

**CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-Bank)**

**STAFF REPORT**

**EXECUTIVE SUMMARY**

<b>Applicant:</b>	King City Joint Union High School District (District)	<b>Amount Requested:</b>	Not to exceed \$16,000,000*
<b>Applicant Description:</b>	The District is a 9-12 <sup>th</sup> grade public high school district and consists of approximately 2,500 square miles in California's Salinas Valley. The majority of the District lies in Monterey County and includes the incorporated cities of Greenfield and King City.	<b>Date of Board Meeting:</b>	March 23, 2010
		<b>Type of Bonds Issue:</b>	New Issue
<b>Title of Bonds:</b>	California Infrastructure and Economic Development Bank State School Fund Apportionment Lease Revenue Bonds, Series 2010 (Bonds)	<b>Resolution No.:</b>	10-14
		<b>Prepared by:</b>	Tara Dunn
<b>Uses of Bond Proceeds:</b>	The proceeds of the Bonds will be used to: (1) repay the \$5,000,000 emergency apportionment (including accrued interest) made from the State General Fund to the District; (2) fund an \$8,000,000 increase to that emergency apportionment; (3) fund capitalized interest; (4) fund a reserve fund; and (5) pay costs of issuance.		
<b>Public Benefits:</b>	The State's General Fund will be reimbursed for approximately \$5 million plus accrued interest owed by the District and the Bonds will provide an additional emergency apportionment to the District to help mitigate its financial distress.		

**Financing Structure:**

<b>Type of Issue:</b>	Publicly-offered fixed-rate bonds issued in minimum denominations of \$5,000 or any integral multiple thereof.
<b>Tax Status:</b>	Tax-exempt.
<b>Term:</b>	Not to exceed 20 years.
<b>Credit Enhancement:</b>	The Bonds may be credit enhanced by a bond insurance policy from Assured Guaranty, if cost effective.
<b>Credit Rating:</b>	Expected to be rated at least "A-" by Standard & Poor's (S&P) based upon the State's current general obligation bond rating. If insured: AAA, by S&P, based upon Assured Guaranty's rating.

<b>Est. of Sources of Funds:</b>	<b>Est. Uses of Funds:</b>
Par amount of Bonds	Disbursement Fund
\$16,000,000	Deposit to State General Fund
	Debt Service Reserve Fund
	Capitalized Interest
	Costs of Issuance/Bond Insurance
	Underwriter's Discount
<b>TOTAL SOURCES</b>	<b>TOTAL USES</b>
<b>\$16,000,000</b>	<b>\$16,000,000*</b>

**Financing Team:**

<b>Bond and Disclosure Counsel:</b>	Stradling Yocca Carlson & Rauth
<b>Senior Managing Underwriter:</b>	Piper Jaffray & Co.
<b>Underwriter's Counsel:</b>	Fulbright & Jaworski LLP
<b>Financial Advisor:</b>	KNN Public Finance
<b>Trustee:</b>	U.S. Bank, National Association

**Staff Recommendation:**

Staff recommends approval of Resolution 10-14 authorizing the issuance of not to exceed \$16 million\* par amount of lease revenue bonds for the King City Joint Union High School District, and approving, authorizing and directing the execution of documents in connection therewith.

\*The total of \$16 million includes capitalized interest on the Bonds. Currently, the District is seeking a level debt service structure without capitalized interest which would require less Bonds to be issued.

## BACKGROUND

Each year the State of California (State) provides funding to school districts via apportionments from, among other things, the State School Fund<sup>1</sup>, calculated in accordance with the Education Code. When the annual apportionments from the School Fund, together with Federal and local sources, have not been sufficient to pay the expenses of a certain school district, the financially troubled school district may apply to the State for one or more additional apportionments from the General Fund on an emergency basis (Emergency Apportionment or Emergency Apportionments). An Emergency Apportionment is considered an advance of a school district's future apportionment funds.

