California League of Bond Oversight Committees

Preserving the Public Trust:
Case Studies in Technical Financial Analysis

Government Financial Strategies inc.

Presented by Lori Raineri
May 11, 2012

One (Important) Mission of the BOC

- **Education Code Section 15278 (c)**
  "In furtherance of its purpose, the citizens' oversight committee may engage in any of the following activities: …
- **(5) Reviewing efforts by the school district or community college district to maximize bond revenues by implementing cost-saving measures, including, but not limited to, all of the following:**
  - **(A) Mechanisms designed to reduce the costs of professional fees.**
  - **(B) Mechanisms designed to reduce the costs of site preparation.**
  - **(C) Recommendations regarding the joint use of core facilities.**
  - **(D) Mechanisms designed to reduce costs by incorporating efficiencies in school site design.**
  - **(E) Recommendations regarding the use of cost-effective and efficient reusable facility plans.**

Breaking News

fresnobee.com
Covering California's Central Valley

With campaign donations, school bond underwriters also secure contracts

By Will Evans - California Watch
Thursday, May. 03, 2012 | 12:00 AM

San Francisco Chronicle

Bond firms' campaign gifts linked to sales pacts

Will Evans, California Watch
Sunday, May 6, 2012

*Note: the timing of these articles gave an opportunity to prepare a preliminary analysis for presentation. We plan to undertake a more rigorous analysis.

Two Marketplaces

Underwriters' donations linked to school bond campaigns

Leading bond underwriters over the past five years donated $1.8 million to 111 successful school bond measures in the state authorizing $15.5 billion in debt. For 106 out of 111 bond measures, all of the underwriting companies that donated were also hired to sell the bonds. In four cases, multiple under- writers gave money, but the school district hired only the company that gave the most. In only one case, an underwriter gave money, but the contract went to other companies that didn't make contributions.

	CONTRIBUTIONS TO ...		... BOND MEASURES		
Underwriter	Total no.	Total dollar amount	Total no.	Total debt authorized	Bonds hired to sell
Piper Jaffray	52	$805,350	53	$6.7 billion	51
Stone & Youngberg	38	$368,500	34	$5.7 billion	31
George K. Baum & Co.	49	$307,999	20	$1.9 billion	20
RBC Capital Markets	10	$227,500	10	$2.4 billion	10
De La Rosa & Co.	6	$77,800	6	$545 million	6

Source: Municipal Securities Rulemaking Board; California Secretary of State

BRIAN CRAGIN / CALIFORNIA WATCH

Government Financial Strategies Experience with Bids
Underwriters' Bids on School GO Bonds Over Past 5 Years

	Underwriter	Bids
1	Stone & Youngberg LLC	33
2	Morgan Stanley & Co	29
3	Citigroup Global Markets	25
4	UBS Financial Services Inc.	19
5	Wells Fargo	19
6	Robert W. Baird & Co., Inc.	18
7	Southwest Securities	16
8	JP Morgan	15
9	Piper Jaffray, Inc.	15
10	Banc of America Securities	13
11	Hutchinson, Shockey, Erley & Co.	12
12	Fidelity Capital Markets	9
13	Merrill Lynch	7
14	Raymond James & Associates, Inc	7
15	Prager Sealy & Co., LLC	6
16	Stifel Nicolaus & Company, Inc	6
17	BMO Capital Markets	4
18	Sterne, Agee & Leach, Inc.	4
19	Barclays Capital, Inc	3
20	Morgan Keegan & Co., Inc.	3
21	BOSC, Inc.	2
22	Lehman Brothers	2
23	Bear, Stearns & Company	1
24	Bernardi Securities, Inc.	1
25	Duncan-Williams, Inc.	1
26	Ramirez & Co	1
27	RBC Dain Rauscher	1

Note: information is for general obligation bonds issued by school districts from 2007 through 2011 publically offered via competitive bidding where Government Financial Strategies served as financial advisor (50 bond sales totaling $1.2 billion).

