

CERTIFICATES OF PARTICIPATION

METHOD OF FINANCING PUBLIC PROJECTS WITHOUT VOTER APPROVAL WITHIN PLACER COUNTY

Background

The 2000-2001 Grand Jury received a complaint late in the year that dealt with the use of Certificates of Participation (COPs) by a city within the County. This complaint was passed on to the 2001-2002 Grand Jury for follow up investigation.

During the course of its initial investigation, the Grand Jury became aware of the widespread use of this method of financing major projects in the County, all without voter approval.

While the use of COPs is legal and in some instances necessary, many projects were undertaken without full and easily understandable disclosure to the general public of the reasons for the projects and the costs that would be involved.

Because of the number of COPs that are outstanding within the County and the large dollar amount that is associated with them, the Grand Jury, with its oversight responsibility, chose to include all current countywide COPs in its investigation and inform the general public of its findings.

A Certificate of Participation is a method of funding used by governing agencies for construction or improvement of public facilities. By use of a lease type repayment structure, the monies needed to fund these building projects, even though some may be payable over periods in excess of 20 years, do not, by California State law, constitute a public debt; therefore they do not require voter approval. Federal tax laws, however, treat these lease type obligations as debt, which allows for tax-exempt interest to the underwriting agency. Government agencies with this statutory authorization of funding include the County Board of Supervisors, City Councils, Special District Boards of Directors, and County, City, and District School Boards.

Other key elements of the COP are:

- The approving public agency enters into a tax-exempt lease with a lessor. Lessor acquires site through purchase from a third party or by leasing it from the public agency.
- Facilities are implemented more quickly than those approved by a General Obligation Bond.
- COPs obligate the General Fund.
- COPs can encumber the facility and the land.

- Usually requires rental interruption insurance (in addition to regular insurance).

Governing Boards may, by resolution, also create Enterprise Funds, using COPs. These funds are established for activities normally found in the private sector, i.e., parking garages, golf courses, public utilities, airports, sports and entertainment venues. They are meant to be self-supporting through user charges and should be operated in accordance with generally accepted accounting procedures and reporting requirements of similar private sector business. The nature and purpose of such a fund is to provide goods or services to the general public on a continuing basis. By the use of COPs, these Enterprise Funds do not require voter approval.

COPs were not largely used until the passage of California Proposition 13 in 1978. This Proposition required a two-thirds majority vote of those living within the affected area for issuance of a General Obligation Bond.

General Obligation Bonds may be sold by a public entity that has the authority to impose ad valorem taxes. This is a tax based on assessed value of real property and must be approved by a two-thirds majority vote of the people. Primary use of this tax is to acquire and improve public land and property. As enacted in 2001, General Obligation Bond elections for schools are an exception to the two-thirds majority in that they require only a 55% majority. If, however, the bond is tied into a previous bond under the two-thirds majority rule, the 55% figure will not apply.

Since 1978 most local government entities have had a difficult time gaining approval of General Obligation Bonds. They also have had difficulty in accumulating cash reserves as funding levels have been reduced as a result of funds being transferred to the State, with no guarantee of how much will be returned. This has led to a sharp increase of lease purchase financing, primarily within the Penal System and School Districts.

The use of COPs has been tested in the court system. The most notable case was in 1942, City of Los Angeles v. Offner. The California Supreme Court held that a lease is not a debt, and therefore does not need voter approval. It was of interest to the Grand Jury that all County Agencies and District Budgets that were reviewed listed these COP's/Enterprise Funds in their financial statements under Long Term Debt.

Finding 1

The following table represents the principal balance due on COP/Enterprise Funds as of June 30, 2001. Interest that will be paid over the term of the lease has not been computed as the figure can change through re-financing the COPs or converting them into Revenue Bonds.

Schools:

<u>District</u>	<u>Remaining Principal</u>
Auburn Union	\$27,443,580
Eureka	502,000
Placer County Office of Education	3,200,000
Loomis Union	7,000,000
Placer Union High	3,534,208
Placer Hills Union	680,000
Roseville Joint Union High	2,320,000
Roseville City Schools	22,500,000
Tahoe-Truckee Union	15,631,000
Western Placer Unified	8,035,000
Sierra Community College	<u>5,200,000</u>
Total	<u>\$92,845,788</u>

Cities:

	<u>Remaining Principal</u>
Auburn	\$2,325,000
Rocklin	3,019,610
Roseville	<u>87,140,000</u>
Total	<u>\$92,484,610</u>

Placer County:

Total	<u>\$29,961,000</u>
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Special Districts:

North Tahoe Public Utility District	\$7,310,000
Placer County Water Agency	<u>54,150,000</u>
Total	<u>\$61,460,000</u>

COP Totals:

School Districts	\$92,845,788
Cities	92,484,610
Placer County	29,961,000
Special Districts	<u>61,460,000</u>

Total outstanding obligation in Placer County as of June 30,2001 **\$276,751,398**

As a point of reference, if \$276,751,400 at 5.5% matured in 15 years, the total cost would be \$407,032,182. If the same \$276,751,400 at 5.5% matured in 25 years, the total cost would be \$509,848,719. This is assuming all COPs matured at the same time at the same rate of interest.

Finding 2:

All COPs issued were legally initiated and implemented.

Finding 3:

There is no central repository that has on file COP information for all agencies within the County.

Finding 4:

There appears to be little understanding or awareness of this type of financing on the part of the public.

