San Diego County Taxpayers Association
Taxpayers watchdog since 1945
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Proposition Y: South Bay Union School District $26.0 Million Bond Reauthorization Measure Brief Summary

SDCTA is **NEUTRAL** on the South Bay Union School District bond reauthorization measure. In 2009, projected project costs were found to be grossly underestimated. Revised estimates exceeded the originals by approximately 60 percent. To address this issue, several personnel changes were made, timelines were changed, and scope was revisited. If reauthorization fails, the district has indicated that they would consider issuing Capital Appreciation Bonds (CABs) in order to continue construction without further delays.

In addition, SDCTA recommends that the District not issue CABs in order to continue construction.

- South Bay Union School District is proposing the reauthorization of $26.0 million in bonds, representing some of the remaining portion of the $59.4 million initially authorized in 2008 under Proposition X.
- The measure would increase the current tax rate by a maximum $30 per $100,000 of assessed valuation.
- Starting in 2009, it became clear that there was a "staggering miss in estimating costs and selected scope" in the Master Plan. Revised estimates for the work on the seven campuses to be fully modernized exceeded Master Plan estimate by approximately 60 percent.
- The District made personnel changes and addressed the budget shortfall issues primarily by changing scopes of work and finding additional revenues. They now say they are on budget.
- In 2010, the District issued $3.33 million in bond anticipation notes (BANs). BANs are a short term financing mechanism.
- Because assessed value has not grown in recent years, and State matching fund revenues have not been realized, the District will be forced to choose between delaying their projects further and resorting to capital appreciation bonds (CABS) if reauthorization fails.

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Proposition Y: South Bay Union School District Bond Reauthorization Measure

Board Action: **NEUTRAL**

Title: *"Proposition Y: South Bay Union School District $26.0 Million Bond Reauthorization Measure"*
Election: November 2012 General
Description: The reauthorization of $26.0 million of Proposition X (2008) approved bonds with an increase in property taxes of $30 per $100,000 of assessed value to fund school modernization.
Jurisdiction: Local
Vote: 55% Super Majority
Fiscal Impact: Allows for completion of projects without use of additional short term financing, or long term capital appreciation bonds.

Rationale:

In 2009, projected project costs were found to be grossly underestimated. Revised estimates exceeded the originals by approximately 60 percent. To address this issue, several personnel changes were made, timelines were changed, and scope was revisited. If reauthorization fails, the district has indicated that they would consider issuing Capital Appreciation Bonds (CABs) in order to continue construction without further delays.

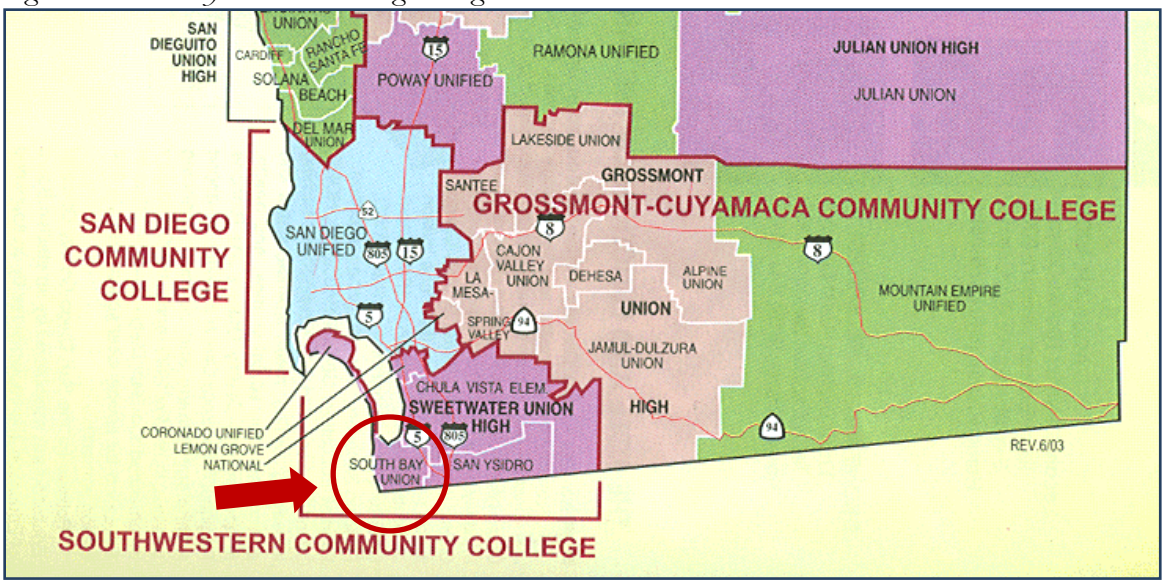
In addition, SDCTA recommends that the District not issue CABs in order to continue construction.