Pursuant to Chapter 20, Statutes of 2009 (SB 130), enacted on July 22, 2009, the State provided for an initial Emergency Apportionment to the King City Union High School District (District) of \$5 million funded from the General Fund of the State, and for an increase of the apportionment in the amount of \$8 million to be financed through the issuance of the bonds (Bonds) to be issued by the I-Bank. Pursuant to SB 130 and the Emergency Apportionment Financing Act (described below), the Bonds are being issued to: (1) reimburse the State General Fund for the \$5 million initial Emergency Apportionment (together with accrued interest thereon); (2) finance the \$8 million increase to the Emergency Apportionment; (3) fund capitalized interest; (4) fund a reserve fund; and (5) pay costs of issuance of the Bonds.

### **Emergency Apportionment Financing Act**

Chapter 263, Statutes of 2004 (AB 1554), as amended by Chapter 97, Statutes of 2005 (AB 1303) and Chapter 710, Statutes of 2005 (AB 491) added sections to the I-Bank's enabling law and to the Education Code governing, among other things, the funding of Emergency Apportionments through lease revenue bonds issued by the I-Bank. (Collectively, AB 1554, AB 1303 and AB 491 are referred to as the Emergency Apportionment Financing Act or the Act.)

The Act requires that I-Bank bonds issued for Emergency Apportionments be repaid via a direct intercept by the State Controller from funds in the State School Fund (see Intercept Mechanism below). The Act also does not allow school districts participating in a lease revenue bond financing pursuant to the Act to file for bankruptcy, and prohibits any government officer or organization from authorizing the school district to be a debtor under the bankruptcy code. The Act also includes other pledges of the State Legislature, including that the State will not alter the intercept repayment mechanism in a way that will materially impair the security of bondholders.

Pursuant to the Act, future Emergency Apportionments may be made from the State General Fund or from the proceeds of a lease financing by the I-Bank.

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<sup>1</sup> Funding for kindergarten through twelfth grade public school districts is from Section A of the State School Fund. Funding for public institutions of higher education is from Section B of the State School Fund.

### **Prior State School Bonds**

In December, 2005, the I-Bank issued \$97 million of State School Fund Apportionment Lease Revenue Bonds in three series, one of which was refunded by bonds issued by the I-Bank in 2008 (together, Prior School Bonds). Each series of the Prior School Bonds is being repaid from lease payments made through a direct intercept of State School Fund monies designated for apportionment to one of three school districts – Vallejo City Unified School District, West Contra Costa Unified School District and Oakland Unified School District. The current cumulative outstanding balance of the Prior School Bonds is \$87,615,000.

### **King City Joint Union High School District**

The District is a 9-12<sup>th</sup> grade public high school district and consists of approximately 2,500 square miles in California's Salinas Valley. The majority of the District lies in Monterey County and includes the incorporated cities of Greenfield and King City. Monterey County is the 19th most populous county in the State, with most of its population concentrated in the northern portion of the county, in and around the City of Salinas.

The District operates two 9-12<sup>th</sup> grade comprehensive high schools and two alternative education (continuation) high schools located on the high school sites. The enrollment for the 2009-2010 school year is 2,134 students, and the District has approximately 150 employees. From 1995 to 2009, the District shared common administration with King City Union Elementary School District (KCESD). KCESD chose to return to separate administration when it became clear that the District did not have sufficient resources to manage independently, and would require a State emergency apportionment.

### **Governance**

Pursuant to SB 130, in July 2009 the State Superintendent of Public Instruction (State Superintendent) assumed control of the District in order to ensure the return to the District of fiscal solvency. SB 130 requires the State Superintendent to assume all of the rights, duties, and powers of the District governing board. The State Superintendent, in consultation with the Monterey County Office of Education Superintendent, appointed a State Administrator to act on behalf of the State Superintendent in exercising the authority described in SB 130. The State Administrator serves under the direction and supervision of the State Superintendent until terminated by the State Superintendent at his or her discretion.

For the period of time during which the State Superintendent exercises the authority described in SB 130, the District governing board serves as an advisory body reporting to the State Administrator, but has no rights, duties or powers, and is not entitled to any stipend, benefits or other compensation from the District. With the approval of the State Superintendent, the State Administrator may enter into agreements on behalf of the District and, subject to any contractual and statutory obligation of the District, change any existing District rules, regulations, policies or practices as necessary for the effective implementation of the improvement plan required by SB 130.

