



COUNTY OF LOS ANGELES TREASURER AND TAX COLLECTOR



KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 437
LOS ANGELES, CALIFORNIA 90012
TELEPHONE: (213) 974-2101 FAX: (213) 626-1812

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

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August 8, 2013

TO: Supervisor Mark Ridley-Thomas, Chairman
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Mark J. Saladino
Treasurer and Tax Collector 

SUBJECT: **PROPOSED UNDERWRITER POOL CHANGES**

On August 6, 2013 an article was printed in the Los Angeles Times (attached) with the headline "County Treasurer Targets Contributions to School Bond Campaigns." This article describes a new policy that my office intends to develop and implement regarding underwriters in the County's underwriter pool. In our long standing efforts to address certain excesses and abuses by finance professionals participating in school bond financings, this is just the latest step by the Los Angeles County Treasurer and Tax Collector (TTC) to address specific items and practices that are of questionable legality, reflect bad public policy, and are not in the best interest of taxpayers.

A little background will help frame this issue. In calendar year 2010 and early 2011, my office noticed several pending school bond sales with unusual bond structures that dramatically increased the total debt service that would have to be repaid when compared to more traditional structures. As we looked into the issue further, we identified several troublesome new trends and practices that served to provide small and often questionable benefits to the school districts at the expense of the taxpayers who would have to repay the debt. These concerns came on the heels of another questionable school financing practice – a technique known as "cash-out refunding" – that the California Attorney General opined is illegal in January 2009.

In order to prevent school districts from spending time and money working on transactions that we would seek to restructure, and to be proactive in addressing our concerns, my office issued a White Paper on school district general obligation bonds that spelled out the practices and bond structures that we would no longer support. These included: using a Joint Powers Authority structure to artificially inflate the amount of bond proceeds available to the district beyond the amount authorized by the voters; impermissibly using federal bond subsidies for district operations; aggressive valuations and structures in connection with Proposition 39 bonds that exceed statutory limits; impermissible borrowing from bond funds to pay operating expenses; and issuing capital appreciation bonds (CABs) with maturities longer than 25 years. It is this last item that captured most of the press attention when the excesses of the Poway school district bonds were exposed in August 2012.

In response to the widespread abuse of CAB structures, in November 2012, the State Treasurer warned that underwriters, financial advisors and bond counsel involved in "egregious" California school CAB transactions would likely be cut out of future State bond business unless they are willing to renegotiate CAB deals that have high repayment ratios.

After issuing our White Paper, we have continued to identify additional issues and problems with school district financings such as: paying costs of issuance from bond premium (the amount paid for the bonds that exceeds the par value of the bonds), which the Attorney General also informally disapproved in 2011; districts soliciting contributions from finance professionals, contractors and consultants to pay election costs and expenses; and excessive fees paid to bond counsel, financial advisors, special consultants and underwriters. Regarding the latter, we developed pro-forma RFP documents that several districts have used to competitively bid for these types of services, and in the process saved many tens of thousands of dollars compared to districts simply appointing their favorite firms and not questioning the fees.

The issue with using bond premium to pay costs of issuance involves the interpretation among bond counsel regarding certain sections of the Education and Government Codes. A literal reading of these code sections says that the bond premium may not be used to pay bond costs of issuance, consistent with the Attorney General's informal 2011 advice letter referred to above. Some bond counsel have taken a more liberal approach and determined that this practice does not violate State law. We disagree, and in conjunction with County Counsel sent a request for a formal legal opinion on this matter to the State Attorney General on January 7, 2013. We are still waiting for a determination.

Working with the California Association of County Treasurers and Tax Collectors we have suggested and supported several efforts for legislation to address many of the issues highlighted above. This effort culminated in the introduction of AB 182 on January 24, 2013, and AB 621 on March 19, 2013. AB 182 has passed the Assembly and is currently pending in the State Senate. In its current form, the bill seeks to address the concerns about CABs raised in our White Paper, and it includes several structural limitations such as bond sale reporting requirements, requiring call provision on CABs, a 30 year final maturity, and a requirement that the ratio of total debt service to principal not exceed 4 to 1.

AB 621 has also passed the Assembly and is currently pending in the Senate Governance and Finance Committee. In its current form, the bill would prohibit a school district from entering into a financial advisory, legal advisory, underwriting, or similar relationship with any individual or firm that has donated or will donate cash or in-kind services in support of the district's bond campaign. Such arrangements are often referred to as "pay-to-play", and while they may be technically legal under existing laws and regulations, they are widely criticized as creating the appearance of conflict of interest at best and potentially constituting a corrupt practice. Independent studies have shown that firms that contribute to school bond campaigns are often awarded contracts on a sole-source, no-bid basis, to purchase bonds on a non-competitive basis, and the fees paid to such firms are higher than fees paid under competitively bid contracts. AB 621's goal of eliminating "pay-to-play" in school bond transactions is completely consistent with your Board's longstanding policies regarding competition in the award of public contracts, as well as your support for high standards of ethics and integrity in our conduct of the public's business.

Honorable Board of Supervisors
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In August 2012, the Municipal Securities Rulemaking Board (MSRB) proposed rule changes that would require bond dealers to disclose details about their contributions to bond ballot campaigns. The proposed changes are still under consideration.