Background:

South Bay Union School District is comprised of 12 elementary schools centered in Imperial Beach, CA. Enrollment has declined in recent years from 8,352 in School Year 2006-2007 to 7,682 in School Year 2011-2012[1].

[1] South Bay Union School District.

Figure 1: South Bay Union and Neighboring School Districts



Source: San Diego County Office of Education

Prior to Proposition X passing in 2008, the District's last General Obligation (GO) bond was approved by voters in 1997 for the construction of new multi-purpose rooms, a music room, and restroom facilities.

This analysis does not reassess the need for the proposed facilities given that the needs have not all been addressed since SDCTA's rationale for endorsement of the $59.4 million Proposition X in 2008 noted that:

> *"South Bay Union School District displays the need for facilities improvements, has developed a comprehensive Facilities Master Plan that outlines its facilities needs in detail by site, has obtained reliable cost estimates for the proposed projects and prioritized those needs."*

Proposition X passed with 76.4 percent of the vote. The projects that were planned to be funded by Proposition X bonds included complete modernization of seven of the 12 elementary schools, and major facility improvements including window replacements, sewer system replacements and bathroom replacements at the remaining five campuses.

Table 1: Campuses Planned to be Improved

Campuses Intended to be Fully Modernized	Other Campuses Intended to Receive Major Facility Improvements
Bayside Elementary	Central Elementary
Berry Elementary	Emory Elementary
Nestor Elementary	Imperial Beach Elementary
Nicoloff Elementary	Mendoza Elementary
Oneonta Elementary	Westview Elementary
Pence Elementary	
Sunnyslope Elementary	

Facility needs were prioritized into phases. Phase one included issuing two series of bonds ($12.4 million in 2009 and $11.9 million in 2012, which along with State matching funds of $17 million, were expected to allow for the district to "complete the majority of work" at the seven sites to be completely modernized. Although all seven sites have achieved "approved" status for state matching funds, only four of them have received full funding totaling a reimbursement of $12.4 million that is paying for current work that is being done.

Proposal:

To date, the District has issued $16.0 million in bonds. Due to declining property values, the District is unable to collect sufficient tax revenue to continue funding these improvements. To illustrate, the average assessed value of properties within the boundaries of the South Bay Union District decreased by 9.5 percent from 2008 to 2012. Therefore, the District is proposing a tax increase of up to $30 per $100,000 of assessed property value in addition to the $30 per $100,000 of assessed property value that was established by Proposition X in 2008.

Proposition Y would require the decertification of some of the remaining $43.8 million in authorized but unissued bonds to prevent the issuance of additional debt. In their place, $26.0 million in bonds would be re-authorized at the proposed tax rate in addition to that which was authorized by the voters in 2008.

The South Bay Union School District has proposed a bond measure for the November 2012 election that reads as follows:

> *"To continue elementary classroom/school renovations; safety improvements; computers/technology access; roof, plumbing, heating/air-conditioning repairs; and reduce overall borrowing costs, shall $26,000,000 of South Bay Union School District General Obligation Bonds, previously approved by voters in November 2008, be reauthorized through issuance of new bonds, with no increase in total authorized District debt, interest rates below legal limits, independent citizen oversight, no money for administrator salaries, and all funds spent locally and not taken by the State?"*

Staff has said that the following SDCTA recommended policy language regarding the use of CABs will go to their governing board in September for adoption by resolution:

> *"In connection with the sale of any bonds, capital appreciation bonds (CABs) should only be pursued if it can be demonstrated that their use will result in less debt service than other bond structures or other financial alternatives. Other financing options that should be compared to the potential use of CABs include additional voter approved tax increases. It is further stipulated that the District will not authorize the sale of any form of Capital Appreciation Bonds or Convertible Capital Appreciation Bonds without review by the District's citizens' bond oversight committee. Defensible assumptions for growth in assessed value shall be used for development of any proposed financing method."*

Tax Rate Implications:

This bond would require residents to pay a tax of up to $30 per $100,000 of assessed property value. This amount is in addition to the $30 per $100,000 of assessed property value authorized by Proposition X in 2008. The average assessed value of a single family detached home in the District is $217,996; therefore, those homeowners should expect to pay on average an additional $65.40 in property taxes annually. The tax is scheduled to take effect in 2014 and will last through 2047.

