

Critics Bring 'Cash Out' Controversy to California Attorney General's Attention

Continued from page 1

accorded 'great respect' and 'great weight' by the courts," according to the attorney general's Web site.

The leader of a watchdog group in San Jose says she is waiting for the attorney general's opinion before filing a lawsuit challenging a San Jose Unified School District transaction from 2005. The district illegally pulled \$20 million of cash out of a 2005 deal to refund bonds authorized by voters in a 1997 ballot measure, said Jill Escher, chairwoman of Citizens for School Bond Accountability, the group planning the suit.

The attorney general typically does not issue an opinion on an issue that is the subject of ongoing litigation. The December 2005 bond issue was for a par amount of \$148.1 million, according to its official statement. In addition to the principal amount of the bonds, the issuance generated an original issue premium of \$20.4 million, deposited into a building fund for the prior bonds, according to the OS.

UBS Securities LLC underwrote the issue. Stradling Yocca Carlson & Rauth was bond counsel.

Escher said the savings generated in a refunding should have been passed to the SJUSD's taxpayers, instead of generating extra cash.

Opponents of the cash out practice say the California Government Code prohibits issuers from doing a refunding that generates principal in excess of what is needed to retire the refunded bonds and pay issuing costs.

"The proceeds of any sale of refunding bonds for cash shall be placed in the treasury of the local agency to the credit of a fund to be established for the purpose of refunding the bonds to be refunded," the code says in part.

"I don't get what loopholes they see that I'm not seeing," said Escher, a Berke-

ley law graduate who is currently raising children instead of practicing law. She began following the district's finances as a member of a citizens bond oversight committee created for another school district bond measure, the 2002 Measure F, which authorized \$429 million.

When the \$20 million in new capital funds appeared, Escher said, she was skeptical.

"How does the district get cash out of a refinancing of a bond where they've already spent all the money?" she said. "I knew what their accounts look like. Did it fall from the sky? Where did it come from?"

"It really is an affront and a violation of the trust that voters have given with their support of the bond measure to begin with."

Michael Smith,
Marin County treasurer

Eventually, she said, that led her to the cash out refinancing arrangement, despite stonewalling from the school district.

"Some bond counsel may argue that the premium generated by issuing higher than market-rate bonds does not count as 'proceeds,' but how is that possible when we taxpayers are paying higher taxes to provide the district with this very pot of excess cash?" Escher wrote in a letter submitted to the attorney general's office for consideration in the opinion process. "Calling the premium anything other than 'proceeds' is just an attempt to linguistically dance a way around the rules."

Issuers should think carefully about any cash out refunding, according to an article written by Jeffrey Small and Cathleen Dominic of financial advisory firm Capitol Public Finance Group LLC in late 2005.

"When school districts attempt to capture the savings up front to pay for additional school facilities, they should proceed with caution, as this transaction is complex and controversial," the article said.

Small said the impetus for the article came from a client school district that was solicited by an investment banking firm with a proposal to generate cash through a refunding by amortizing debt more quickly and taking advantage of a run-up in assessed property valuations.

"We found that it was not appropriate because of the way it was structured," he said.

The article describes two basic variations of "cash out" deal. One is a direct

Ann Jones, said it conducted its business openly.

"All resolutions referenced were part of the regular posted agenda. Action was taken in open public session," she said in an e-mail.

The refunding bonds provided additional funds for capital projects, decreased total debt service, and reduced the term of the bonds while maintaining the estimated tax rates promised to the voters during the 1997 election, Jones said.

Small said he believes school district issuers should obtain a legal opinion for cash out refundings endorsing the use of the proceeds, preferably from general counsel rather than bond counsel.

"It's one thing to opine that it's a tax-exempt borrowing," he said. "It's a completely separate issue to opine that the proceeds are being used properly."

Smith said that cash out deals often occur with little public discussion.

"County treasurers can all of a sudden look at themselves receiving funds at the eleventh hour," he said.

Escher said she needed to file public records act requests with the SJUSD to learn anything about the deal, even months later.

Bond counsel did not respond to requests for comment by press time.

Escher said her group has retained the firm McManis, Faulkner & Morgan to represent it. She said the group wants the \$20.4 million returned to taxpayers, plus the \$1.6 million cost of issuance. The cost of any litigation is exponentially more than the additional property tax Escher's family is paying, but that's not the point, she said.

"What else can we do, just let it happen, let it slide? I'm not just going to let it slide. What I'm doing makes no economic sense for me. I'm pissed. I see taxpayer abuse going on," she said, adding that she would expect to recover attorney's fees. □

THE WEST INVISIBLE SUPPLY

Issuer and purpose	Amount*	Approval status	Underwriter choice	Expected sale date	Issuer and purpose	Amount*	Approval status	Underwriter choice	Expected sale date
CALIFORNIA					State Public Works Boards	\$120	A	UBS	June
State GOs	\$2,500	A	Citigroup	June	IDAHO				
State gambling securitization	\$850	P	JPMorgan	2007-08	IHFA Garvees	\$250	A	Citigroup	fall
State pension bonds	\$760	P	UBS	2007-08	NEVADA				
Univ. of Calif. rev. bonds	\$600	A	Merrill	May	State fuel-tax GOs	\$135	P		2007-08
San Diego wastewater rev. bonds	\$500	P		2007	OREGON				
LAUSD GOs	\$500	A		summer	DOT rev. bonds	\$520	A	Morgan Stanley	May
San Diego pension obligation bonds	\$374	P	Citigroup, Lehman	2007	DOT rev. bonds	\$300	A		2008
DWR rev. bonds	\$200	A	Goldman	2007	WASHINGTON				
El Camino Hospital rev. bonds	\$130	A		2008	State motor vehicle fuel tax bonds	\$450	P	competitive	fall
Veterans home purchase rev. bonds	\$140	A	Merrill	May	State GOs	\$340	P	competitive	fall

*Dollars in millions. A = approved, P = pending