Recommendations:

This Grand Jury would suggest all County entities with outstanding COPs issue an end-of-the-fiscal-year report on each such COP. This report should be made available to the public and the media. The report should include:

- Original amount of COP issued
- Brief description of the project financed
- Name of Trustee
- Balance remaining
- Interest costs incurred to date
- Estimated future interest costs

The Grand Jury would further recommend that future use of this type of financing include:

- Full disclosure to the public of the need for the project. Use clearly understandable language and work with the media to provide maximum coverage.
- Full disclosure of the anticipated costs of the project, including anticipated interest charges over the life of the bonds, Bond Counsel charges and insurance fees. These figures should be included in the meeting agendas when the item is on the calendar.

Responses Required

No response is required. If, however, any of the issuing authorities, including the Placer County Board of Supervisors, would care to comment on the recommendations please respond within 90 days to:

The Honorable James D. Garbolino
Presiding Judge of the Superior Court
County of Placer
Historic Court House
101 Maple Street
Auburn California 95603

SOURCE MATERIAL

Loomis Union School District Financial Statements For Year Ending June 30, 2001.

Auburn Union School District Financial Statements For Year Ending June 30, 2001

City of Lincoln Annual Budget 2001-2002

City of Auburn Financial Plan 2000-2001

Sacramento County Grand Jury Final Report 1993-1994

San Bernardino County Grand Jury Final Report 1996-1997

San Bernardino County Grand Jury Final Report 1995-1996

Monterey County Grand Jury Final Report 1996-1997

League of California Cities-California Municipal Law Handbook

California Government Code 37350-37364

PERSONAL CONTACTS

Interviews were held with 28 people representing the following public entities. The Grand Jury would like to thank all those individuals for their cooperation and the professional manner in which it was given.

Auburn Union Elementary School District

Colfax Elementary School District

Loomis Union School District

Placer Hills Union School District

Placer Union High School District

Rocklin Unified School District

Roseville City School District

Roseville Joint Union High School District

Western Placer Unified School District

Placer County Office of Education

City of Auburn

City of Rocklin

City of Roseville

City of Lincoln

Placer County Auditor-Controller's Office

Placer County Executive's Office

North Tahoe Public Utility District

Sierra Joint Community College District

APPENDIX

There does not appear to be any one definition for a COP. For example, the following were found during investigation:

City of Auburn Financial Report

“Bonds issued by the City to construct capital facilities and buildings. Non-specific revenue sources are used to pay debt service on these bonds.”

California Debt and Investment Commission

“A certificate (which looks very much like a bond) representing an undivided interest in the payments made by a public agency pursuant to a financing lease (or an installment purchase agreement). Also known as COP’s.”

“A portion of each lease payment (and, therefore, a portion of each interest in a lease payment) is designated as being principal, and the remainder as interest. Even though COP’s are not treated as indebtedness of the issuer under state law (particularly the California Constitution), the federal tax law treats the lease obligation as if it were a debt, and, as a result, the interest component of each lease payment may be treated as tax-exempt interest.”

League of California Cities, The California Municipal Law Handbook

“Certificates of Participation (COPs) use a tax-exempt lease structure to finance the construction of public facilities or improvements. If structured properly, COPs do not constitute “debt” for purposes of the state constitution. Because COPs often rely upon an annual appropriation from the cities general fund, the interest rate and the cost of financing often depend upon whether the improvements to be financed and the property which is the basis for the underlying lease are essential to the functioning of the city. However, COPs can be used to finance virtually any public improvement or facility. COPs do not require an election, even if the payments are secured by enterprise revenues.”

Monterey County Grand Jury

“Certificates of Participation are debt instruments for financing capital projects by the local government. They were developed in response to the difficulties encountered by local governmental bodies in obtaining voter approval. COPs do not require voter approval.”

“COPs differ from a bond issue, in that a non-profit Corporation is given the legal right to the revenue developed by the new facility up to the level required to pay the interest and the amortized principal sum of the borrowing. This legal right to a share of the revenue is usually expressed in the form of a lease with the

Corporation, the lessor, and the government body, the lessee. The Corporation, in turn, sells shares in this revenue stream to individual or commercial investors. The government body sponsoring the new facility leases it back from the Corporation; the government body also guarantees the return of the principal and interest. In effect, the facility is paid for by its own revenue, but to make the deal possible, the government body must guarantee the required revenue to pay off the loan. Thus, if the costs of the project exceed original estimates or the planned revenue streams do not meet expectations, the taxpayers must ultimately make up the shortfall.”

Glossary of Bond Terms

“COP’s are a structure where investors buy certificates that entitle them to receive a participation, or share, in the lease payment from a particular project. The lease payments are passed through the lessor to the certificate holders with the tax advantages intact. The lessor typically assigns the lease and lease payments to a trustee, which then distributes the lease payments to the certificate holders.”

City of Lincoln Annual Budget 2001-2002

“A type of fund established for the total cost of those governmental facilities and services which are operated in a manner similar to private enterprise. These programs are entirely self-supporting.”

City of Roseville Annual Financial Report for fiscal year ended June 30, 2001

“Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the City is that the costs and expenses, including depreciation, of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the City has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.”

San Bernardino County

“Governing boards may, by resolution, create Enterprise Funds, using COP’s. These funds account for governmental activities that are similar to those found in the private sector. Generally accepted accounting procedures, principles and reporting requirements used by similar private sector businesses apply.”

“The nature and purpose of such a fund is to provide goods or services to the general public on a continuing basis:

- That are financed and operated in a manner similar to private enterprise
- Where the intent of the governing body is that all costs are to be financed or recovered through user charges.”