Fiscal Impact:

If the $26.0 million in bonds cannot be reauthorized, the South Bay Union District has essentially two options. One option would be some combination of additional short term financing and delaying projects. The other would be the use of capital appreciation bonds (CABs) with long durations. While District staff has said that delaying repayment of bonds into the future by issuing CABs would not be preferred, the governing board would ultimately make that decision.

In 2010, the District issued $3.33 million in bond anticipation notes (BANs) in order to ensure that two campus projects would have the funds to be completed. BANs are a short term financing mechanism. When they were issued, the hope was that assessed values would increase, and/or State matching funds would be realized, allowing for the BANs to be paid off. This has not occurred. The District has been unclear as to if reauthorization does not pass, and State matching funds are not realized in an amount necessary to fulfill the obligation created by the BANs, if they would be able to support traditional current interest bonds to pay off the BANs. If current interest bonds are not an option, they would need to issue either additional BANs or CABs to pay off the 2010 BANs. It is expected to cost $3.7 million to pay of the 2010 BANs. If CABs were used to refinance these costs, they would mature in 2040 and $13.6 million would be paid in interest.

Unlike general obligation bonds, capital appreciation bonds do not require interest payments until the bond reaches its maturity date, meaning that construction can continue at the current tax level while issuing additional debt in order to fund projects. However, a series of deferred payments must be made down the road consisting of both accrued interest and the principal amount. Essentially, CABs require substantially higher interest payments in

exchange for buying more time to repay them. In this situation, total interest costs are projected to be approximately $32.6 million if the bonds are reauthorized and up to $105.8 million if capital appreciation bonds are issued.

As a further result of delaying repayment, the District will be responsible for repaying the bonds from approximately 2026-2064. Decades from now, residents within the boundaries of the District will be liable to pay these escalating costs for projects that were completed years earlier. The following table illustrates a cost/benefit comparison between issuing CABs and reauthorizing the remaining bonds:

Table 2: Reauthorization vs. Issuing CABs Cost/Benefit Comparison ($26.0 million of projects)

	Alt #1: Reauthorization	Alt. #2: CABs
Principal	$26,000,000	$26,000,000
Interest	**$32,613,197**	**$105,805,835**
Total	**$58,613,197**	**$131,805,835**

Source: Dale Scott & Company

In comparing these two options, it is evident that delaying repayment by issuing CABs will require approximately $73.2 million more in total interest payments than reauthorizing the remaining bonds.

Project Management:

In one 2009 issuance, $16.0 million of bonds were issued, putting the tax rate at its $30 per $100,000 of assessed value authorized limit. $28.5 million has been expended in the program that includes other revenues. Other revenues include Basic Modernization Grants (State Matching Funds). Bayside Elementary and Oneonta Elementary have been modernized, some improvements have been made to Emory Elementary, and Berry and Nestor are currently being modernized. While they were originally planned to be completed at this point, because of funding limitations, it was deemed necessary to break up the Berry and Nestor modernization projects into phases. The District communicated to SDCTA that the lack of complete funding to implement these projects has added to the overall program costs by extending the life of the program and had an impact on the team's ability to efficiently plan the most cost effective implementation program.

Starting in 2009, it became clear that there was a significant "program management challenge." There was a "staggering miss in estimating costs and selected scope" in the Master Plan. Revised estimates for the work on the seven campuses to be fully modernized exceeded Master Plan estimate by approximately 60 percent.

The District feels that communication within the team was a major issue and that this challenge has been addressed by:

- SGI's efforts rigorously examining the budget, schedule and scope assumptions
- The establishment of standing meetings
- New reports that provide greater budget and schedule transparency
- Running practice bid workshops with subcontractors

The budget shortfall issues that rose as a result were addressed with the following primary approaches:

- Finding savings
- Finding additional revenues
- Differing scope of work for cash flow management
- Altering scope of work within the original intent of the bonds

These efforts, and others, resulted in "all budgets being brought back in line with original projections," "the successful completion of the Bayside and Oneonta scope" and "confidence in the accuracy of the remaining planned budgets and schedules." [2]

Please see "Appendix A: Budget vs. Actual" for the original budget, actual expenditures to-date and current projected expenditures for each campus and additional categories.