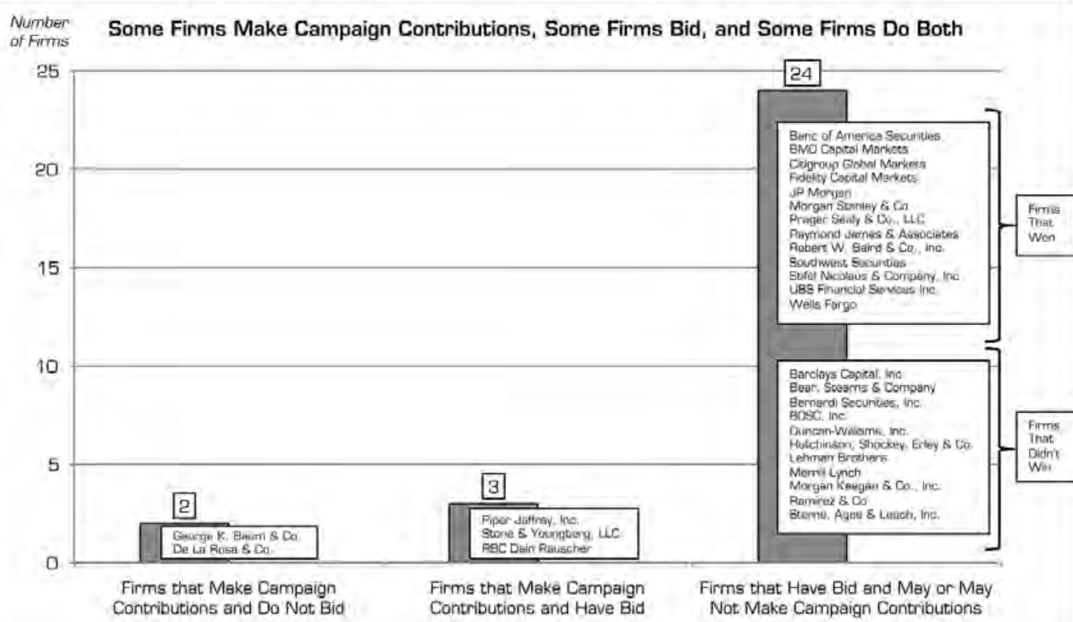
Firms that Win the Business By Bidding

Government Financial Strategies Experience with Bids
Underwriters' Bids on School GO Bonds Over Past 5 Years

	Underwriter	Wins	Bids	% Won
1	Morgan Stanley & Co	7	29	24%
2	Stone & Youngberg LLC	7	33	21%
3	Southwest Securities	5	16	31%
4	Robert W. Baird & Co., Inc.	5	18	28%
5	UBS Financial Services Inc.	5	19	26%
6	Citigroup Global Markets	4	25	16%
7	Banc of America Securities	3	13	23%
8	Piper Jaffray, Inc.	3	15	20%
9	Wells Fargo	3	19	16%
10	Stifel Nicolaus & Company, Inc	2	6	33%
11	Raymond James & Associates, Inc	2	7	29%
12	BMO Capital Markets	1	4	25%
13	Prager Sealy & Co., LLC	1	6	17%
14	Fidelity Capital Markets	1	9	11%
15	JP Morgan	1	15	7%
16	Hutchinson, Shockey, Erley & Co.	0	12	0%
17	Merrill Lynch	0	7	0%
18	Sterne, Agee & Leach, Inc.	0	4	0%
19	Barclays Capital, Inc	0	3	0%
20	Morgan Keegan & Co., Inc.	0	3	0%
21	BOSC, Inc.	0	2	0%
22	Lehman Brothers	0	2	0%
23	Bear, Stearns & Company	0	1	0%
24	Bernardi Securities, Inc.	0	1	0%
25	Duncan-Williams, Inc.	0	1	0%
26	Ramirez & Co	0	1	0%
27	RBC Dain Rauscher	0	1	0%

Note: information is for general obligation bonds issued by school districts from 2007 through 2011 publically offered via competitive bidding where Government Financial Strategies served as financial advisor (50 bond sales totaling $1.2 billion).

Summary of How Firms Win the Business



Notes: Campaign contribution information per Fresno Bee, "With Campaign Donations, School Bond Underwriters Also Secure Contracts" by Will Evans, May 3, 2012. Information sources reported as Municipal Securities Rulemaking Board and California Secretary of State. Bidding information is for general obligation bonds issued by school districts from 2007 through 2011 publically offered via competitive bidding where Government Financial Strategies served as financial advisor (50 sales of bonds totaling $1.2 billion).

What's the Cost of Not Bidding?

