CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION
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MEASURING K-14 PROPERTY TAX RATES
AGAINST PROPOSITION 39 LIMITS

CDIAC

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CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

The California Debt and Investment Advisory Commission (CDIAC) provides information, education, and technical assistance on debt issuance and public funds investments to local public agencies and other public finance professionals. CDIAC was created to serve as the state's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt.

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K-14 VOTER APPROVED GENERAL OBLIGATION BONDS:

PROPERTY TAX RATES FOR BOND MEASURES AUTHORIZED UNDER PROPOSITION 39

The California Debt and Investment Advisory Commission (CDIAC) has released three reports focused on the amount of general obligation (GO) bond authority granted by voters to California K-12 school and community college districts since November 2002 and the amount of that authority remaining unissued.[1] In this report, CDIAC focused its review on the ad valorem property tax rates assessed in Fiscal Year (FY) 2015-2016 to service the K-14 district debt authorized by voters under Proposition 39 and issued from November 2002 through November 2015.

K-12 school districts and community college districts have been issuing unlimited tax obligation bonds with super-majority (2/3) voter support since 1986. These are commonly referred to as Proposition 46 bonds. In 2000, California voters approved Proposition 39 (Prop 39), amending the State Constitution to establish a 55 percent voter approval threshold for school GO bonds.[2] Both types of bonds are secured by a statutory lien to levy ad valorem property taxes in an unlimited amount as needed to repay the bonds.[3] Between

FIGURE 1
SCHOOL GO AUTHORITY COMPARISON

PROPOSITION 46	• Two-thirds voter approval. • GO debt limit for unified school districts and community college districts is 2.5 percent of AV; elementary and high school districts is 1.25 percent of AV.
PROPOSITION 39	• Fifty-five (55) percent voter approval • Limits the total of all bonds issued under any single bond measure for elementary and high school districts to an amount that requires taxes of no more than $30 per year per $100,000 of assessed valuation (AV) on property within the district to pay the principal and interest on the bonds. For unified school districts, the limit is $60, and for community college districts it is $25. In addition to the GO debt limits imposed by Proposition 46 as noted above. • Requires project specificity in ballot initiative, annual audits, and citizen oversight.

[1] CDIAC No. 14-01, K-14 Voter Approved General Obligation Bonds: Authorized, But Unissued, www.treasurer.ca.gov/cdiac/publications/k14.pdf; CDIAC No. 16-01, K-14 Voter Approved General Obligation Bonds: Authorized, But Unissued – 2016 Update, www.treasurer.ca.gov/cdiac/publications/k14update.pdf, and CDIAC No. 17-04, K-14 Voter Approved General Obligation Bonds: Authorized, But Unissued – 2017 Update, http://www.treasurer.ca.gov/cdiac/publications/k14update-2017.pdf

[2] In November 2000, voters in California approved Proposition 39, the "Smaller Classes, Safer Schools and Financial Accountability Act," amending portions of the California Constitution to provide school and community college districts the authority to issue a GO bond with 55 percent voter approval.

[3] In July 2015, SB 222 was approved requiring general obligation bonds issued and sold by or on behalf of a local agency (including K-14 districts) to be secured by a statutory lien on all revenues received pursuant to the levy and collection of the tax.

November 2002 and November 2015, 97 percent of all K-14 GO bonds were authorized under Prop 39.[4]

To compensate for the lower vote threshold, the State Constitution and State law impose additional accountability measures on Prop 39 bonds, including a limit on the tax rate applied to properties in the district (Figure 1). These tax rate limits must be communicated to voters at the time of the bond election. Following voter approval, at the time of each bond issuance, the district must attest that the tax rate is projected to stay within tax rate limits.

The bond election documents are required to include a brief tax rate statement that, once approved by the district board, is published along with the ballot measure language in the official election ballot provided to voters.[5] The tax rate statement is required to provide voters with:

1. The estimated tax rate in the first fiscal year following the issuance of the first series of bonds;

2. The estimated tax rate in the fiscal year following the issuance of the final series of bonds; and

3. The estimated maximum tax rate for the entire bond authorization and the fiscal year in which it is expected to occur.