Policy Discussion:

At this juncture, there are essentially three policy options available for the District: (1) some combination of additional short term financing and delaying projects until property values rise, (2) issue capital appreciation bonds, or (3) reauthorize some of the remaining bonds.

If the District were to wait for property values to rise, projects would be delayed and the costs of completing them would diminish the buying power of the bond over time.

In order to continue construction on schedule and avoid initial interest payments, the District could issue capital appreciation bonds. As mentioned earlier, issuing CABs would allow the District to delay making interest payments until 2026. However, it would extend the payment period through as late as 2064. If the District only issued CABs to pay back the $3.33 million of BANs, the District would pay $13.6 million in interest costs.

Alternatively, the District could continue to fund construction projects if it reauthorizes $26.0 million of funds by imposing a tax of up to $30 per $100,000 of assessed property value. This would be in addition to the tax levied in accordance with the initial bond authorization in 2008. In the end, both CABs and reauthorization will allow for projects to be completed on schedule. Ultimately, reauthorization will do so with increased property taxes for approximately the next 30 years, whereas CABs will defer payments for years allowing more interest to accrue on the principle, and interest to accrue on interest.

Because as tax revenues are to be allocated to pay for projects clearly delineated in the Master Plan and Needs Assessment that was the basis for the SDCTA supported Proposition X Bond in 2008, it appears that reauthorization is the best policy option as it allows for the District to complete the remaining projects on time without placing an excessive burden on the future generations of taxpayers.

[2] Eric Hall & Associates LLC. "South Bay Union School District Bond Measure X Performance Audit. June 17, 2011.

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Arguments in Favor:

According to the South Bay Union School District, reauthorization of the remaining bonds is the best alternative to waiting for property values to rise and issuing capital appreciation bonds for the following reasons:

1) The District has demonstrated the ability to make the needed adjustments to ensure projects are completed on budget.
2) Proposition Y would minimize project cost escalation, by allowing for the completion of all bond projects without delay.
3) Reauthorization saves taxpayers millions of dollars in interest compared to issuing capital appreciation bonds which would be necessary in order to repay the bond anticipatory notes that were issued in 2010.

Arguments Against:

1) If the District's assessed values decrease significantly again, there is no protecting against continued tax increases in 2016 and beyond.
2) The South Bay Union School District has had problems with Project Management at the beginning of this bond. They have changed the scope of projects and many of the program managers, but the costs and the consulting firms remain the same.
3) The District showed recent lack of fiscal responsibility when they forced taxpayers into a tradeoff between reauthorization and capital appreciation bonds by issuing bond anticipation notes. This removed the option of waiting for assessed value growth before building new projects with Proposition X bonds. This is true for the two campuses that are current projects.

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Appendix A: Budget vs. Actual

	Original Budget	Actual To-Date	Projected Expenditures
Phase One			
Bayside	$7,111,263	$7,216,006	$7,738,552
Berry	$6,447,401	$4,315,775	$6,844,199
Nestor	$8,004,542	$5,346,052	$8,497,173
Nicoloff	$6,313,866	$817,771	$6,702,446
Oneonta	$6,889,447	$6,534,717	$7,240,305
Pence	$6,628,565	$818,887	$7,036,513
Sunnyslope	$8,529,896	$937,847	$9,054,859
Phase Two			
Central	$4,429,582	$221,026	$4,457,417
Emory	$5,501,466	$1,400,163	$5,571,743
Imperial Beach	$6,004,958	$273,134	$6,023,339
Mendoza	$1,874,722	$336,080	$1,912,878
VIP Villiage	$2,198,364	$5,871	$2,217,544
Westview	$3,627,134	$28,216	$3,667,370
Ed Center	$1,115,499	$6,634	$1,155,720
Transportation	$601,672	$0	$615,508
Purchasing	$281,101	$65,055	$286,433
Contingency	$4,440,522	$168,730	$4,408,977
Total	$80,000,000	$28,491,964	$83,430,976
Projected Over Budget	—	—	$3,430,976
New Funding Identified	—	—	$3,312,703
Difference	—	—	($118,273)

Source: South Bay Union School District

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Appendix B: Assessed Value Assumptions and Estimated Debt Service