SB 130 also requires the Fiscal Crisis and Management Assistance Team (FCMAT) to conduct comprehensive assessments and complete improvement plans for specified key District service areas and to periodically report on the District's progress in these areas. When the State Administrator certifies that a certain level of achievement is reached in a service area, the FCMAT will recommend to the State Superintendent that control of that functional area should be returned to the District's governing board. The authority of the State Superintendent and the State Administrator will continue until a number of conditions relating to financial and operational improvements are satisfied, after which the District governing board may regain its rights, duties and powers.

The first FCMAT comprehensive review report (Report) on the King City JUHSD was posted on the FCMAT Web site ([www.fcmat.org](http://www.fcmat.org)). The report evaluates the District at the time of the State takeover in July 2009 in five areas: financial management; pupil achievement; personnel management; facilities management; community relations and governance. The Report identified significant deficiencies in all of the areas and will serve as a guide for future improvements so that local control can eventually return to the District's governing board.

## STATE FUNDING OF SCHOOL DISTRICTS

### **Constitutional Funding Priority**

Article XVI, Section 8 of the Constitution requires that from all State revenues there will first be set apart the moneys to be applied by the State for support of the public school system and public institutions of higher education.

### **Principal Sources of School District Funding Revenue Limit**

State school districts receive most of their revenues under a formula known as the State revenue limit (Revenue Limit). Generally, the Revenue Limit is an amount calculated under the Education Code for each school district on a per unit of average daily attendance (ADA) basis and adjusted annually to provide cost of living increases and periodically to equalize funding among similar types and sizes of school districts. ADA is determined by school districts three times per fiscal year.

The Revenue Limit per ADA is then multiplied by a school district's ADA to derive each school district's Revenue Limit. Various adjustments are added or subtracted from the simple multiplication of ADA and the Revenue Limit per ADA to derive each school district's Total Revenue Limit. The majority of the adjustments are accounted for from the State's deficit factor and the California Public Employees Retirement System (PERS) adjustment.

### **State Aid Portion of the Revenue Limit**

From the Total Revenue Limit calculated for each school district, the amount anticipated to be collected from local sources including primarily property taxes, as well as community redevelopment and miscellaneous funds is then deducted, and other statutory adjustments are made. The net State apportionment is commonly referred to

as “State Aid”. In general, as property tax revenues increase, State Aid decreases, and vice-versa.

The statutory adjustments referred to above include a reduction to a school district’s local property tax revenues to account for the in-lieu of property tax revenues charter schools receive from a school district through a school district’s State Aid. The effect of this adjustment is to increase a school district’s State Aid. The statutory adjustments required to determine State Aid also include a reduction in the Total Revenue Limit by the amount that goes directly to charter schools in that school district. The effect of this adjustment is to decrease a school district’s State Aid. Finally, other Revenue Limit adjustments, if any, are applied to determine the final State Aid amount.

State Aid is subject to the Intercept (described below). Property taxes and revenues associated with the reductions described in this section are not subject to the Intercept.

### **Other State Aid**

In addition to State Aid, school districts receive State funding for numerous categorical programs that are usually for specific purposes. Recently enacted legislation, Senate Bill 4 of the Third Extraordinary Session (Chapter 12, Statutes of 2009), added California Education Code Section 42605, which authorizes complete flexibility by a local educational agency in the use of many categorical program funds for fiscal years 2008-09 through 2012-13, and allowing, with some exceptions, these funds to be used for any educational purpose. Categorical programs may be funded from the State School Fund or from other funds and are commonly referred to as Other State Aid. Funding for categorical programs is approved annually in the State budget and implementing legislation and distributed at different times throughout each fiscal year or as otherwise prescribed by law, and can vary from year to year. Individual school districts must qualify for a categorical program to receive funding.

The Other State Aid programs that are subject to the Intercept (described below) consist of the categorical programs that are funded from the moneys in the State School Fund designated for apportionment to the school districts (Other State Aid Subject to the Intercept). The programs that qualify as Other State Aid Subject to the Intercept are subject to change over time.

### **Total State Aid Subject to Intercept**

The District’s apportionments that are subject to the Intercept (described below), consist of State Aid and Other State Aid Subject to the Intercept as described above.

