In world of bonds, voter information is incomplete

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Santa Clarita Valley voters will be asked June 7 to approve a $230 million bond measure on their primary election ballots to modernize buildings and construct new facilities for College of the Canyons.

But the actual cost to taxpayers will likely end up being more than double the amount of the bond and could become much higher than that.

The tax rate statement provided with Measure E ballot materials calculates the total taxpayer cost of the bond at $483 million. This is based on projected interest rates of the bonds when issued, the number of years the bonds are financed, the assessed valuation of property within the district and the projected growth rate of property values, according to Eric Harnish, spokesman for College of the Canyons.

In reality, taxpayers cannot know the actual cost of bonds at the time they ink their ballots because factors like interest rates and property assessments can change markedly.

But the biggest — and the most controversial — variable of all is the type of school bond issued. That decision is in the hands of the issuing agency, not the voting public, although the state has imposed some restrictions to prevent school districts, and their property owners, from facing crushing debt.

Although $483 million is the best-case scenario for the potential cost to homeowners of Measure E, it could rise higher. Harnish said the payback ratio is estimated at 2.3 to 1, which adds up $529 million cost to homeowners.

Bruce Fortine, founding trustee for College of the Canyons who still serves on the board, is a staunch supporter of Measure E, but he recognizes voters can't know the cost of future bonds they are asked to approve June 7.

"That figure is from the imagination," he said of the $483 million estimate.

Types of bonds

School bonds — those secured by the county government through its resources — are largely favored by voters in the Santa Clarita Valley. If approved, Measure E would be the third COC bond measure within the past 15 years.

Voters have smiled upon William S. Hart Union High School District bond proposals twice over the same time span, and each of the Santa Clarita Valley's four elementary school districts has won voter approval for a bond measure within the past six years.

As homeowners may choose between variable- and fixed-interest mortgages, school districts in California can choose between two types of general obligation bonds: current interest bonds and capital appreciation bonds.

Like an amortizing home mortgage, current interest bonds are paid off, with interest, during the lifetime of the bond.

Capital appreciation bonds have no payments until the maturity date at the end of the bond's term. Thus interest is compounded over the lifetime of the bond with a balloon payment having a much larger total that has to be paid off at the end.

To illustrate the expensive nature of capital appreciation bonds, if all the bonds issued under Measure E were issued as capital appreciation bonds at the limits allowed by law, the debt service could be as high as $920 million.

Capital appreciation bonds have been banned by the state of Michigan. Texas is considering such a ban to prevent school districts from hitting a wall of debt without the resources to deal with it.

Sub-prime

"This is a municipal bond equivalent of a sub-prime mortgage," Jim de Bree said of capital appreciation bonds.

A retired senior tax professional who worked with a nationally known accounting firm for more than 40 years, de Bree is a Santa Clarita Valley resident who has spent much of the last year studying school bonds.

In a sub-prime home mortgage, borrowers initially pay a lower interest rate, but the payments increase significantly after a few years as the interest rates escalate. The idea was to refinance to a stable interest rate after the home has appreciated but before the prevailing interest rates skyrocketed.

Such mortgages are largely blamed for the housing crash of 2008 because homeowners became unable to refinance.

With Measure E, the college district anticipates an increase in assessed property value every year, Harnish said. This is due to new construction, turn-over of property and yearly appreciation of the property.

Essentially, the school district is betting on sustained growth in the property tax base to pay the bonds, de Bree said.

Plans for Measure E call for it to be divided between current interest bonds (83 percent) and capital appreciation bonds (17 percent). The bonds would be issued four times over 12 years, Harnish said.

Bond restrictions

Besides a ban on capital appreciation bonds in Michigan and a potential ban in Texas, California has passed a law restricting public school districts' use of the bonds after too many districts wound up owing 10 times or more the amount borrowed.

Poway Unified School District in San Diego County, for example, borrowed $105 million in capital appreciation bonds in 2011. That bond requires a payoff of $982 million.

Poway Unified came under scrutiny statewide in 2012 over the debt it incurred, but it is not alone.

Savanna School District in Anaheim issued $239,721 in bonds and will have to pay back $3.6 million. That's $14 of interest for every $1 borrowed.