- Ignoring legal and ethical considerations, what is the potential cost of selecting an underwriter based on a campaign contribution?
- We use the last place bid as a proxy for the best case scenario of a negotiated sale. Actual example:

COMPETITIVE BIDDING RESULTS
Sale Date of Thursday, June 9, 2011

Bid #	Name of Bidder	Before Federal Subsidy True Interest Cost (TIC%)	Approximate Difference in Present Value From Winning Bid
1	**BMO Capital Markets**	**4.973817%**	**n/a**
2	Robert W. Baird & Co, Inc	4.982498%	$20,199
3	Stone & Youngberg LLC	4.985385%	$26,967
4	Banc of America Merrill Lynch	4.993087%	$44,921
5	Stifel Nicolaus & Company, Inc	5.000880%	$62,989
6	J.P. Morgan Securities LLC	5.004221%	$70,875
7	Wells Fargo Bank, National Association	5.007861%	$79,196
8	Ramirez & Co	5.011405%	$87,628
9	Southwest Securities, Inc	5.014159%	$93,987
10	Barclays Capital, Inc	5.086609%	$262,457
11	Piper Jaffray	5.095824%	$283,745
12	Morgan Stanley & Co Inc	5.119563%	$338,019
13	Citigroup Global Markets Inc	5.272917%	$693,045

Economic Cost-Benefit of Not Bidding

Potential Cost of Underwriters' Not Bidding for Business - All Bid Financings	
Total Increase In Cost If Last Place Bid Represented Negotiated Price:	$20,778,408
From CA Watch Research, Average Campaign Contribution for Bond Measures:	$16,100
Number of Bid Financings:	x 50
	$805,022
Conservative Estimated Cost Of Not Bidding, Net of Campaign Contribution:	$19,973,385

Published Academics Weigh In

- **Published academic articles have analyzed the cost of underwriters not bidding.**
  - **Articles are independent, peer-reviewed, and use sophisticated statistical analysis with each article analyzing hundreds to thousands of bond issuances.**
  - **Our research uncovered 11 academic articles spanning three decades of research evaluating bond issuances across the United States.**
- **The average increase in cost for underwriters not bidding across all articles was 0.25%*.**
  - **Results ranged from 0.00% (one study found no difference in cost) to 0.54% (savings from bidding).**

*Note: a recent study of general obligation bonds in particular by local governments in Missouri identified an increase in cost of 0.23%.

Academic Research Applied to CA Watch

- **If we use the 0.25% increase in interest cost and apply it to the amount of bonds described in California Watch's research:**

Potential Cost of Underwriters' Not Bidding for Business - All Financings Identified in Article	
Total Amount of Bonds Authorized in the Bond Measures:	$15,499,300,000
Conservative Estimate of Additional Interest Cost of 0.25% & 30 Year Term:	$1,244,382,975
Total Amount of Campaign Contributions:	$1,787,149
Potential Cost Of Not Bidding, Net of Campaign Contribution:	$1,242,595,826

Note: Total amount of bonds authorized in the bond measures is the amount of bond authorization that the districts requested from voters. Interest cost based on academic research is the average of 0.25% across all articles researched and assumes an increase from 5.00% to 5.25%, a 30 year term, level repayment structure, and a principal amount equal to the total amount of bonds in the bond measures. Total amount of campaign contributions is for all bond measures by all underwriters.

Case Studies on Bond Financial Plans

- What are the consequences of a general obligation bond financial plan failing?

- There are 3 likely consequences:
  - Bonds are not issued and projects are not completed
  - Bonds are issued and:
    - Tax rates are higher than communicated to voters
    - The term of taxation is extended longer
  - Bridge financing is issued instead, resulting in:
    - Higher costs to taxpayers
    - Operational budget and fiscal solvency at risk

Case Study #1 – "Look Before You Leap"