The tax rate statement is typically prepared by the district's financial advisor and projects fiscal year debt service based upon the principal amount of the bond authorization; the estimated principal amount, coupons, yields and issuance date of each series of bonds according to when the district's capital plan expenditures are expected to occur; and the estimated pattern of assessed valuation growth over the entire term of all bonds issued. While it is necessary to build a model that covers each fiscal year any bonds are expected to be outstanding to demonstrate the statutory tax rate requirement is never exceeded, voters are provided only the limited subset of specific projections listed in 1 through 3 in the tax rate statement.

There are no specific guidelines regarding how conservative the underlying assumptions should be when preparing the tax rate statement. The projections typically cover terms up to 25-40 years.[6] Because it is virtually certain that such projections cannot realistically incorporate the actual timing and magnitude of economic cycles and consequent changes in assessed valuation over these long periods, it is important for districts to be conservative when approving the assumptions being used by the financial advisor. The Legislature took note of the problems that arise from erroneous projections of AV when passing AB 2116 (Chapter 129, Statutes of 2016). Under the legislation that took effect January 1, 2017, K-14 school districts must obtain reasonable and informed projections of assessed property valuations that take into consideration projections of assessed property valuations made by the county assessor prior to asking voters for bond authorization.

But, because the district specifically covenants in its bond documents that tax rates will be raised to any level necessary to make the required principal and interest payments, the actual tax rate may exceed the applicable statutory limit at some point during the life of the bonds.

CDIAC undertook a study of Prop 39 bonds to better understand the trajectory of the rates

[4]From November 2002- November 2015 97.9 percent of bond elections were approved under Proposition 39, CDIAC No. 16-01, K-14 Voter Approved General Obligation Bonds: Authorized, But Unissued – 2016 Update, Footnote 3, www.treasurer.ca.gov/cdiac/publications/k14update.pdf

[5]Elections Code sections 9400-9404.

[6]K-14 GO bonds may have a term of up to 25 years if issued under authority contained in Education Code section 15144 or up to 40 years if issued under Government Code section 53508 or section 53553, if refunding.

approved by voters on bonds issued between November 2002 and November 2015. The study was motivated, in part, by a desire to understand the impact of the Great Recession on Prop 39 bond tax rates and to identify factors that might cause these rates to exceed the statutory limit in future years.

CDIAC identified 796 Prop 39 elections held during this study period, accounting for 2,151 bond issues, including refunding bonds (Figure 2). While most of the elections studied fell within the statutory tax rate limits imposed by Prop 39, CDIAC determined that 88 (11%) elections exceeded the limits.

The task of obtaining the tax rates necessary for this study led to another finding. That is, the difficult work of obtaining and matching tax rates to the actual bond issues the tax revenues support impedes analysis and, by extension, an informed understanding of the costs and benefits of school bond issuance. Taxpayers are asked to approve school bonds based upon estimates contained in the tax rate statement but when subsequent tax rate data is obscure, the lack of information about existing bond measures limits their ability to make informed decisions on future school bond ballots or to weigh in on the district's proposed capital improvement plans.

DATA COLLECTION. While State law requires a district to disclose certain estimated tax rates in the tax rate statement provided to voters, there is no requirement that a district inform its taxpayers about the actual rates. Instead, the reporting of tax rates for all local taxing jurisdictions – including school and community college districts – is the responsibility of counties. Three departments are involved in the process:

1. The assessor's office, where assessed valuations are determined;

2. The auditor-controller's office, where tax rates are calculated; and,

3. The treasurer-tax collector's office, where the property tax bills are prepared and mailed to taxpayers.

Prop 39 bonds are supported by ad valorem taxes assessed on real property in the district; that is, the taxes are based on the value of the property (assessed value or AV). To establish the tax rate to be assessed, the county auditor-controller must essentially divide the amount of debt service to

FIGURE 2
PROP 39 ELECTIONS
NUMBER OF ELECTIONS AND BONDS ISSUED BY DISTRICT
NOVEMBER 2002 AND NOVEMBER 2015

TYPE OF DISTRICT	ELECTIONS	NUMBER OF BOND ISSUES
Elementary School Districts	288 (36%)	574
High School Districts	74 (9%)	192
Unified School Districts	349 (44%)	1053
Community College Districts	85 (11%)	332
TOTAL	796	2151

be paid during the forthcoming year by the total value of the property to be assessed. This latter number is based upon the assessor's assessed valuation of properties as of January 1st of a given calendar year.

