Where Borrowing $105 Million Will Cost $1 Billion: Poway Schools

Posted: Monday, August 6, 2012 6:00 am

Last year the Poway Unified School District made a deal: It borrowed $105 million from investors to fund a final push in its decade-long effort to revamp aging schools.

In many ways, the deal was unspectacular. Some of the money was used to pay off previous debts from delayed and over-budget construction projects. The rest went towards finishing upgrades that Poway taxpayers had been promised as far back as 2002. To a casual observer, it was just another school bond.

But Poway Unified's deal was far from normal.

In 2008, voters had given the district permission to borrow more money to finish its modernization, and they had received a big promise from the elected school board in return: No tax increases.

Without increasing taxes, the district couldn't afford to borrow money in the conventional way. So, instead of borrowing from investors over 20 or 30 years and paying the debt down each year, like a mortgage, the district got creative.

With advice from an Orange County financial consultant, the district borrowed the money over 40 years in a controversial loan called a capital appreciation bond. The key point for the district: It won't make any payments on the debt for 20 years.

And that means the district's debt will keep getting bigger and bigger as interest on the loan piles up.

The bottom line: For borrowing $105 million in 2011, taxpayers will end up paying investors more than $981 million by 2051, or almost 10 times what the district borrowed. That's wildly more expensive than a typical school bond, in which a district pays back two or maybe three times what it borrowed.

As well as being expensive, capital appreciation bonds work by tapping future growth in property values to pay today's debts, a concept considered by many in the school bond business to be both risky and inequitable. In 1994, the state of Michigan banned school districts from issuing bonds like this, deeming them too toxic to taxpayers.

Nevertheless, California's ever-strapped districts have increasingly looked to capital appreciation bonds to raise money for improvements without increasing taxes on current residents. Across the state, districts have borrowed billions this way, using exotic financing to shift the burden for paying for today's school construction to future generations of Californians.

Poway Unified, a district more accustomed to praise for its fiscal austerity, has found itself at the center of the debate over these bonds. For a year now, it's come under fire from taxpayer groups and concerned elected officials around the state, for whom Poway's bond has reached legendary status.

"This is way worse than loan sharking," said Michael Turnipseed, executive director of the Kern County Taxpayers Association in central California, which has lobbied the state Legislature to tighten laws on school district borrowing. "And Poway is the poster child. What they have done is absolutely insane."

Officials at the district and two members of the school board who approved it acknowledge that the deal is expensive. But they say Poway's overall construction program has been a roaring success and a boon to local students and homeowners alike.

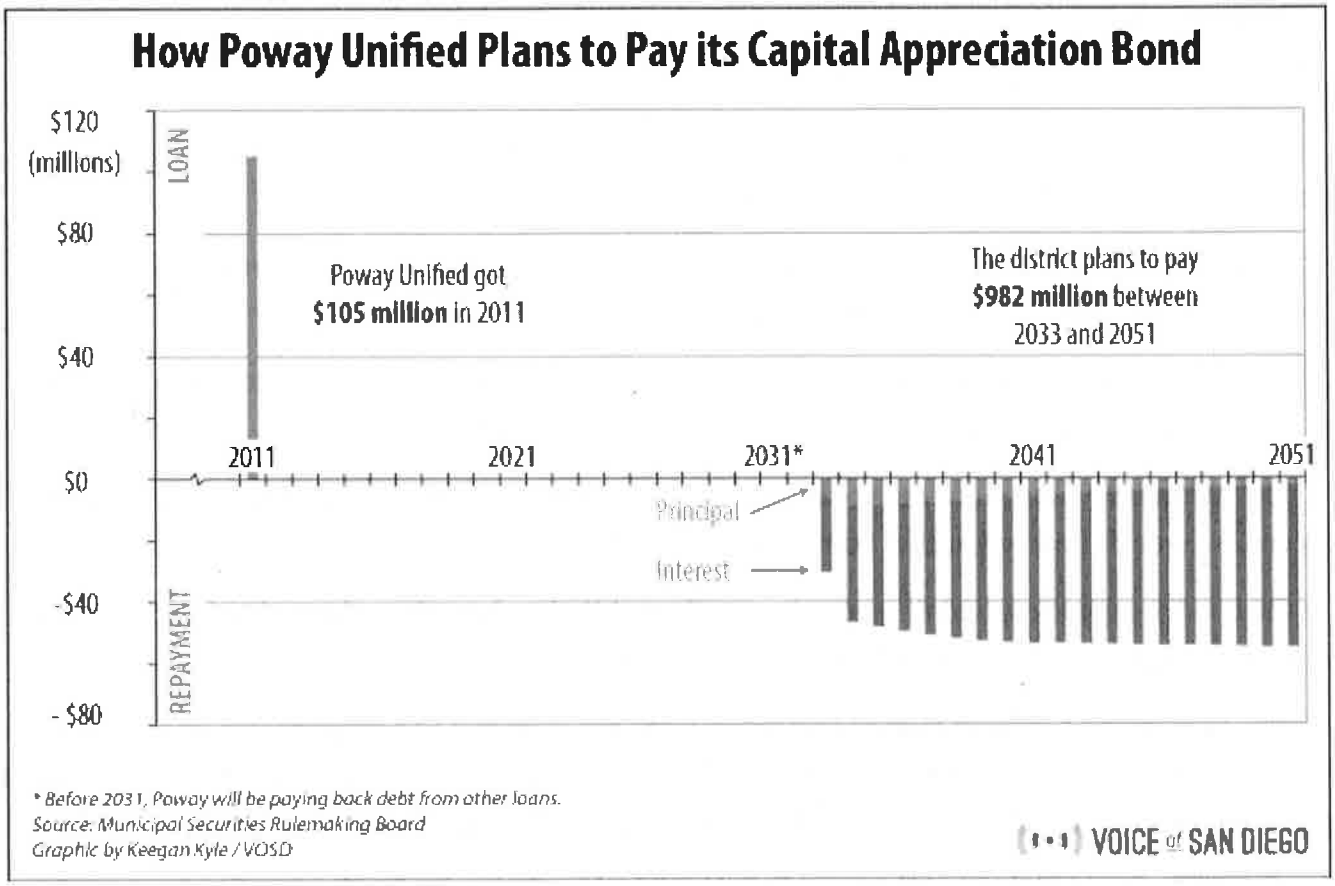
District taxpayers should have understood that borrowing money over a longer period of time, without raising taxes, would be pricey, the officials said. And, they said, they've stuck to their word.