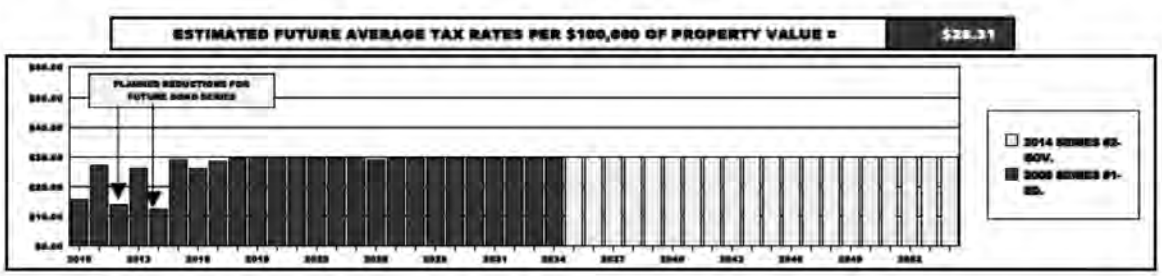
- The District began construction of a $12 million school
  - Only had $8 million of funds available
    - $4 million from a prior General Obligation bond
    - $4 million from a lease-purchase financing
  - The District could not issue sufficient General Obligation bonds (GO bonds) to cover the difference
    - Tax rates were already at $26.10 per $100,000 of AV and could not exceed $30.00
- The District decided to issue $4 million of bridge financing with a Bond Anticipation Note (BAN)
  - To be repaid by eventual issuance GO bonds
  - Law requires repayment within 5 years

“Look Before You Leap” – Taxpayer Cost

- For comparison, the District’s first GO bond issuance:
  - Issued in the amount of $4 million
  - Term of bonds/taxation for 25 years
  - Required taxpayers to repay $10.7 million
    - » Total repayment is 2.7 times the borrowed amount
- To issue the GO bonds within the 5 years required:
  - Issued in the amount of $4 million
  - No payments for 20 years
  - Term of bonds/taxation for 40 years
  - Required taxpayers to repay $31 million
    - » Total repayment is 7.8 times the borrowed amount

“Look Before You Leap” – Taxpayer Benefit

- The District requested $20 million of bond authorization at the ballot within the $30 tax rate limitation.
  - Voters would expect $20 million of improvements.
- The bridge financing plan called for using up the $30 tax rate limitation for the next 45 years, as shown:



- Yet the District and its taxpayers would only get $8 million worth of improvements.

"Look Before You Leap" - Assumptions

"Look Before You Leap"– Plan Assumptions

- **The District's financial advisor provided a range of AV growth assumptions from a best case to a worst case:**

FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12	FY 2012/13	FY 2013/14
+ 8.54%	- 16.40%	- 5% = SCEN. A - 10% = SCEN. B - 15% = SCEN. C	0% = SCEN. A 0% = SCEN. B 0% = SCEN. B	2% = SCEN. A 2% = SCEN. B 2% = SCEN. B	5% = SCEN. A 5% = SCEN. B 5% = SCEN. B
ACTUAL CHANGE	ACTUAL CHANGE	ANALYSES ESTIMATE	ANALYSES ESTIMATE	ANALYSES ESTIMATE	ANALYSES ESTIMATE

- **The presumed worst case ("Scen. C") is not as bad as what had occurred in the prior year.**

- **Actual AV decline to date since 2009-10 is an additional -17% (worse than the worst case that was planned).**

"Look Before You Leap" – Results

- We estimate that based on:
  - Current AV (worse than the worst case)
  - Reasonable AV projection (no boom in 5 years time)
  - Use of the $30 tax rate limit over the full 45 years
    - » The District could issue less than $1 million
- What are the consequences?
  - Operating budget (General Fund) will have to carry debt for the rest of the BAN repayment owed
    - » District has already laid off 25% of its teachers
  - Taxpayers get $8 million of $20 million authorized
  - Taxpayers still pay full freight of $30 tax rate

Case Study #2 - "Buyer Beware"

- The District had planned on paying for a facilities project with a combination of:
  - General Obligation Bonds
  - State funding
- The District began the project and spent nearly all of its cash from the general obligation bonds, with the expectation that State funding would be received soon
  - The State froze allocation of its facilities funding
- The District decided to proceed with a Bond Anticipation Note (BAN), to be repaid by:
  - eventual issuance of more General Obligation Bonds
  - "Backup Plan": eventual receipt of State funding

“Buyer Beware” - Contract Review

“Buyer Beware” - District’s Obligation

As represented in Financial Advisor’s Memorandum:

*Important Note: The 2009 BANs are secured by (i) future Proposition R GO bond issuances and (ii) expected State Funding receipts. ***The 2009 BANs are not secured by the General Fund.***

As represented in legal documents (Indenture):

Section 5.02. **<u>Issuance of Obligations to Pay Notes.</u>** The District shall (a) issue or cause to be issued General Obligation Bonds, (b) issue bond anticipation notes in renewal of the Notes pursuant to Section 15150 of the California Education Code, and/or (c) issue or incur such other obligations as the District may legally issue or incur, at a time or times and in a principal amount or amounts, the available proceeds of which are sufficient, together with such other moneys as are available therefor, to pay [the principal of and interest on the Notes due and payable on the Maturity Date] [the Accreted Value of the Notes due and payable on the Maturity Date]. The District shall transfer or cause to be transferred such proceeds of any such General Obligation Bonds, bond anticipation notes or other obligations to the Trustee for deposit in the Note Repayment Fund.

