

Reporting Requirements for Non-Voter-Approved Debt

*AB 2197 (Mullin, D-South San Francisco),
Chapter 128/2008*

Background

Debt management policies have been developed by local educational agencies (LEAs) to provide guidelines for the issuance of general obligation bonds, certificates of participation (COPs) and other forms of indebtedness. While issuing debt can be an appropriate method of financing capital projects, prudent fiscal management and consistent monitoring of such debt issuance is required to preserve a district's credit worthiness, budget and financial solvency. In an effort to determine the appropriate uses for debt financing and debt structures, and to establish prudent debt management, the Legislature enacted Assembly Bill (AB) 2197 to clarify the reporting requirements for non-voter-approved debt.

Under current law, Education Code section 17150 requires school districts to notify the county superintendent of schools and the county auditor when the school district's governing board approves the issuance of non-voter-approved debt. Included in this is the requirement that the school district superintendent provide the repayment schedules for the debt obligation and evidence of the school district's ability to repay the obligation to the county superintendent of schools, the county auditor and the public. The law permits the county superintendent of schools and the county auditor to comment publicly to the governing board of the school district within 15 days of the receipt of this information regarding the school district's capability to repay that debt obligation. County boards of education have a similar disclosure obligation to the Superintendent of Public Instruction (SPI), who in turn has the ability to

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publicly comment on the county board's ability to repay the debt (Education Code section 17150).

Assembly Bill (AB) 2197 (Chapter 128/2008), effective January 1, 2009, changes the reporting requirements for issuing non-voter-approved debt, for both school districts and county offices of education. In addition, this bill adds other kinds of non-voter-approved debt instruments secured by real property to the list of what must be disclosed. Many LEAs use debt instruments that do not require voter approval; many of these will now fall under Assembly Bill (AB) 2197, including the following:

- Certificates of participation (COPs)
 - Lease purchases (LPs) secured by real property
 - Qualified Zone Academy Bonds (QZABs) secured by real property
 - Revenue bonds
 - Any other debt instrument secured by real property and not subject to voter approval.
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- School districts MUST notify the county superintendent of schools and county auditor at least 30 days prior to the governing board's approval of the issuance of certificates of participation (COPs) or other non-voter-approved debt instruments secured by real property. School districts are required to furnish information necessary to assess the anticipated effect of the debt issuance, including repayment schedules, evidence of the ability to repay, and costs of issuance. Current law already requires that repayment schedules and evidence of ability to repay be provided, but the new law adds the requirement that the school district provide information necessary to assess the anticipated effect of the debt issuance, including the issuance costs. Within 15 days of receipt of the information, the county superintendent of schools and the county auditor are authorized to comment publicly to a district's governing board regarding the district's capacity to repay the debt obligation, based on the information provided. This authorization is also contained in current law.

Whenever possible, the county office of education should work with the county auditor to ensure that both entities are requesting the same information from local school districts.

- County offices of education MUST notify the SPI at least 30 days prior to the county board of education's approval of the issuance of certificates of participation (COPs) or other non-voter-approved debt instruments secured by real property. County offices of education are required to furnish information necessary to assess the anticipated

effect of the debt issuance, including repayment schedules, evidence of the ability to repay, and costs of issuance. Current law already requires that repayment schedules and evidence of ability to repay be provided, but the new law adds a requirement that the county office of education provide information necessary to assess the anticipated effect of the debt issuance, including the issuance costs. Within 15 days of receipt of the information, the SPI is authorized to comment publicly to the county board of education regarding the county office's capacity to repay that debt obligation, based on the information provided. This authorization is also contained in current law.

Current law requires that districts and county offices of education with qualified or negative budgets obtain county office of education or SPI approval, respectively, prior to issuing non-voter-approved debt. Assembly Bill 2197 does not change or eliminate this requirement.

Assembly Bill (AB) 2197 (Chapter 128/2008) also amends Education Code section 42133.5 to prohibit the proceeds from COPs and other non-voter-approved debt secured by real property from being used for a district's general operations, regardless of the district's budget certification. Long-term debt financing mechanisms should not be used to finance current operations or to capitalize expenses. Capital debt should not be used as a credit card to pay for salary and benefit compensation, transportation services, or other recurring expenses. Current law already requires LEAs to use solely for capital outlay purposes any proceeds obtained through the sale or lease of LEA property (lease-leaseback). The provisions of AB 2197 clarify that the proceeds of COPs are similarly restricted.

The author of the legislation, Assembly Member Mullin, argued that several districts have run into financial difficulty due to over-reliance on debt instruments such as COPs, citing situations in which districts issued large COPs and the projected level of developer fees and other repayment sources did not materialize to service the debt service requirements over multiple fiscal years.. The Senate Floor Analysis states, "By the time county and state entities are notified, the decision to issue COPS or other nonvoter approved debt would have been made with no ability to repay the debt."

In assessing this new law, LEAs should examine their overlapping debt and update their debt management policies to include consideration of one or more debt management ratios.

The Ratio of Outstanding Debt to Assessed Value is one such ratio. The formula for this type of computation is referenced in Education Code section 15106. This type of ratio can be calculated for both general obligation bonds and

COPS or overall debt obligations typically contained in the overlapping debt statement prepared by the district's independent auditor or financial advisor.

The determination of how much indebtedness the LEA should incur is normally based on a multiyear capital financing plan, which analyzes the LEAs long-term infrastructure needs and the impact of planned debt issuances on the long-term affordability of all funds. The financing plan should be based on the LEA's long term capital plan and include all LEA financings to be repaid from the general fund or special funds. The affordability of the debt should be determined by calculating the various debt ratios that would result after the proposed issuance of additional debt and analyzing the trends over the current and five subsequent fiscal years to determine the fiscal impact on the LEA's long-term financial solvency. Multiple financial limitations may be utilized to measure different types of debt, and establishing ratios such as the debt service payments as a percentage of revenues or expenditures may also be an applicable methodology for many LEAs.