"We could have authorized more taxes, it would just have been breaking the promises we made to the community," said school board member Todd Gutschow.

But last year's bond doesn't just affect the taxpayers who voted on it. It also saddles their children and grandchildren with hundreds of millions of dollars in debt, and raises the risk that property taxes could spike once the district finally starts making payments on its loan.

In short: In order to keep its promises to current residents, the district entered into a deal that places a billion-dollar burden on future residents. Last year's deal, in the words of County Treasurer and Tax Collector Dan McAllister, "is a perfect example of how something that's done today can adversely affect the next generation and the generation after that."

A Hard Sell



In 2008, Poway Unified's school modernization plans were way off schedule.

Construction costs had spiraled upwards, fueled by the region's real estate boom. This, combined with other construction delays and cost overruns, meant the district needed more money to complete its ambitious renovation program.

Voters had agreed back in 2002 to allow the district to borrow $198 million to bring state-of-the art facilities to 24 schools. But by 2008, the district was asking for $179 million more to finish the job.

Traditionally, school districts in California fund renovation programs by borrowing money from investors and paying back those loans with small increases in local property taxes.

That's what Poway Unified's first bond did in 2002. With California's economy starting to warm up from the boom-and-bust of the late-1990s, voters approved the district bumping local property taxes up by $55 for every $100,000 of home value. That revenue was then tapped to pay off the district's construction loans.

By 2008, however, the economy was in trouble. The real estate market had already been tanking for a couple of years. Stocks were sliding downwards and unemployment was on the rise.

It was a tough time to sell a tax increase to voters.

But with some Poway Unified residents still waiting for the renovations they had been promised back in 2002, the district decided to approach voters once more.

"We knew the voters wanted these projects, and we knew they wanted them sooner rather than later," said Poway Superintendent John Collins.

This time, Poway Unified didn't try to push a tax increase. Instead, it came up with a different way to pay for its new bond program, Proposition C.

Rather than increasing the tax rate, the district asked voters if they'd be willing to extend the life of the existing property taxes for an estimated additional 11 to 14 years.

That passed muster. Despite some vocal opposition, on Feb. 5, 2008, district residents voted 63.9 percent in favor of Poway Unified borrowing another $179 million.

But the bond's supporters hadn't made clear to the public just how they planned to borrow money without raising taxes, or how much that would end up costing taxpayers.

In 2008, there wasn't enough money coming in from the district's $55 property tax levy to pay for all the new borrowing it wanted to do. All the cash being generated by the existing taxes was eaten up paying off old loans that had already been used for upgrading schools.

The district's plan, then, was to borrow money against the future tax revenues it would receive by extending the life of the taxes. In other words, it would get the money now, but wouldn't start paying it back for a long time.

