State school chief says stop bonds with over 4:1 payment ratio

Certain bonds are time bombs, huge payments await future generations

By Amy Sylvestri

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State officials have told San Leandro and other school districts throughout California to stop using the type of high interest rate bonds that will have to be paid out in balloon payments by future generations.

Many school districts, including San Leandro, use Capitol Appreciation Bonds (CABs) to fund part of their construction projects. But the problem with CABs is that it costs much more to pay them off, and a huge, balloon payment can become due years or decades later.

But the San Leandro school district has defended its use of CABs, saying they are a valuable flexible source of funding and calling the state officials' request for a moratorium on CABs unfair.

Recently, State Superintendent of Public Schools Tom Torlakson and State Treasurer Bill Lockyer sent out a joint press release advising school districts to not use CABs, saying they jeopardize the financial future of California students.

CABs are different from other bonds because CABs come due in one lump sum at a set date in the future (usually 20 or more years away), but interest adds up, creating balloon payments.

By the time the payments are due, the current school district employees and board members will most likely be long retired, leaving the problem for their successors.

Lockyer and Torlakson said that the danger of CABs over other types of bonds are that no regular payments are scheduled, so the districts could rack up a lot more debt by delaying payments.

Also, the bonds have such long lives that the districts do not know how they will be paid – where is the money coming from 15 or 20 years down the line?

The San Leandro school district's CABs will be paid back at around five times the value of the original loan, a ratio which the state treasurer warns against.

"It's certainly not in the range of what we would consider best practices," said Tom Dresslar, a spokesman for Lockyer. "It falls outside of the limits we wish for reform."

The reform Dresslar is speaking of is a new bill that was recently introduced in the state assembly that would not allow payback ratios of more than 4-to-1.

Dresslar said that San Leandro's rate is above the state average, but that some districts in California have ratios of 15-to-1 or more.

But San Leandro Assistant Superintendent Song Chin-Bendib says that the district uses the bonds responsibly and that they are often the only funding source for projects that the district believes are necessary.

“It was somewhat unfortunate for (Torlakson) to say that, because we use the bond money responsibly,” said Chin-Bendib. “We aren’t spending it on unnecessary projects. These were things the district needed to do and no one was looking to give us funding.”

Chin-Bendib added that CABs were used after state matching funds for projects were cut, so the state is criticizing districts for using alternative funding at the same time they cut their funding.

The district currently has two CABs pending that could wind up costing taxpayers around five times or more than the initial amount of the loans – a total of up to $107 million on loans of $20 million.

The San Leandro school district currently has two CABs as part of the $109 Measure B bond that funded the ninth grade campus, arts center, and other projects. The CABs are used conjunction with other bonds.

The two CABs were issued in 2010 — one in the amount of $5.6 million that will reach maturity in 2035 with interest adding up to $27.5 million. The other is in the amount of $14.3 million and that will reach maturity in 2039 with interest totaling $80.7 million.

Those CABs have payback ratios of 4.8-to-1 and 5.6-to-1, respectively.

Chin-Bendib says that using the CABs allowed the district to start projects immediately, which was helpful as the construction market fell and contractors were bidding competitively on the projects.

Chin-Bendib compared the use of CABs to a home mortgage – a family might end up paying a lot more than the worth of the house over a 30-year mortgage, but they also are able to raise a family there and be happy, much like CABs end up costing more than face value, but they are used to improve the lives of San Leandro students.

But home mortgages don’t cost five times the cost or the house or more and Torlakson said that it is simply unfair to spend money that the districts don’t have and leave it for future generations to pay.

“In too many cases, CAB deals have forced taxpayers to pay more than 10 times the principal to retire the bonds,” wrote Torlakson. “Also, some transactions have been structured with 40-year terms that delay interest and principal payments for decades, resulting in burdens on future taxpayers that cannot be justified.”