Additional assistance

For additional assistance, LEAs should contact their respective oversight agencies or visit FCMAT's Web site at www.fcmat.org and submit an online request for assistance

Assembly Bill AB 2197

Assembly Bill No. 2197

CHAPTER 128

An act to amend Sections 17150 and 42133.5 of, and to add Section 17150.1 to, the Education Code, relating to school facilities.

[Approved by Governor July 16, 2008. Filed with Secretary of State July 16, 2008.]

LEGISLATIVE COUNSEL'S DIGEST

AB 2197, Mullin. School facilities.

(1) Existing law requires a school district to notify the county superintendent of schools and the county auditor when the governing board of the school district approves proceeding with the issuance of certificates of participation or revenue bonds or entering into specified agreements for financing school construction pursuant to the California School Finance Authority Act. The superintendent of the school district is required to provide specified information to the county auditor, the county superintendent of schools, the governing board, and the public regarding that debt.

Existing law requires the county superintendent of schools or superintendent of a school district for which the county board serves as governing board to notify the Superintendent of Public Instruction when the county board of education approves proceeding with the issuance of certificates of participation or revenue bonds or to entering into an agreement for financing pursuant the California School Finance Authority Act. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board is required to provide specified information to the Superintendent of Public Instruction, the governing board, and the public.

This bill would require these notices to be made no later than 30 days before the approval of the debt in the case of certificates of participation and would impose this notice requirement on other debt instruments that are secured by real property and do not require the approval of the voters of the school district. The county superintendent of schools and the county auditor would be authorized to comment publicly to the governing board of the school district regarding the capability of the school district to repay the debt obligation. By requiring the county superintendent of schools and county auditor to receive the notice and information, the bill would impose a state-mandated local program.

(2) Existing law prohibits the proceeds obtained by a school district from the sale of a saleback or leaseback agreement, or interests in that agreement, or a debt instrument payable from payments under a saleback or leaseback agreement from being used for general operating purposes of a school district.

This bill would extend that prohibition to proceeds from the issuance of certificates of participation or other debt instruments that are secured by real property and do not require the approval of the voters of the district.

(3) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that, if the Commission on State Mandates determines that the bill contains costs mandated by the state, reimbursement for those costs shall be made pursuant to these statutory provisions.

The people of the State of California do enact as follows:

SECTION 1. Section 17150 of the Education Code is amended to read:

17150. (a) Upon the approval by the governing board of the school district to proceed with the issuance of revenue bonds or to enter into an agreement for financing school construction pursuant to Chapter 18 (commencing with Section 17170), the school district shall notify the county superintendent of schools and the county auditor. The superintendent of the school district shall provide the repayment schedules for that debt obligation and evidence of the ability of the school district to repay that obligation to the county auditor, the county superintendent, the governing board, and the public. Within 15 days of the receipt of the information, the county superintendent of schools and the county auditor may comment publicly to the governing board of the school district regarding the capability of the school district to repay that debt obligation.

(b) Upon the approval by the county board of education to proceed with the issuance of revenue bonds or to enter into an agreement for financing pursuant to Chapter 18 (commencing with Section 17170), the county superintendent of schools or superintendent of a school district for which the county board serves as governing board shall notify the Superintendent. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board shall provide the repayment schedules for that debt obligation and evidence of the ability of the county office of education or school district to repay that obligation, to the Superintendent, the governing board, and the public. Within 15 days of the receipt of the information the Superintendent may comment publicly to the county board of education regarding the capability of the county office of education or school district to repay that debt obligation.

(c) Prior to delivery of the notice required by subdivision (a) neither the county nor its officers shall have responsibility for the administration of the indebtedness of the school district. Failure to comply with the requirements of this section will not affect the validity of the indebtedness.

SEC. 2. Section 17150.1 is added to the Education Code, to read:

17150.1. (a) No later than 30 days before the approval by the governing board of the school district to proceed with the issuance of certificates of participation and other debt instruments that are secured by real property and do not require approval of the voters of the school district, the school district shall notify the county superintendent of schools and the county auditor. 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. Within 15 days of the receipt of the information, the county superintendent of schools and the county auditor may comment publicly to the governing board of the school district regarding the capability of the school district to repay that debt obligation.

(b) No later than 30 days before the approval by the county board of education to proceed with the issuance of certificates of participation and other debt instruments that are secured by real property and do not require

approval of the voters of the county, the county superintendent of schools or superintendent of a school district for which the county board serves as governing board shall notify the Superintendent. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, the evidence of the ability of the county office of education or school district to repay that obligation, and issuance costs, to the Superintendent, the governing board, and the public. Within 15 days of the receipt of the information the Superintendent may comment publicly to the county board of education regarding the capability of the county office of education or school district to repay that debt obligation.

SEC. 3. Section 42133.5 of the Education Code is amended to read:

42133.5. Regardless of the certification of the budgetary status of a school district or county office of education under subdivision (l) of Section 1240 or Section 42131, the proceeds obtained by a school district from the sources listed in subdivisions (a) to (f), inclusive, shall not be used for general operating purposes of the school district.

- (a) The sale of a saleback or leaseback agreement, or interests in the agreement.
- (b) A debt instrument payable from payments under a saleback or leaseback agreement.
- (c) Certificates of participation.
- (d) Other debt instruments that meet both of the following criteria:
 - (A) They are secured by real property.
 - (B) They do not require the approval of the voters of the school district.

SEC. 4. If the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code.