Other obligations the District may legally issue include General Fund obligations (COPs, Lease-purchases, etc.)

"Buyer Beware" - Assumptions

"Buyer Beware" – Plan's Assumptions

CONSERVATIVE OVERALL TAX BASE ASSESSED VALUE ESTIMATES FOR 2014 G.O. BOND ISSUANCE

Over the last 10-years, the District's tax base has increased by an annual average of almost 8%. Issuance of ALL of the District's remaining G.O. Bond authorization needs an overall average annual tax base increase of only 4.01%. The District's BACKUP CONTINGENCY payoff plan further reduces the overall average annual tax base increase needed for the BAN payoff to only 3.30%.

HISTORICAL ASSESSED VALUES

FISCAL YEAR		DISTRICT TAXABLE ASSESSED VALUE	ANNUAL CHANGE IN ASSESSED VALUE	ASSESSED VALUE GROWTH RATE
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

FISCAL YEAR		DISTRICT TAXABLE ASSESSED VALUE	ANNUAL CHANGE IN ASSESSED VALUE	ASSESSED VALUE GROWTH RATE
1993	1994	$2,095,752,894	$50,130,281	2.451%
1994	1995	$2,159,937,447	$64,184,553	3.063%
1995	1996	$2,212,087,008	$52,149,561	2.414%
1996	1997	$2,228,748,532	$16,661,524	0.753%
1997	1998	$2,252,613,649	$23,865,117	1.071%

- **Plan's AV growth was 4.01% & Backup Plan was 3.30%**
  - **Last real estate recession: average 1.95%, high 3.06%**
  - **County estimating a 5% decline for 2009-10**
  - **To date, AV has declined 7.45%**

"Buyer Beware" - A Bit of a Magic Trick

UNSECURED AV	TOTAL AV	AV BASE INCREASE	NEW BASE AV	NEW DEV. AV
$0	$4,973,035,399	103.90%	$5,166,090,167	
$0	$5,166,090,167	102.00%	$5,270,227,970	
$0	$5,270,227,970	103.00%	$5,428,334,809	
$0	$5,428,334,809	103.00%	$5,591,184,853	
$0	$5,591,184,853	104.00%	$5,814,832,247	
$0	$5,814,832,247	104.50%	$6,076,499,698	
$0	$6,076,499,698	105.00%	$6,380,324,683	
$0	$6,380,324,683	106.00%	$6,763,144,164	
$0	$6,763,144,164	107.00%	$7,236,564,255	
$0	$7,236,564,255	108.00%	$7,815,489,395	
$0	$7,815,489,395	109.00%	$8,518,883,441	
$0	$8,518,883,441	108.00%	$9,200,394,116	
$0	$9,200,394,116	107.00%	$9,844,421,704	
$0	$9,844,421,704	106.00%	$10,435,087,006	
$0	$10,435,087,006	105.00%	$10,956,841,356	
$0	$10,956,841,356	104.00%	$11,395,115,010	
$0	$11,395,115,010	103.00%	$11,736,968,460	
$0	$11,736,968,460	104.00%	$12,206,447,198	
$0	$12,206,447,198	105.00%	$12,816,769,558	
	12,816,769,558	106.00%	$13,585,775,731	
	13,585,775,731	107.00%	$14,536,780,032	
	14,536,780,032	108.00%	$15,699,722,435	
	15,699,722,435	109.00%	$17,112,697,454	
	17,112,697,454	108.00%	$18,481,713,250	
	18,481,713,250	107.00%	$19,775,433,178	
	19,775,433,178	106.00%	$20,961,959,169	
$0	$20,961,959,169	105.00%	$22,010,057,127	
$0	$22,010,057,127	104.00%	$22,890,459,412	
$0	$22,890,459,412	105.00%	$24,034,982,383	
$0	$24,034,982,383	106.00%	$25,477,081,326	
$0	$25,477,081,326	107.00%	$27,260,477,019	
$0	$27,260,477,019	106.00%	$28,896,105,640	
$0	$28,896,105,640	105.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	
$0	$30,340,910,922	100.00%	$30,340,910,922	

NEXT 5-YEAR AVERAGE AV GROWTH = 3.30%

OVERALL G.O. BOND TERM AVERAGE AV GROWTH = 4.01%

Table prepared by District's financial advisor.