South Bay Union School District

New Money $ 26,000,000

Assessed Valuation			Estimated Debt Service						Tax Rate
FYE	Assessed Valuation	Increase						Total	
1998	1,713,347,025								
1999	1,733,631,543	1.18%							
2000	1,819,760,846	4.97%							
2001	1,934,442,490	6.30%							
2002	2,086,739,162	7.87%							
2003	2,218,687,603	6.32%							
2004	2,399,826,697	8.16%							
2005	2,633,325,675	9.73%							
2006	2,991,497,438	13.60%							
2007	3,342,892,532	11.75%							
2008	3,612,561,933	8.07%	Since 2000	79.7%					
2009	3,659,230,756	1.29%							
2010	3,378,219,255	-7.68%							
2011	3,295,807,730	-2.44%							
2012	3,270,069,330	-0.78%							
	5 year average	-2.40%	10 year average	4.63%					
Estimated Assessed Valuation			FYE 2013	FYE 2018					30
2013	3,270,069,330	0.00%	-					-	
2014	3,335,470,717	2.00%	1,000,641					1,000,641	30.00
2015	3,468,889,545	4.00%	1,040,667					1,040,667	30.00
2016	3,607,645,127	4.00%	1,082,294					1,082,294	30.00
2017	3,751,950,932	4.00%	1,125,585					1,125,585	30.00
2018	3,902,028,969	4.00%	1,170,609	-				1,170,609	30.00
2019	4,058,110,128	4.00%	730,460	486,973				1,217,433	30.00
2020	4,220,434,533	4.00%	759,678	506,452				1,266,130	30.00
2021	4,389,251,915	4.00%	790,065	526,710				1,316,776	30.00
2022	4,564,821,991	4.00%	821,668	547,779				1,369,447	30.00
2023	4,747,414,871	4.00%	854,535	569,690				1,424,224	30.00
2024	4,937,311,466	4.00%	888,716	592,477				1,481,193	30.00
2025	5,134,803,924	4.00%	924,265	616,176				1,540,441	30.00
2026	5,340,196,081	4.00%	961,235	640,824				1,602,059	30.00
2027	5,553,803,925	4.00%	999,685	666,456				1,666,141	30.00
2028	5,775,956,082	4.00%	1,039,672	693,115				1,732,787	30.00
2029	6,006,994,325	4.00%	1,081,259	720,839				1,802,098	30.00
2030	6,247,274,098	4.00%	937,091	937,091				1,874,182	30.00
2031	6,497,165,062	4.00%	974,575	974,575				1,949,150	30.00
2032	6,757,051,664	4.00%	1,013,558	1,013,558				2,027,115	30.00
2033	7,027,333,731	4.00%	1,054,100	1,054,100				2,108,200	30.00
2034	7,308,427,080	4.00%	1,096,264	1,096,264				2,192,528	30.00
2035	7,600,764,163	4.00%	1,140,115	1,140,115				2,280,229	30.00
2036	7,904,794,730	4.00%	1,185,719	1,185,719				2,371,438	30.00
2037	8,220,986,519	4.00%	1,233,148	1,250,000				2,483,148	30.20
2038	8,549,825,980	4.00%	1,282,474	1,250,000				2,532,474	29.62
2039	8,891,819,019	4.00%	1,333,773	1,250,000				2,583,773	29.06
2040	9,247,491,780	4.00%	1,387,124	1,250,000				2,637,124	28.52
2041	9,617,391,451	4.00%	1,442,609	1,250,000				2,692,609	28.00
2042	10,002,087,109	4.00%	1,500,313	1,250,000				2,750,313	27.50
2043	10,402,170,593	4.00%		1,250,000				1,250,000	12.02
2044	10,818,257,417	4.00%		1,250,000				1,250,000	11.55
2045	11,250,987,714	4.00%		1,250,000				1,250,000	11.11
2046	11,701,027,222	4.00%		1,250,000				1,250,000	10.68
2047	12,169,068,311	4.00%		1,250,000				1,250,000	10.27
2048	12,655,831,044	4.00%						-	0.00
Net Present Value Totals			14,681,062	11,276,550	-	-	-	25,957,611	30.00
		26,000,000	14,700,000	11,300,000	-	-	-	Max Tax Rate	30.20
Discount Rate			5.00%	5.50%				Min Tax Rate	10.27
Issue Period			30	30	-	-	-	Avg Tax Rate	27.02