Principal impacts to the Total State Aid Subject to Intercept include the fluctuations in property taxes, a decline in ADA figures resulting from declines in populations of school age children or increasing attendance by school age children at private or charter schools, or changes to such adjustments as the State deficit factor or other negative adjustments, and the impact of state or federal programs, including programs designed to improve school performance.

## SECURITY AND SOURCE OF REPAYMENT FOR THE BONDS

### **Lease Structure**

The District will enter into a lease/lease back agreement with the I-Bank wherein the District will lease to the I-Bank, pursuant to a site lease (Site Lease), existing school facilities that have a total value approximately equal to the principal amount of the Bonds. The I-Bank will simultaneously lease the facilities back to the District through a lease agreement (Lease Agreement) in exchange for the payment of rental payments equivalent to the principal and interest due on the Bonds. The term of the Lease Agreement shall not extend beyond 20 years, except that if at the end of the lease term any required rental payment has not been fully paid, or if rental payments have been abated, the term of the Lease Agreement shall be extended for a period not to exceed ten years. Rental payments include base rental payments to cover repayment of the Bonds and additional rental payments to cover administrative costs (collectively, Rental Payments).

Under the Lease Agreement, rental payments may be abated for loss of use of the leased premises. Rental interruption insurance will be required to offset any abated rental payment. Rental interruption and hazard insurance is not available to cover earthquakes.

### **Intercept Mechanism**

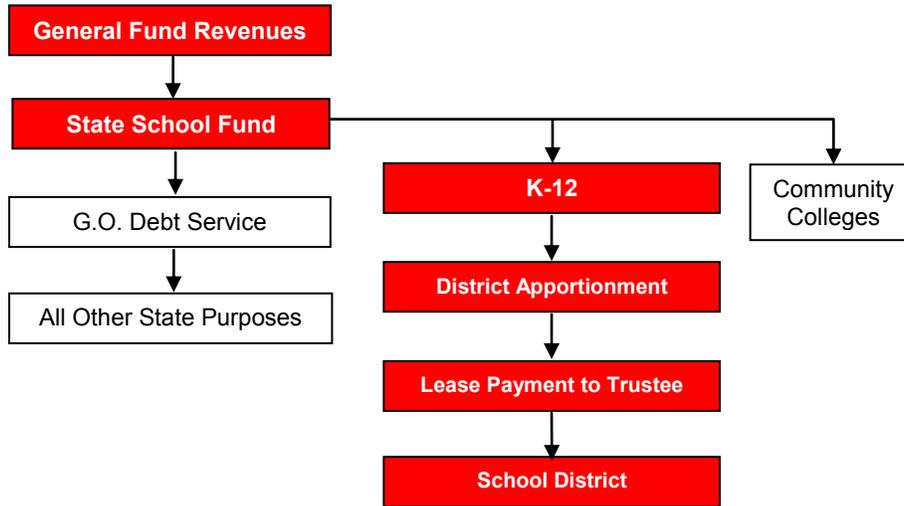
Pursuant to the Education Code, during each fiscal year the State Controller transfers from the State General Fund to the State School Fund an amount sufficient to fund apportionments to school districts for that fiscal year.

The Act requires that, concurrently with each lease financing, the I-Bank must provide the State Controller and the District with a notice of the financing, including a schedule of the Rental Payments that will be due from the District under the Lease Agreement. Pursuant to the Lease Agreement, the I-Bank may amend or supplement the Rental Payment schedules from time to time as necessary or appropriate.

Via an intercept mechanism (Intercept), the State Controller will pay directly to the trustee for the Bonds (Trustee) from State School Fund apportionments due to the District all Rental Payments under the District's Lease Agreement. These Rental Payments will be made prior to the disbursement of any State School Fund payments to the District. The District shall not be obligated to pay Rental Payments under its Lease Agreement to the extent such Rental Payments are paid from the Intercept by the State Controller. However, to the extent that Rental Payments are not paid by the State Controller, each Rental Payment will be payable by or on behalf of the District from any lawfully available funds.

Pursuant to the Act, no party, including the District or any creditors thereof, will have any claim to moneys intercepted by the State Controller and directed to the Trustee, and, the Intercept shall constitute a lien senior to any other apportionment or payment of State School Fund moneys to or for the District.

