Date of Hearing: June 17, 2015

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Brian Maienschein, Chair
SB 222 (Block) – As Amended May 19, 2015

SENATE VOTE: 38-0

SUBJECT: Local agencies: school bonds: general obligation bonds: statutory lien.

SUMMARY: Enacts a statutory lien to secure general obligation (G.O.) bonds issued or sold by a city, county, city and county, school district, community college district, authority, or special district. Specifically, **this bill**:

1) Requires all GO bonds issued and sold by or on behalf of a local agency to be secured by a statutory lien on all revenues received, pursuant to the levy and collection of the tax.

2) Requires the lien to automatically arise without any further action or authorization by the local agency or its governing board

3) Requires the lien to be valid and binding from the time the bonds are executed and delivered.

4) Requires the revenue received, pursuant to the levy and collection of the tax, to be immediately subject to the lien and requires the lien to immediately attach to the revenues and be effective, binding, and enforceable against the local agency, its successors, transfers, and creditors, irrespective of whether those parties have notice of the lien and without the need for any physical delivery, recordation, filing or further act.

5) Specifies that this section is not intended to supplement or limit a local agency's power to issue GO bonds conferred by any other law.

6) Defines local agency to mean any city, county, city and county, school district, community college district, authority, or special district.

7) Defines GO bonds to mean bonds, warrants, notes, or other evidence of indebtedness of a local agency payable from the proceeds of ad valorem taxes that may be lived, pursuant to paragraphs 2 and 3 of subdivision (b) of Section 1 of Article XIII A of the California Constitution.

FISCAL EFFECT: None

COMMENTS:

1) **General Obligation Bonds.** The Legislature has granted cities, counties, school districts and several types of special districts the authority to issue GO bonds. These GO bonds issued by local agencies are secured by the legal obligation to levy an ad valorem property tax on taxable property in an amount sufficient to pay the debt service. The rate of the annual ad valorem taxes levied by the local agency to repay GO bonds is determined by the relationship between the assessed valuation of taxable property in the local agency and the amount of debt service due on the GO bonds in any year. Two-thirds of voters must approve the issuance of a GO bond, and in doing so, approve the levy of an ad valorem tax to pay the

bond. Proposition 39 (2000) enables school districts to issue GO bonds upon a 55% voter approval, subject to specified conditions. Because GO bonds are backed by such a broad and reliable security pledge, they typically obtain the highest bond ratings and widest investor acceptance, which results in the lowest borrowing costs among various types of long-term bonds.

2) **Bankruptcy.** Recent bankruptcy cases across the country (Jefferson County, Alabama and City of Detroit, Michigan) have raised new questions about the security and treatment of GO bonds after the filing of Chapter 9 (municipal bankruptcy). It is difficult to conclude the treatment of GO bonds in all Chapter 9 cases due to the differences in state law. However, California is listed as one of the five states that have GO bonds backed by a statutory lien, pursuant to the requirements under state law which require local agencies to secure GO bonds with a broad pledge of voter approved ad valorem tax revenues. A statutory lien is one type of lien recognized by the Bankruptcy Code that arises by statute, and does not require any consent between parties (security interests) or judicial action (judicial lien). In Bankruptcy Court, GO bonds backed by statutory liens are secured claims meaning they cannot be altered.

   In past bankruptcy cases in California (San Jose Unified in 1983, Orange County in 1994, and Sierra Kings Health Care District in 2009), GO bond debt was preserved and the local agencies continued to make payments to bondholders. While there have been more recent cases of bankruptcy in California among cities and special districts, financially struggling school districts take a different path. As a result of court decisions (*Butt v. State of California*, 1992) placing the ultimate responsibility for ensuring the equitable provision of public education to all students, including those in financially failing school districts, and the resulting early experiences with districts on the verge of insolvency, the state developed a process for providing financial oversight to school districts, and for providing financial assistance and financial recovery to school districts in financial trouble [AB 1200 (Eastin), Chapter 1213, Statutes of 1991]. As a result, the AB 1200 process has been sufficient to pull nine school districts out of immediate financial trouble and return them to a more stable fiscal condition.

3) **Bill Summary.** This bill enacts a statutory lien to secure GO bonds issued by a city, county, city and county, special district, authority, school district, and community college district. This bill requires the statutory lien arise automatically without the need for any action or authorization by the local agency or its governing body. Under this bill, the lien will be valid and binding from the time the bonds are executed and delivered. Additionally, this bill requires that the lien must immediately attach to the GO bond revenues and be effective, binding, and enforceable against the local agency, its successors, purchasers of those revenues, creditors, and all other asserting rights therein, irrespective of whether those parties have notice of the lien and without the need for any physical delivery, recordation, filing, or further act. School districts have the authority to issue GO bonds under both the Government Code and the Education Code, therefore, the author and sponsor want to amend both codes to emphasize the statutory lien for school districts.

   This bill is sponsored by San Diego Unified School District.

4) **Author's Statement.** According to the author, "[This bill] clarifies that GO bonds issued and sold by school districts, community college districts, and local governments are secured

by a statutory lien on the taxes collected for their payment. Current practice among bond rating agencies is to analyze the fiscal strength of the issuing district or region when giving the bonds a rating because they are concerned that if the district or local government were to declare bankruptcy, the taxes levied for payment of their general obligation bonds could be diverted by the bankruptcy court reducing or suspending payments to the bondholders. In the case of school districts with less financial stability, it can result in a lower rating on the bond issuance which results in taxpayers paying more for improvements to their schools than their counterparts in districts with more financial stability, even though the risk is the same.

"[This bill] clarifies that the statutory liens protect GO bonds thus eliminating the risk of non-repayment. In the event credit ratings were improved, it could result in savings to a school district, community college district, or local government."

5) **Policy Consideration.** Supporters of the bill contend that current practice among bond rating agencies is to analyze the financial strength of the issuing local agency as opposed to the actual security for repayment of the GO bond debt, the property tax base. Proponents argue that this causes school districts with less financial stability to get a lower rating on bond issuance causing some districts to pay more for school improvements than other districts with greater financial stability. While equity is a good public policy goal, the Committee may wish to consider if this bill will achieve that equity and if bond rating agencies will still analyze the overall financial strength of a local agency despite the pledged security of a statutory lien on the revenue that will be used to repay the bond debt.

6) **Arguments in Support.** Supporters argue that this bill clarifies existing law to secure GO bonds by way of a statutory lien on the taxes collected for their repayment. By clarifying in statute that these are statutory liens, it would reduce bankruptcy risks on GO bonds and local agencies would potentially benefit from higher credit ratings, improved interest rates, and savings to their bond costs.

7) **Arguments in Opposition.** None on file.

REGISTERED SUPPORT / OPPOSITION:

Support	**Opposition**
California Association of School Business Officials	None on file
California School Boards Association	
California Public Securities Association	
Coalition for Adequate School Housing	
Lemon Grove School District	
Los Angeles Unified School District	
Riverside County Superintendent of Schools	
Santee School District	
San Diego Unified School District	
San Marcos Unified School District	
Vista Unified School District	

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