving such delayed interest and the market price of CABs have greater volatility. The District's taxpayers may benefit from the issuance of CABs if inflation occurs prior to the date such CAB matures.

Finding #02: When school districts divert premiums to unauthorized uses and by artificially inflating interest rates to generate the premium, they are not acting consistent with statutory law and are incurring debt beyond what voters authorized in violation of the California Constitution.

Response: The District disagrees partially with this finding. (Penal Code § 933.05(a)(2).)

Explanation: State law (Education Code 15146) requires that proceeds of school bond issues, exclusive of any premium "received," be deposited in the District's building fund and that any premium or accrued interest "received" be deposited in the interest and sinking fund of the District. The District requires that the purchasers pay the cost of issuance of its bonds and that the District receive proceeds at least equal to the principal amount of its bonds to deposit into the building fund. The principal amount of bonds is the amount the voters approve to be issued and the District believes this amount should be deposited in the building fund and used for the voter approved projects. By necessity, a bond premium that is not "received" by the District, but it is used by the purchasers to pay the costs of issuance. The District believes this is consistent with the statutory law and with the voter authorization under the California Constitution.

Finding #03: AB 182, if enacted, will require governing boards of school and community college districts to provide greater transparency to voters concerning:

- **Whether CABs are proposed and the reasoning for them**
- **Cost comparisons between CIBs and CABs**
- **Total debt service to principal ratios**
- **Mandatory early redemption guarantees**
- **Analysis of the overall bond cost**
- **Underwriter disclosure.**

This mandatory reporting will provide greater bond referendum clarity for the taxpayers.

Response: The District disagrees wholly with this finding. (Penal Code § 933.05(a)(2).)

Explanation: The District disagrees that passage of AB 182 will provide greater bond referendum clarity for the taxpayers as it believes its current and past practices have provided adequate disclosure. In addition, the reduction in the length of time for bond repayment actually reduces the amount of money available for construction – projected for a loss of \$100 million by not issuing 30 year bonds (instead of 25 year bonds).

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RESPONSE TO RECOMMENDATIONS

Recommendation 13-79: Structure future loans to offer more flexibility by allowing a variety of financing options to include:

- 1. Limit the maturity of a bond to no more than 25 years**
- 2. Early prepayment of bonds**
- 3. A callable feature in all debt issuances**
- 4. No interest rates greater than 8%**
- 5. A debt ratio not to exceed 4 to 1**
- 6. Using the Education Code rather than Government Code.**

Response: This recommendation will not be implemented because it is not warranted or is not reasonable, as explained below. (Penal Code § 933.05(b)(4).)

Explanation:

1. This recommendation would prohibit the issuance of 30 year bonds that are standard in the marketplace, thereby artificially restricting the best structure for the District's debt and would severely constrain the issuance of Proposition S bonds due to current assessed value limits.
2. The market will require an increased rate to have this early prepayment option in a bond.
3. The market will require an increased interest rate to have callable feature option in a bond.
4. This is fine in today's low interest rate environment, but 8% may not always be sufficient. It is contrary to Government Code section 53531 and, therefore, puts school districts at a disadvantage vis a vis other public agencies placing debt on the market.
5. In a higher interest rate environment it may be problematic to have a 4 to 1 or less debt ratio. Also a simple ratio should be balanced by a present value analysis that recognizes the reduction in value of future dollars.
6. The Education Code restricts the repayment term of the bonds to 25 years, thereby artificially restricting the best structure for the District's debt. It would severely constrain the future issuance of Proposition S bonds due to current assessed value limits. This would slow down the District's Facilities Master Plan, increase future costs due to delay and increased constructions based on future inflation, and reduce the number of facilities that could be built or modernized.

Recommendation 13-80: Hold public meetings to discuss the financial impact on the school district for all future bond proposals. The discussion should include:

- **The bond amount**
- **Interest rate**
- **Terms**
- **Cost to homeowners in increased property taxes**

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- **Total repayment amount**
- **What the new issue may do to future bond requirements.**

Response: This recommendation has been implemented, as explained below. (Penal Code § 933.05(b)(1).)

Explanation: The School District has historically operated in a very transparent way and this would not be anything different than its customary practice.

Recommendation 13-81: For all future bond proposals send public notices to all district residents to ensure that the community has adequate notice of school board meetings where bond proposals will be discussed. Meeting notices must be posted in several public locations (e.g., school bulletin boards, school websites, school offices, classrooms and district offices), as defined by the Brown Act.

Response: This recommendation has been implemented in part, as explained below. (Penal Code § 933.05(b)(1).) This recommendation will not be implemented in part, because it is not warranted or is not reasonable, as explained below. (Penal Code § 933.05(b)(4).)

Explanation: The District widely disseminates its meeting notices, but sending public notices to all district residents would be prohibitively expensive. All meetings of the District where bond issues are authorized comply with the Brown Act. In addition, prior to the election, voters receive voter pamphlets containing the complete language of the bond proposition and, of course, may vote against the proposition.

Conclusion

On behalf of the Board of Education and its staff of the San Diego Unified School District, we appreciate your concern for our District.

Sincerely,



William A. Kowba
Superintendent