CDIAC obtained property tax data from the county assessor or tax collectors offices in each of the 58 counties in California for the FY 2015-16 tax year. Statute gives counties the latitude to report the tax rates in any manner sufficient to identify the taxing entity. As a result, there is no standardized form to report tax rates across the 58 counties. Among the bonds issued CDIAC found that tax rates may be reported in one of three ways: by bond series, bond election or in aggregate for each K-14 district.

In instances where the tax rate was reported at the bond election level or as a composite of the underlying bond issues, CDIAC needed to estimate the individual series tax rates for these bonds. To do this, CDIAC relied on debt service schedules provided in bond offering documents (official statements) or other documents found either on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) or CDIAC's Debt Watch. CDIAC was unable to find tax rate data for 254 (12%) outstanding GO bonds issued during the study period. (Figure 3).

Once tax rates were matched to each bond series and election, CDIAC found that the tax rates for 88 (11%) of the elections exceeded the statutory tax limits (Figure 4). When compared to the total number of elections by district type elementary school districts were found to have a slightly higher concentration of bond measures over Prop 39 limits than other types of districts.

FIGURE 3
PROP 39 ELECTIONS
FORM OF TAX RATE DATA

TYPE OF OF TAX RATE	TAX RATES MATCHED TO BOND ISSUES
Tax Rate Listed by Bond Issue	923 (43%)
Aggregate Tax Rate, Estimated for Bond Issue	718 (12%)
Bond Issue Outstanding, Tax Rate = 0	254 (12%)
Bond Issue Not Outstanding	256 (12%)
Total	2151

The context of this analysis makes the fact that 88 (11%) of the elections exceeded the statutory tax limits more significant than the outcome suggests. CDIAC's analysis is based upon FY 2015-16 tax rates (the product of debt service divided by assessed values), fully six years after the start of the recovery. Had the study been based upon property values at the peak of the Great Recession the number of elections exceeding the statutory tax limits would likely have been more.

UNDERSTANDING CHANGES IN TAX RATES. Of the 88 elections with FY 2015-16 tax rates above the statutory limit, CDIAC focused additional attention on the 30 elections with the highest tax rates. Of these, five elections had tax rates that ranged between 138 to 52 percent over the appli-

[7] According to Legislative Analyst's Office, Understanding California's Property Taxes, November 29, 2012, (p. 8); property values are assessed each January for property tax payments due the following fiscal year (December 10th and April 10th). In addition, Government Code section 29100 requires tax rates to be adopted by each county board on or before October 3rd each year so that property tax bills can be mailed by the treasurer-tax collector by October 15th.

[8] The K-14 districts in Alpine, Mariposa, Modoc and Sierra counties did not have voter approved debt.

[9] Government Code section 29106 provides that "In the annual resolution adopted tax rates, the entity or fund with its corresponding rate shall be classified in any manner sufficient to identify it".

[10] In aggregate means the rate reported represented all voter approved authorizations for an individual district as a single tax rate regardless of the year of authorization.

FIGURE 4

PROP 39 ELECTIONS OVER THE STATUTORY TAX RATE LIMITS BY DISTRICT

TYPE OF DISTRICT	ELECTIONS OVER PROP 39	% OF ALL PROP 39 ELECTIONS
Elementary School Districts	288 (36%)	574
High School Districts	74 (9%)	192
Unified School Districts	349 (44%)	1053
Community College Districts	85 (11%)	332
TOTAL	796	2151

cable statutory limit, twenty were between 50 to 10 percent over and the remaining districts measured less than 10 percent over their respective limit. Although each district varies in the degree to which one factor or another affected its tax rate, CDIAC identified two factors that appear to directly affect whether actual tax rates exceed the statutory tax rate in the years following the bond election: 1) declining AVs within the district; and 2) decisions made by the district related to the bond structure in the original issue or in a subsequent refunding of the bonds.

