

May 30, 2007

Honorable Judge Melville
Superior Court
312-M East Cook St.
Santa Maria, CA 93455

Santa Barbara County Grand Jury
Attention: Foreperson
1100 Anacapa St.
Santa Barbara, CA 93101

Re: 2006 2007 Grand Jury Report: Certificates of Participation in Public Finances

Dear Gentlemen:

On March 26, 2007, a copy of the 2006-2007 Grand Jury Report: *Certificates of Participation in Public Finances* was received by the Santa Maria Joint Union High School District.

In accordance with Penal Code sections 933.05 (a) through (f), and 933 (c), the district has prepared a response for the findings and recommendations.

The Grand Jury investigated and reported on the issuance of Certificates of Participation (COPs) by public entities. The core issue is whether public entities can utilize the COPs as a financing instrument without direct voter approval or notification to the public to fund the purchase of equipment, finance construction projects, or refinance existing leases. Of particular interest was the use of COPs to finance capital projects on a long-term basis.

The Santa Maria Joint Union High School District (SMJUHSD) is a public school district governed under the regulations of the California Department of Education (CDE) and the Constitution for the State of California. Under the CDE regulations, school districts are authorized to execute COPs as approved by the district's Board of Trustees through a resolution during a public meeting.

The issuance of COPs is a financing instrument very similar to General Obligation Bonds (GO Bonds) with one major exception: GO Bonds are repaid through a levy of ad valorem tax applied to all landowners within the geographical area of the issuing entity. COPs, on the other hand, are completely repaid through the district's General Fund or from other available sources; therefore, landowners/taxpayers are not under any obligation to support the repayment.

The California School Accounting Manual authorizes the use of COPs by school district and provides guidance to ensure compliance with generally accepted accounting principles (GAAP.) Should the voters within the district disapprove of a GO Bond, this is the only mechanism available to proceed with a capital project, or create “bridge” financing pending an approved State appropriation. Districts must have an avenue to provide housing for students in overcrowded conditions until voters approve a GO Bond, or finance capital equipment.

There are several concerns noted throughout the report. Of major concern, is the presumption that a failed project financed with a COPs may create risk of the debt obligation to be the obligation of the taxpayers, cities or County. Schools districts that experience severe financial failure are taken over by the State; therefore, the voters of Santa Barbara county would not be subject to bear the burden of the remaining COPs debt.

Response to Findings and Recommendations:

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

Recommendation: A consistent, mandatory public notice and approval process should be implemented and sale of COPs should not proceed until completion of that process.

District’s Response To Finding: The district disagrees partially with the finding.

District’s Response To Recommendation: Projects funded by COPs for school districts requires the approval of the Board of Trustees through a formal resolution at a public meeting. These meetings are posted in several public places and on the district’s web site. The public has an opportunity to comment and make suggestions to the trustees during this meeting. The recommendation will not be implemented because it is not warranted. School districts are governed by the State of California, Department of Education and the Constitution for the State of California. The standards, guidelines and procedures are comprehensive. Further, the issuance of COPs is limited to finance any real or personal property, the cost of which constitutes a capital expenditure including land, relocatable structures, buildings, vehicles, computers and equipment (Education Code Sections 17400, 17430, 17450 and 17455). State laws prohibit proceeds of a lease financing for general operating purposes. The district believes there was adequate public notice, the district followed Education Code requirements and the district utilized COPs for capital expenditures.

2. **Finding:** Taxpayers and/or investors may be at risk if standard assurances (e.g. environmental and “escrow”) are not consistently required prior to issuance of COPs.

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

District’s Response To Finding: The district disagrees with the finding.

District’s Response To Recommendation: Taxpayers and investors are not at risk if environmental and escrow accounts are not required prior to the issuance of COPs.

Should the school district default on the COPs payments, the district would be required to work with the County Office of Education (COE) to develop a fiscal recovery plan. The COE has fiscal oversight for the district's finances and can make recommendations to insure fiscal recovery. Ultimately, the Department of Education may take over a school district and force fiscal recovery which may involve a state loan.

At no time, are the taxpayers or investors at risk.

3. **Finding:** 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.

Recommendation: The use of COPs should be restricted to short-term projects. Long-term projects should be funded with General Obligation of Revenue Bonds.

District's Response To Finding: The district disagrees with the finding.

District's Response To Recommendation: Maturity terms of COPs are limited to the useful life of the property leased. Many times the term is long-term, however, this is not to suggest that school districts have inappropriately substituted this type of debt financing in lieu of voter approved indebtedness.

Schools districts have no control over the approval of a General Obligation Bond and therefore need to have other available financing instruments to make much needed capital expenditures. Certainly GO Bond financing would be the preferred methodology as the debt obligation would be repaid by the voters not the district's general fund.

4. **Finding:** The regulations regarding the sales of COPs and the use of the proceeds from those sales are inadequate.

Recommendation: 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.

District's Response To Finding: The district disagrees partially.

District's Response To Recommendation: Proceeds from COPs should be limited to the uses as described in the resolution as approved by the Board of Trustees. However, should different needs arise, the Board of Trustees should have the ability to redirect the proceeds in the best interests of the school district without spending an inordinate amount of money to reissue a COPs.

Naturally, the COPs would earn interest until the district pays for the capital expenditure(s). In the case of construction, this could take many months to complete with partial payments made over a period of time. It is prudent for the district's management to invest these funds in the County Treasury to earn interest for the project at hand.

The district does agree that earning interest should not be the sole purpose of issuing a COPs.

5. **Finding:** Districts and government agencies are not required to give notification of the use of COPs to County or city governments which might be affected.

Recommendation: 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.

District's Response To Finding: The district disagrees.

District's Response To Recommendation: County and/or city governments are not "affected" by the district's issuance of COPs as there is no obligation to the County or the city government to repay the COPs should the district default. The agenda for the Board of Trustee meetings is posted in numerous public places as well on the district's web site and therefore serves as adequate notification.

If you have any further questions, please feel free to contact me at (805) 922-4573 extension 4401.

Sincerely,

Debi Deal
Assistant Superintendent of Business Services

DD:mpb