Borrowing money in this way is possible for school districts, but it's much more expensive than paying a loan back year-by-year.

Last year, the district put together its deal to borrow $105 million, without paying anything towards the debt for 20 years.

In two decades' time, taxpayers will start paying about $50 million a year towards the loan. They'll make those payments for the next 20 years or so.

It's a bit like a massive version of one of those exotic loans that got homeowners into so much trouble.

With one key difference: For the next 20 years, Poway Unified isn't even paying the interest.

'If They Ever Told the Truth'

Photo by Sam Hodgson

The headquarters of the Poway Unified School District.

Poway officials say it's important to look at the big picture.

Yes, last year's bond is expensive, they say, but it's just one part of a larger $540 million campaign that has totally revamped 24 local schools. They said the district has been an effective steward of the taxpayers' money, and that the school board has the support of taxpayers, who understand the cost and implications of the latest deal.

But a voter reading the ballot statement for Proposition C in 2008 would have learned nothing about the overall cost of the deal the district was setting itself up for.

The full 2,200 word statement makes no mention of capital appreciation bonds, and says little about how the borrowing would be paid back. The ballot arguments against the bond don't mention the unusually high costs involved in borrowing money that won't begin to be paid back for 20 years.

The bond also had considerable cachet, thanks to a coveted endorsement from the San Diego County Taxpayers Association. Indeed, association President Lani Lutar's name was first on a list of five local dignitaries named on the ballot as supporting the bond.

Lutar said had she known the full implications of the bond, she would not have recommended the association support it.

The taxpayers association recently started studying capital appreciation bonds to fully understand their impact. Its main case study: Poway Unified.

Last month, the association changed its criteria for endorsing school bonds. In the future, it will ask districts how, exactly, they will finance their bonds. If a district plans on using expensive long-term capital appreciation bonds like Poway's, it won't get the association's backing.

"Poway should have been more forthright with us," Lutar said. "Had we known then what we know now, we would probably have taken a different path."

Poway's bond has received negative attention from elsewhere, too.

County Tax Collector McAllister said his office met with the district last year to raise concerns about the deal.

He said his staff was worried both about the sheer cost of the bond and the idea of placing such a large burden on future taxpayers. And, because the deal depends on property taxes steadily increasing in order to pencil out, McAllister said his staff warned Poway Unified against making the deal.

"We suggested it might be something they want to rethink," McAllister said.

In the wake of Poway's deal last year, Los Angeles County Treasurer and Tax Collector Mark Saladino wrote an open letter to school finance officials in California warning against the use of long-term capital appreciation bonds for the same reasons.

Glenn Byers, Los Angeles' assistant treasurer and tax collector, said districts like Poway have been dishonest by issuing bonds without laying out the consequences and costs of the loans for taxpayers.

"If they ever told the truth, they would never get these approved by the voters," Byers said.

On The Hook

Apart from its overall cost, there's another reason why Poway's massive capital appreciation bond should matter to taxpayers.

In 20 years, the school district will be on the hook for its first payment towards last year's loan. That payment will be a little more than $30 million, $24 million of which is interest.

The following year, the payment will balloon to almost $47 million. And, for the next 18 years after that, until 2051, district taxpayers will have to pay about $50 million every year towards the debt — essentially paying off their initial loan every two years for the next two decades.

The district and its advisors assumed that Poway Unified would have enough coming in from the existing taxes by 2033 to pay those bills. But that's far from certain.

Right now, the district receives about $11 million a year from homeowners towards paying off its bonds.

So, to be able to afford its debt payments 20 years from now, the total assessed value of property within the taxed area would have to quadruple.

That's possible. In the last 10 years, the total value of property in the school district almost doubled. But if the last decade has shown municipal governments anything, it's that relying on consistent growth in tax revenues is a risky business.

If the district's projections don't come true, homeowners will see their taxes spike to make up the difference.

And there's no chance of the district refinancing the deal. The loan contains a provision strictly barring the district from refinancing its debt.

The district told taxpayers back in 2008 that it probably wouldn't have to raise taxes to meet its payments. But it's fully within its legal rights to do so.

McAllister, whose office is tasked with making sure local school districts pay their bond debts, said his office could be compelled to raise property tax rates to ensure the district can make its payments on the bond.

Of course, many of the residents who voted on Proposition C will be long gone by then. They'll be dead, or living somewhere else.

But whoever's left living in the taxed area will have to pick up the tab for the money the district borrowed last year, and for the $877 million in interest the district will have accumulated by then.

Will Carless is an investigative reporter at Voice of San Diego currently focused on local education. You can reach him at will.carless@voiceofsandiego.org *or 619.550.5670.*

Like VOSD on Facebook.