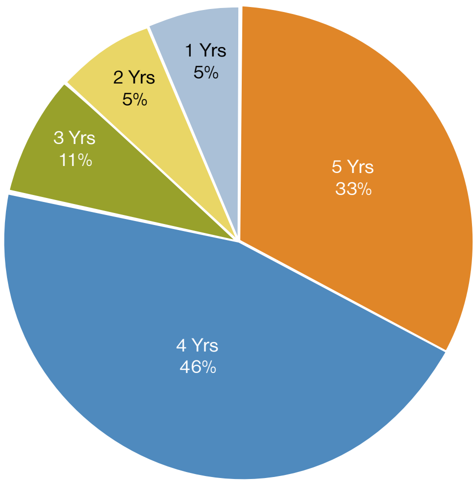
The unlimited tax obligation backing of local school GO bonds establishes a fundamental relationship between AV and the tax rates such that increasing AVs generally lead to stable or declining property tax rates and falling AVs lead to higher or increasing tax rates. Districts suffering negative or flat AV growth that push tax rates over the statutory limit cannot issue new bonds under the remaining authority. They must wait until AVs rise and provide the district the opportunity to issue new bonds under the tax rate limit. They may restructure their debt through refunding. Or they may return to the voters request additional voter approval under a new bond measure.[11] We discuss the first two in the context of the top 30 issues reviewed.

Decrease in AV. Bond ballot measures approved by voters must include a tax rate statement that provides an estimate of the maximum tax rate. This estimate is based on a projection of AV growth over some period of time, usually 10 or more years. Few of the bond elections studied anticipated the Great Recession and the impact it would have on property values in their districts and, as evidence shows, these losses disproportionately affected some parts of the state. Ninety (90) percent of the K-14 districts that exceeded the Prop 39 tax rate limits and for which AV information was available experienced three to five years of AV growth under two percent (2%) between FY 2007-2008 and 2013-2014 (Figure 5). Of these, 57 percent experienced three to five years of negative annual percentage change in AV.

Some of issues studied were sold by districts that suffered other economic fates during the Great Recession. For example, in Kern County, an area economically sensitive to the price of oil, the total percentage AV growth from FY 2014-2015 to 2015-2016 was reported as negative (-8.6%) by the California State Board of Equalization. Approximately eleven percent (11%) of elections with tax rates over Prop 39 are located in Kern County.

[11] While the State Board of Education can approve waivers for a school district to exceed statutory GO debt limits; those waivers have contained a condition that statutory lien levies not exceed tax rate limits, if applicable, at the time the bonds are issued.

FIGURE 5
PROP 39 ELECTIONS
K-14 DISTRICTS RECORDING 2% OR LESS AV GROWTH, 1 TO 5 YEARS
2008-2014



Bond Structuring. It is in the issuer's interest to structure the repayment of their debt service in such a way as to keep their tax rates below the statutory limit over time but to maximize the amount of proceeds received from the sale of the bonds. One way to do so is to create an escalating debt service schedule that matches the estimated rate of growth in property values. This approach fails when actual AV growth does not keep up with the actual debt service schedule.

CDIAC found in 71 percent of the 30 elections studied the average rate of change in debt service exceeded the actual growth of AV from FY 2013-2014 through 2016-2017 (i.e. two fiscal years prior to 2015-16 and the fiscal year immediately following). In other words, the bond structure (escalation of debt service payments) exceeded the actual growth in AVs. This may have been true for the remaining 29 percent of the 30 elections, but for the fact that districts had refunded the original bonds or are still recovering from AV losses that started in 2008.

In some instances, districts shifted more of their repayment obligation to the end of the repayment schedule (backloading debt service), where theoretically AV will be peaking. Issuing capital appreciation bonds (CABs) is one way districts have structured debt in order to delay repayment of principal and interest for years. As noted previously the majority of elections with the highest tax rates appeared to have debt service repayments that have increased faster than the AV growth used to determine the statutory liens pledged as security and of those, sixteen or over half, used a CAB structure when issuing bonds. A look at the 88 elections identified as over Prop 39 limits shows forty-five percent (45%) have outstanding bonds with a structure that delays repayment (Figure 6). Because CABs backload debt service, the number of Prop 39 elections exceeding the statutory tax limits may rise in future years.

