## **COUNCIL AGENDA REPORT**

June 19, 2007

**TO:** City Council

FROM: City Manager

Prepared by: Director of Administrative Services

SUBJECT: RESPONSES AND RECOMMENDATIONS TO SANTA BARBARA

COUNTY'S GRAND JURY REPORT - "CERTIFICATES OF PARTICIPATION IN PUBLIC FINANCES: IS MORE SCRUTINY

**NEEDED?**"

### **RECOMMENDATION:**

It is recommended that the City Council:

- Review City staff's responses and recommendations to Santa Barbara County's Grand Jury (Grand Jury) report titled "Certificates of Participation in Public Finances: Is More Scrutiny Needed?";
- 2. Authorize the Mayor to sign a letter, addressed to the Presiding Judge of the Superior Court, which responds to the Grand Jury's findings and recommendations; and
- 3. Direct the City Clerk's Office to submit the City's responses to the Presiding Judge of the Superior Court, the Santa Barbara County Grand Jury Foreperson, and the Santa Barbara County Board of Supervisors.

### **BACKGROUND:**

On March 27, 2007, the City received a report from the Grand Jury regarding Certificates of Participation in Public Finances: Is More Scrutiny Needed? The Grand Jury requested a response from the City Council and the Director of Administrative Services to the findings and recommendations listed in the report. Elected officials are required to respond to the Grand Jury's findings and recommendations within 60 days of receiving the report and public agencies are required to respond within 90 days of receiving the report. The response date requires that the City reply to the Grand Jury's findings and recommendations by June 25, 2007. Since the City Council and the Director of Administrative Services are required to respond to the same findings and

recommendations, one combined response will be submitted on behalf of the City Council and the Director of Administrative Services.

## **DISCUSSION:**

The Grand Jury conducted an inquiry into the public notice provided for the issuance of Certificates of Participation (COPs) and subsequently produced a report titled Certificates of Participation in Public Financing: Is More Scrutiny Needed? The inquiry examined the issuance of COPs because there is no specific rule of law or direct voter approval required for the authorization of COPs. The Grand Jury's inquiry examined the concern that COPs may be an expedient method for funding projects that may not be supported by the public. While there are no comments in the report on the legality of the current process, the inquiry did analyze the necessity for public approval and resulted in number of findings and recommendations.

In total, the Grand Jury report lists five findings and five recommendations regarding the process that agencies in Santa Barbara County perform regarding COPs. The following, for Council's consideration, is City staff's response to the five findings and five recommendations:

Response to the Grand Jury's Findings and Recommendations Regarding Certificates of Participation in Public Finances: Is More Scrutiny Needed?

# **Grand Jury Findings**

<u>Finding 1</u>: Projects funded by COPs are not subject to a well-regulated, mandatory public notice process, and this deficiency can preclude the general public from either registering opposition or participating as investors.

<u>City's Response</u>: The City disagrees with Finding 1. The current public notice process serves the intent of notifying the public, allowing the community an opportunity to learn about the proposed debt issuance, and to voice support or opposition to the debt. The City subjects all new debt, whether revenue bonds or COPs, to the same public notice procedure in compliance with the Brown Act. City staff prepares a City Council agenda item, which is available to the public to review; a public meeting is held and publicly noticed to present the item to the governing board; the public is then afforded the opportunity to comment for or against the debt issuance; and, finally, City Council adopts a resolution that approves or denies the debt issuance. The City/Authority and a financial advisor issues an Official Statement explaining the nature of the issuance; the proposed use of the debt proceeds; and provides the public with information needed to make an informed decision on investing in the project. The public is fully informed.

<u>Finding 2</u>: Tax payers and/or investors may be at risk if standard assurances (e.g. environmental and "escrow") are not consistently required prior to issuance of COPs.

<u>City's Response</u>: The City disagrees with Finding 2. The issuance of COPs is a financial procedure where the approval of a project is a development approval process. Environmental issues are best addressed through Environmental Impact Reports (EIR) to gain approval of a project while the issuance of COPs are best handled under the guidelines of the Security Exchange Commission (SEC), whose rules and regulations are very stringent.

<u>Finding 3</u>: The maturity terms of COPs are often comparable to those (20-30 years) for General Obligation and Revenue Bonds, suggesting that COPs may be an inappropriate substitute for such bonds.

<u>City Response</u>: The City disagrees with Finding 3. The maximum term of a COP is the useful life of the assets/infrastructure purchased with the COP debt. If the assets/infrastructure has a 20 to 30 year term it is appropriate that the debt issue be for that term.