The underwriter pool policy that was highlighted in the Los Angeles Times and other publications this week represents the next step in our efforts to secure the best possible bond structures, pricing and cost containment for each school district in the County, and to promote fairness and transparency in school bond transactions by curbing "pay-to-play" practices. Over the next few weeks, we will evaluate and determine the details of how best to restrict underwriter contributions in school bond elections. As presently contemplated, this would entail a complete ban on cash and in-kind contributions from all firms in our underwriter pool starting no later than when we renew our pool for another year in January 2014. Early feedback has been very positive from other county treasurers, large and small underwriter firms, financial advisors, and even from one underwriter that will be directly impacted by this change. We have also reached out to the State Treasurer's office and they are also considering a ban on campaign contributions, not just for their underwriter pools, but also for their financial advisor and bond counsel pools.

We will inform your Board when we have finalized the details our new policy, and will include a proposed implementation schedule. Please contact me directly if you have further questions, or your staff may call Glenn Byers of my staff at (213) 974-7175.

Attachment

MJS:GB:pab
Pb/brdmemo/underpoolchanges

c: Executive Officer-Board of Supervisors
Chief Executive Officer
County Counsel
Auditor-Controller

latimes.com/news/local/la-me-bond-restrictions-20130807,0,1675326.story

latimes.com

L.A. County won't sell bonds to school bond campaign donors

The county treasurer will end business with banks that donate to school bond campaigns, saying it influences hiring of underwriters. Other counties may follow.

By Dan Weikel

9:29 PM PDT, August 6, 2013

In an action that could influence government finance officials statewide, the Los Angeles County treasurer announced Tuesday that his office will no longer do business with securities brokers that make political contributions to school bond campaigns.

Mark J. Saladino, whose agency is one of the largest issuers of municipal bonds in California, said he adopted the policy to prevent campaign donations from influencing the hiring of underwriters by school districts, and to increase competition between dealers who often charge millions of dollars for their services.

Underwriters are financial institutions that buy government bonds and sell them to investors.

Saladino also has been concerned that some firms try to recover their donations in their underwriting fees, contrary to a state law that prohibits schools from using public funds to support campaigns that try to convince voters to pass such measures. Bonds are typically repaid from tax revenues over a period of years.

Under the new policy, underwriters must not donate to school bond measures if they want to qualify for the treasurer's list of investment banks and securities dealers eligible to sell county bonds. The restriction applies to monetary donations, non-monetary contributions and pre-election services, such as polling, voter outreach and consulting.

The roster of financial firms — now 40 dealers that include some of the nation's largest banks and brokerages — is reviewed and revised every five years. Saladino said the next evaluation is in 2016.

"If they are giving to school bond campaigns, we won't do business with them," Saladino said.

According to the treasurer-tax collector's office, most, if not all, of the current participants already have agreed to the restriction.

Saladino said he had informed other county treasurers about the new rule and planned to notify state Treasurer Bill Lockyer and encourage him to adopt the same restrictions.

Mendocino County Treasurer-Tax Collector Shari L. Schapmire, president of the California Assn. of County Treasurers and Tax Collectors, said her organization supports Saladino's policy. She added that there was

potential for some of the large counties in the state to adopt similar measures.

"This is an interesting first step. It's in the right direction," said San Diego County Treasurer-Tax Collector Dan McAllister. Banning such a potential conflict of interest "has been raised for years in the state Legislature. We've gotten a big goose egg. Nothing to show for it. But what is really required is a statewide comprehensive effort that involves all the stakeholders to bring change about."

The latest bill to restrict donations from financial firms stalled in the Senate Governance and Finance Committee this year. The author, Assemblyman Donald P. Wagner (R-Irvine), can still pursue the measure in 2014.

Representatives of the California School Boards Assn. were unavailable for comment Tuesday, and the California Assn. of School Business Officials did not return phone calls. David Walrath of the Small School Districts Assn. said such a restriction, if widely adopted, would create a problem, especially for small school systems in rural areas where little financial support exists for bond campaigns.

Saladino said his policy stemmed from a nationwide effort by major investment banks to prevent underwriters from donating to bond ballot measures.

Last month, 12 financial institutions pledged not to make contributions to bond measures they seek to underwrite. They include Morgan Stanley & Co., Wells Fargo Securities, J.P. Morgan Securities, Goldman Sachs, Barclays Capital and Merrill Lynch.

The group notified the federal Municipal Securities Rulemaking Board, which has been considering whether to prohibit underwriters from contributing to the agency's bond campaign if they are seeking business from that agency.

Lockyer, county treasurers and many investment bankers are concerned that campaign donations can create an uneven playing field for bond businesses at the expense of taxpayers.

In statewide surveys by The Times and other publications, virtually every securities broker hired by a school district contributed to the district's bond campaign and was retained without competitive bidding.

According to numerous studies, competition among underwriters often produces lower interest rates and fees, which can save taxpayers millions of dollars in debt payments for large bond issues.

In addition, a recent study by New York University and the University of Colorado, which focused on California school bond issues, found that post-election fees paid to underwriters that made donations were on average \$27,576 higher than those paid to brokers that did not contribute. Researchers said the finding raises serious questions about the circumvention of state and local regulations restricting the use of public resources in election campaigns.

dan.weikel@latimes.com

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