The California Legislature and Gov. Jerry Brown approved Assembly Bill 182 in 2013, which limits the maximum amount of debt a district can be burdened with through any bond measure. It also limits the life of each bond to 25 years.

Under the law, for every $1 borrowed, a maximum $4 of interest can be accrued. In the case of Measure E, $920 million would be the maximum possible debt under the law.

"The payback ratio for all Measure E bond issuances is well below the ceiling allowed by AB 182," Harnish said. "It is estimated at 2.3 to 1, which is very typical for education construction bonds, and very conservative."

Necessity

The district intends to use capital appreciation bonds only if necessary, Harnish said, based upon the growth of assessed property values.

In other words, if the property tax base does not grow fast enough, the district will issue CABs to defer payment until a point in time when the property tax base has grown sufficiently to refinance with CIBs, de Bree said.

If property values increase more slowly than average in future years, Harnish said, he expects the property value assessment to remain very close to the projected cost.

The college district estimates the tax rate to be $15 per $100,000 per year for each bond. This is in addition to the $28.13 per $100,000 taxpayers already pay per year for Measure C and Measure M previously issued by College of the Canyons. Both Measure C and Measure M will be paid off in full by 2030.

Property owners are paying even more if they are living within other school districts. For example, in the Hart district the tax rate is $49.13 per $100,000 per year.

The average assessed value of homes in the SCV is about $400,000, so the average homeowner pays about four times these amounts.

As homes can be refinanced for a better interest rate, school districts can refinance bonds to improve their financial situations, as well.

College of the Canyons trustees voted in April to do just that, gaining a lower interest rate on outstanding Measure C and Measure M bonds. Taxpayers will save $22.8 million due the refinancing, college officials said.

The Hart district board voted Wednesday to approve the refinancing of Measure SA bonds, which is expected to save taxpayers about $3.3 million.

No other way

Longtime Hart district board member Steve Sturgeon says bond measures are the only way residents can build and maintain adequate, safe and well-equipped schools for the present and future.

“You’re building a school for a population 50 years from now, not for the population of today,” he said of voters’ investment in bonds.

The state does not pay for facilities construction or modernization, he said.

“Bonds get passed to supplement state funding,” Sturgeon said. State funding pays for salaries and costs of operating schools, but taxpayers must fund the structures.

Facilities and operational funds are completely separate and never commingled, school officials say. Homeowners who pass a bond measure are not paying for teacher salaries or other operational expenses.

In the dark

Over the years as property tax policy has changed in California, requirements to pass a school bond measure have changed with it, generally shifting toward greater accountability in spending.

To win approval for a school bond with a favorable 55 percent vote, rather than the former supermajority requirement of 67 percent, districts must specify in advance what they will do with the money and ensure a citizens’ oversight committee is in place to monitor expenditures.

So why, asks de Bree, isn’t more financial oversight also required?

“Why isn’t information provided showing the costs of bonds issued under previous measures and how the actual tax rates compare to the tax rates presented in ballot materials for previous bond measures?” de Bree said during one of several interviews with The Signal. “Why do the required tax rate statements always estimate the same rate of tax throughout the duration of the bonds?”

If COC’s Measure M bonds are any indication, Measure E’s tax rate will increase over the years, de Bree predicted.

The highest tax rate estimated for Measure M, which was approved in 2006, was $9.73 per $100,000 of assessed property valuation per year, according to ballot materials. But the current tax rate for Measure M is now $14.53 per $100,000 of assessed property valuation per year, according to Harnish.

And it’s likely to increase, said de Bree, depending on how quickly property values rise. Ballot materials sent to voters state that tax rates contained therein are estimates only and will vary.

De Bree also criticized ballot materials for failing to provide more complete information on bond financing.

“The materials provide no meaningful information about the biggest cost associated with the expenditures — the financing costs for which there is no independent oversight,” he said.

G. Rick Marshall, chief financial officer for California Taxpayers Action Network and author of the ballot argument against Measure E, also criticized the lack of financial information on ballot materials.

“You’re not paying back $230 million. You’re paying back $230 million plus interest,” he said.

Information available on bonds like Measure E are not written for the average person, Marshall added. Instead, it is written for prospective investors who understand all the technical language involved in these types of documents.

“We think a majority (of voters) don’t understand how bond funding works and what they’re approving,” he said.