- **Using the first 32 years, and excluding the final 13 years of 0% assumed growth, the overall average AV growth = 5.69%**

"Buyer Beware" - Repayment (State Funds)

- **From Financial Advisor's Memorandum:**
  Secondary Repayment Source – Future State Funding Receipts

a.	Total State Funding Receipts:	$36,126,703
	i. Apportioned (but Frozen):	$3,645,585
	ii. Submitted Applications:	$23,200,100
	iii. To-be Submitted Applications:	$9,281,018

- **Concern about receipt of State funding:**
  - **Only approved for $3.65 million (which was frozen)**
  - **Other applications may not be approved**
- **State obtaining additional facilities funds is uncertain**
  - **State's source of funds is voter approved bonds**
  - **No guarantee State will place bonds on ballot in time**
  - **No guarantee voters will approve bonds on ballot**

“Buyer Beware” – Taxpayer Costs

BOND ANTICIPATION NOTE (BAN) SOURCES & USES OF FUNDS

SOURCES OF FUNDS	AMOUNTS
BAN PRINCIPAL AMOUNT ISSUED	$18,902,367
LESS: UNDERWRITERS DISCOUNT	(190,000)
TOTAL SOURCES OF FUNDS =	$18,712,367

USES OF FUNDS	AMOUNTS
PRIOR ISSUE REFUNDING DEPOSIT	$0
RESERVE FUND DEPOSIT	0
INITIAL DP-LOC EXPENSE	45,410
DP-LOC FUTURE LOC PV	1,227,551
COSTS OF ISSUANCE/CONTINGENCY	339,405
PROJECT FUND DEPOSIT =	17,100,000
TOTAL USES OF FUNDS =	$18,712,367

G.O. BOND SERIES E AMOUNTS	G.O. BOND SERIES F AMOUNTS
$9,205,000	$9,700,000
3,098,476	3,333,082
0	0
$12,303,476	$13,033,082

AMOUNTS	AMOUNTS
$373,476	$458,082
0	0
11,060,000	11,645,000
870,000	930,000
$12,303,476	$13,033,082

G.O. BOND SERIES E	G.O. BOND SERIES F
2014	2014
ED. CODE	GOV. CODE
25 YEARS	40-YEARS
7.56%	6.93%
5.75%	6.00%

- **Upfront costs on BAN: $1,802,366**
- **Interest rate on BAN: 3.75%**
- **Upfront costs on 2 GO bond issuances: $831,558**
- **Interest rates on 2 GO bond issuances: 7.56% and 6.93%**

“Buyer Beware” – Taxpayer Impact

- **District and its taxpayers get $17.1 million of improvements from the BAN.**
- **District issues $18.9 of GO bonds to repay BAN.**
- **Taxpayers repay $129 million for GO bonds over 40 years.**
  - **Total repayment is 6.8 times the borrowed amount.**
  - **Repayment is 7.6 times the amount from the BAN.**

"Buyer Beware" - Results

- Summary of concerns in plan:
  - Misrepresentation by Financial Advisor of obligation of General Fund
  - Misrepresentation by Financial Advisor of how overly aggressive the assessed value assumptions were for the issuance of General Obligation Bonds
  - District's ability to proceed with the "Backup Plan" of receiving State funding was far from certain
  - The costs for all of the financings were adding up to a very high expense
  - The costs to the taxpayers were significantly high compared to the benefit received

Recommendations

- What can a Bond Oversight Committee do?
  - Protecting taxpayers requires looking at bond revenues, not just bond expenditures.
  - Information to evaluate:
    - » Method used to select financial professionals
      - Financial advisor
      - Bond counsel
      - Underwriter
    - » Estimated upfront financing costs
    - » Estimated interest costs
    - » Projection of cost to taxpayers
      - Assessed value assumptions
    - » Economic value