<u>Finding 4</u>: The regulations regarding the sales of COPs and the use of the proceeds from those sales are inadequate.

<u>City's Response</u>: The City disagrees with Finding 4. The issuance of debt is highly regulated. Municipalities must furnish financial and project information to potential investors in the form of an Official Statement and must obtain a bond counsel opinion on the legality of the issuance. The governing body and public are informed on the issuance of COPs through meetings open to the public. In some instances, each year the City is required to file continuing disclosures on the debt issuance. The use of the debt proceeds is clearly spelled out in the Official Statement.

<u>Finding 5</u>: Districts and government agencies are not required to give notification of the use of COPs to county or city governments, which might be affected.

<u>City's Response</u>: The City agrees with Finding 5. The City is not required to notify the county or city governments about a potential COP issuance that may not impact them.

### **Grand Jury Recommendations**

<u>Recommendation 1</u>: A consistent, mandatory public notice and approval process should be implemented and the sale of COPs should not proceed until completion of that process.

<u>City's Response</u>: The recommendation has been implemented as SEC regulations, bond counsel legal requirements, and Brown Act notices fulfill this requirement.

<u>Recommendation 2</u>: All projects funded by COPs should receive the necessary assurances that are demanded of projects funded by General Obligation and Revenue Bonds.

<u>City's Response</u>: The recommendation has been implemented. The City's outstanding COPs were issued with the same requirements and assurance as were given for the City's revenue bonds.

<u>Recommendation 3</u>: The use of COPs should be restricted to short-term projects. Long-term projects should be funded with General Obligation or Revenue Bonds.

<u>City's Response</u>: The recommendation will not be implemented because it is not reasonable. The City has the right and authority to use the most appropriate financing mechanism for the construction and purchase of assets. The maximum term of a COP is the useful life of the assets/infrastructure purchased with the COP debt. The COPs and revenue bonds are appropriate financing mechanisms when a segment of the population benefits from the construction or purchase of assets, as opposed to General Obligation Bonds that are appropriate to use when the general populace benefits.

<u>Recommendation 4</u>: COPs should be sold only as needed to fund the specific project for which they were approved, and the funds should not be used for other projects. In particular, COPs should not be sold for the sole purpose of earning interest on the funds.

<u>City's Response</u>: The recommendation has been implemented. The City uses the COP debt issuance funds for the project named in the Official Statement. In addition, SEC and IRS regulations prohibit the earning of arbitrage. Arbitrage occurs when money is borrowed at a low interest rate, and then invested at a higher interest rate, thereby, earning interest income. To ensure that arbitrage does not occur, the

City contracts with an independent consultant to annually review the interest paid and the interest earned on the City's debt issues.

Recommendation 5: Any district or government agency within the County that is planning to issue any COPs should give notification to the County government and any affected municipal government.

<u>City's Response</u>: The recommendation has not yet been implemented, but will be implemented in the future.

The above concludes the City's responses to the Grand Jury's report.

Fiscal Considerations:

None.

Impact to the Community:

None.

LYNDA SNODGRASS
Director of Administrative Services

Attachments: "A" - Grand Jury Report dated March 26, 2007

"B" - Letter from the Mayor to the Presiding Judge of of the Superior Court

June 20, 2007

The Honorable Judge Rodney Melville Superior Court 312-M East Cook Street Santa Maria, CA 93455

Re: Responses and Recommendations to Santa Barbara County's Grand Jury Report - "Certificates Of Participation In Public Finances: Is More Scrutiny Needed?"

The purpose of this letter is to transmit the City of Santa Maria's formal combined response to the above subject report dated March 26, 2007. According to Penal Code Section 933, the City Council has 60 days to reply to the Grand Jury's report and the public agency has 90 days to reply to the Grand Jury's report. This letter is intended to satisfy both those reporting requirements.

The Grand Jury report made five findings and five recommendations regarding "Certificates of Participation in Public Finances: Is More Scrutiny Needed?

Response to the Grand Jury's Findings and Recommendations Regarding Certificates of Participation in Public Finances: Is More Scrutiny Needed?

### **Grand Jury Findings**

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The City of Santa Maria welcomes this opportunity to respond to the Grand Jury Report.

# LARRY LAVAGNINO MAYOR

c: Santa Barbara County Grand JuryAttention: Foreperson1100 Anacapa StreetSanta Barbara, CA 93101

Board of Supervisors Clerk of the Board 105 E. Anapamu St., Room 407 Santa Barbara, CA 93101