

# CLIENT NEWS BRIEF

## AB 182 and Its Impact on General Obligation Bond Financings for California School Districts and Community Colleges

An important public finance bill that would potentially restrict the ability of school districts and community colleges to issue bonds is steadily making its way through the legislative process. As we have brought to your attention in a series of Client News Briefs, Assembly Bill 182 (AB 182) addresses controversial issues concerning the use of bonds that allow for the compounding of interest, including capital appreciation bonds (CABs), to pay for K-12 and community college district facilities construction projects. AB 182 has been proposed in response to negative media attention and heightened political scrutiny over the past few months focused on financing structures that include CABs. While AB 182 is still pending, we expect that the possible imposition of these new restrictions will compel many would-be issuers to accelerate financing timetables and issue bonds before January 1, 2014, when AB 182 would take effect.

As opposed to current interest bonds, on which interest is paid to bond holders periodically during the life of the bond to maturity, CABs are sold at an initial principal value and "accrete" to final principal value at maturity. This structure effectively defers payment of interest and principal during the early life of the CAB and pays bond holders at a later date, typically at maturity. Deferral of payment is often required or desirable for districts that have reached debt service capacity in the near-term. The trade-off for the deferral afforded with CABs is that the effective yield on CABs are often much higher than on current interest bonds.

On January 17, 2013, State Superintendent of Public Instruction Tom Torlakson and State Treasurer Bill Lockyer issued a joint news release urging school districts to impose a moratorium and not issue any new CABs until the Legislature and Governor completed their consideration of the pending reform proposals. Critics of CABs, including Lockyer and Torlakson, have pointed to a handful of what have become high-profile financings in the San Diego area where, due to the interest rate and length of term, the total debt service to initial principal ratio was ten-to-one or higher.

Under current law, school districts and community college districts can issue bonds under the Government Code with a maturity of up to 40 years and with an interest rate of up to 12%. Additionally, under current law, CABs are not required to have a mandatory call or tender feature.

AB 182 limits the way school districts and community college districts may finance their school facilities projects through issuance of general obligation bonds, including placing stricter limits on bond maturity and bond interest rates, mandating debt service-to-principal ratios and mandating redemption or tender for purchase.

Although not as restrictive as when first introduced, barring any further amendments, AB 182 would do the following, effective January 1, 2014:

- Limit the terms of current interest bonds issued under the

August 2013  
Number 45



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Government Code to 30, rather than 40, years, except that until January 1, 2019, a district may issue current interest bonds with terms up to 40 years if the district finds that the useful life of the facility financed with the current interest bonds is equal to or greater than the term of the current interest bonds.

- Limit all CABs to a maximum of 25 years and 8% interest.
- Require all CABs to have a call option after no later than 10 years from issuance.
- Limit the ratio of total debt service to principal to no more than 4:1 on all bond sales.
- Require public disclosure of detailed information about any proposed use of CABs, including financing terms and time of maturity, repayment ratio, and estimated change in assessed value of property in the district over the financing term.
- Require that if the bond sale will include CABs, then the board resolution approving the sale must be presented to the governing board on two consecutive meeting agendas, first as an informational item, and second as an action item.
- Require that the agenda items for bond sales, including CABs, must identify that CABs are proposed and that the governing board be presented with all of the following: (i) an analysis containing the total overall cost of the CABs; (ii) a comparison to the overall cost of current interest bonds; (iii) the reason CABs are being recommended; and (iv) a copy of the written disclosure made by the underwriter to the district in compliance with Rule G-17 adopted by the federal Municipal Securities Rulemaking Board.

Regardless of AB 182, good business practice dictates that school district and community college administrators and governing boards are adequately advised by their financial advisors, bond counsel and other members of the financing team regarding any financing structure in order to promote informed decision making and provide public transparency. It is a good idea to ask your financial advisor to give a presentation on financing options and proposed terms, including an overview of the proposed financing structure, advantages of CABs versus current interest bonds, likely debt service to principal ratios, proposed call features, and likely interest rates and maturities.

If you have any questions regarding bonds, please feel free to contact one of our [eight offices](#) located statewide. You can also visit our [website](#), follow us on [Facebook](#) or [Twitter](#), or download our [Client News Brief App](#).