During post-issuance debt management, districts may consider refunding existing bonds if doing so will achieve savings.[12] Refunding bonds do not count as a new issue against the voter authorization, because the bonds being refunded have already been approved and do not create any additional debt burden on the taxpayers. While it would seem that the savings generated by refunding prior bonds should also lower the tax rate levy, it is not required. Overall savings achieved over the remaining term of the bonds from a refunding may not be reflected in the annual tax rate levied due to structuring decisions by the districts. CDIAC found that 21 of the 30 elections studied, had refunded prior bonds and of those, two-thirds (66%) still had debt service that exceeded the actual growth of AV. These districts restructured debt service by repaying higher amounts in the short term while achieving debt service savings over the remaining term of the bonds. Of the 88 elections over Prop 39 tax rate limits in 2015-2016, 45 (51%) have refund-

[12] California Government Code sections 53550 et. seq. and 53570 et. seq. require the refunding to produce debt service savings—the total principal plus net interest cost to maturity on the refunding bonds must be lower than that of the bonds to be refunded.

FIGURE 6

PROP 39 ELECTIONS
ELECTIONS USING A CAB STRUCTURE

PROP 39 LIMITS	ELECTIONS WITH BOND ISSUES	ELECTIONS USING CABS
Under Prop 39 Tax Rates	697	192 (28%)
Over Prop 39 Tax Rates	88	40 (45%)
TOTAL	785*	232 (29%)

*At the time, of the study, eleven Prop 39 elections had yet to issue bonds

FIGURE 7

PROP 39 ELECTIONS
REFUNDING ACTIVITY OF ELECTIONS

PROP 39 LIMITS	ELECTIONS WITH BOND ISSUES	ELECTIONS WITH REFUNDING ACTIVITY
Under Prop 39 Tax Rates	697	193 (28%)
Over Prop 39 Tax Rates	88	45 (51%)
TOTAL	785*	238 (30%)

ed prior bonds; a higher rate than for elections with tax rates below the Prop 39 limit (Figure 7). It is unknown if a district's prior bonds had not been refunded, whether the 2015-2016 tax rates would have still exceeded Prop 39 limits.

Recent legislation approved last year, SB 1029 (Chapter 307, Statutes of 2016), requires issuers to certify that they have adopted local debt policies concerning the use of debt.[13] It is recommended that local debt policies include a subcategory on debt structuring that should reference the characteristics and features to be considered when issuing GO debt as well as referencing the need to reasonably match debt service to property tax estimates.

ACCESS TO TAX RATE DATA. The lack of standardization in reporting tax rate data, specifically the level of detail provided for each election, each issue, or each district, proved problematic when linking a district's debt by bond measure to the corresponding tax rate by bond measure. Some counties reported tax rates by bond series but did not reflect the series designations in the official statement or link the series to a bond measure. Counties did not always identify whether the series included refunding bonds. In many cases it was unclear whether reported tax rates represented all debt issued by the district, debt issued under a specific election or the individual series tax rate. In addition, property tax bills sent to taxpayers may not delineate the specific tax rate for each series of bonds or bond measure, thereby making it very difficult for a taxpayer to determine if the statutory tax rate for bonds for a given district's bond authorization has been exceeded.

Obtaining and deciphering tax rates requires significant time and resources, a challenge even to the most persistent researcher. Among the bonds studied, CDIAC found there was no tax rate data available for 254 (12%) Prop 39 bonds (Figure 3). Furthermore, for the bonds for which rates were available, 43 percent were available at the issue level and 33 percent at the election or district level. The lack of availability or a consistent form of the data impedes access to the data for any number of purposes, including the public's ability to understand the implications of their votes on bond ballot measures. The obscurity of the data certainly denies researchers and market analysts the ability to monitor the veracity of projections or the financial models built into the bond's structure. In so doing it limits efforts to understand the ability of school districts to achieve or maintain their commitments to voters.

For transparency purposes, CDIAC recommends that counties report tax rate data either by indi-

[13] Government Code section 8855(i).

vidual bond series, including the specific series designation as presented in the official statement or sale agreement, or as a separate rate for each election or bond measure (including refundings of prior bonds from those elections or bond measures).

CDIAC also recommends that districts consider incorporating a provision into their local debt policy to provide tax rate information on each bond measure, including indicating whether the measure was authorized under Prop 39 or Prop 46, to their governing board and to the public.

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