The following chart reflects the flow of apportionment funds:



### Reserve Fund

The reserve fund requirement (Reserve Fund Requirement) for the Bonds, shall be an amount equal to the least of: (1) 10% of the principal amount of the Bonds outstanding; (2) maximum annual debt service on all Bonds outstanding; and, (3) 125% of average annual debt service on all Bonds outstanding. If there is a draw on the reserve fund, there is no requirement to replenish the reserve fund to meet the Reserve Fund Requirement other than from delinquent rental payments.

## THE BONDS

Credit highlights of the Bonds:

<b>Financing Amount</b>	Not to exceed \$16 million
<b>Type of Issue</b>	The Bonds will be publicly offered fixed rate bonds in minimum denominations of \$5,000 or any integral multiple thereof
<b>Tax Status</b>	Tax-exempt
<b>Term</b>	The Bonds will mature in 2029
<b>Repayment</b>	Direct intercept of the District's State Aid
<b>Type of Financing Agreement</b>	Site Lease and Facility Lease
<b>Leased Assets</b>	Portions of Greenfield High School, totaling 71,878 sq ft as follows: <ul style="list-style-type: none"> <li>• Gym</li> <li>• Multipurpose Room</li> <li>• Classrooms 400</li> <li>• Science Classrooms</li> <li>• Administration</li> </ul>

<b>Additional Bonds Test</b>	5X coverage of Maximum Annual Debt Service Coverage Ratio based upon recent historical revenues
<b>Value of Lease Assets</b>	Approximately \$16.7 million
<b>Reserve Fund</b>	Funded with Bond proceeds and invested in permitted investments pursuant to the Bonds' Trust Agreement, including one or more investment agreements, guaranteed contracts, forward delivery agreements or other investment vehicles
<b>Bond Insurance</b>	Assured Guaranty, if determined to be cost effective
<b>Expected Ratings</b>	<u>If uninsured:</u> Expected rating of "A-" from Standard and Poor's (S&P)  <u>If insured:</u> AAA by S&P

<b>Pro Forma Debt Service Coverage for the Bonds</b>	<b>Pro-Forma Debt Service Coverage</b>	
		<b>FY 2008/09</b>
	Revenue Limit per ADA	7,066
	Total ADA	2,048
	Gross Revenue Limit	\$ 14,471,168
	Deficit Factor	7.84%
	Net Revenue Limit	13,344,000
	Local Sources	(4,119,000)
	State Aid Portion	9,225,000
	Other State Aid	1,804,000
	Total Available Intercept Moneys	\$ 11,029,000
	Maximum Annual Debt Service	\$ 1,301,300
	Ratio of Available Intercept Moneys to Maximum Annual Debt Service	8.5

The Bonds do not constitute a debt or liability of the State or of any political subdivision of the State, other than a limited obligation of the Infrastructure Bank payable solely from revenues and amounts available pursuant to the Trust Agreement, or a pledge of the faith and credit of the State or of any political subdivision thereof including the Infrastructure Bank. The obligation of the District to make Rental Payments under the Lease Agreement does not constitute an obligation of the District for which the District is obligated to levy or pledge any form of taxation or for which the District has levied or pledged any form of taxation. The Infrastructure Bank has no taxing power.

## **ON-GOING ROLE OF THE I-BANK**

The Bonds will involve additional duties of the I-Bank above those duties typically required of it in other conduit financings, and will include the following:

- Providing the State Controller and the District with rental payment schedules.
- Filing the annual continuing disclosure report with the Electronic Municipal Market Access System (EMMA) so long as the Bonds are outstanding.
- Monitoring District compliance with insurance requirements on the leased properties.
- Investing the Revenue Fund, and the Disbursement Fund and the Reserve Fund (if applicable).
- Monitor receipt and distribution of revenues by the Trustee in accordance with the terms of the Trust Agreement.
- Filing reports with the IRS relating to arbitrage rebate.
- Annually assist the District and monitor District compliance Tax Certificate requirements

## **RECOMMENDATION**

Staff recommends approval of Resolution 10-14 authorizing the issuance of not to exceed \$16 million par amount of lease revenue bonds for the King City Joint Union High School District, and approving, authorizing and directing the execution of documents in connection therewith.