School districts, including many in valley, on thin ice in refinancing bond debt

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Taking advantage of escalating property values and falling interest rates, hundreds of California school districts refinanced their construction bonds and reaped a windfall to remodel and upgrade their campuses.

Now the California attorney general has issued an opinion that the practice, popularized in the mid-90s, is unconstitutional because it raises the public debt without voter approval.

But to school officials' relief, the Attorney General's Office believes the millions of dollars' worth of bonds issued and refinanced remain valid because taxpayers had only a 60-day window to challenge them. The practice, known as cash-out bond refinancing, tapered off in the past two years, after county treasurers and a San Jose citizens' group raised questions.

Although it's unclear whether taxpayers would get any refunds, critics of the practice felt vindicated and were glad that it would stop.

"I'm absolutely delighted," said San Mateo County Treasurer Lee Buffington. "It's one for the good guys.'

But many school district business officials were disappointed. The opinion means there's one less way for districts to raise funds for capital projects, said Rebecca Wright, assistant superintendent in the Alum Rock School District. She previously worked in the Mountain View-Whisman District, which did a cash-out refinancing, as did dozens of area districts.

Jill Escher, a nonpracticing attorney who heads Citizens for Bond Accountability, questioned San Jose Unified's 2005 bond refinancing, which generated about $22 million, primarily to modernize science buildings at San Jose, Lincoln and Willow Glen high schools. About $2 million was used to reduce tax rates.

While that may seem like a win-win proposal, it's illegal to incur more debt without voter approval. When school districts propose bonds, they specify amounts and how the money will be spent; voters approve bonds based on those limits. "The law doesn't say if you generate additional cash, it can go into your building fund," said Jeffrey Small of the Capitol Public Finance Group.

Although state Attorney General Jerry Brown's nonbinding opinion Jan. 9 left the door open for taxpayers to sue, Escher said, "We're not going to whomp them with some big lawsuit."

However, she's called on the school district to return any unspent funds from the refinance.

Those funds already have been paid out, said Ann Jones, chief budget officer.

The district stands by its refinance decision, Superintendent Don Iglesias said. "Students benefitted from this. We have quality science labs we wouldn't have otherwise. We feel we were within the regulations and the law."

For the future, the ruling makes it harder for schools, already facing the worst budget year in modern times, to remodel aging buildings.

Much like homeowners who may refinance their mortgages and extract dollars to remodel the kitchen, school districts refinanced bonds, often securing lower interest rates, shortening the repayment term and taking out cash. The practice, promoted by a few leading legal and underwriting firms, was attractive at a time when construction costs were skyrocketing, and districts could not stretch their dollars enough to complete all the remodeling projects promised to voters.

"We were assured by our legal counsel that it was legal," Jones said. The cash-out financing promoters, Stradling Yocca Carlson & Rauth of San Francisco, had approached the district, Jones said.

In 2005, San Jose Unified refinanced $148.1 million remaining in Measure C bonds. It reduced its bond debt service from 4.4 cents per $100 assessed valuation in 2001-02 to 3.9 cents five years later. That translated to an annual savings of about $25 for the owners of a home assessed at $500,000.

But the savings would have been more had the district not taken out the funds for construction.

The Stradling firm also advised the Los Altos School District in refinancing $88 million in bonds. The district reaped $10.9 million to remodel what's now Gardner Bullis School in Los Altos Hills.

David Casnocha, a partner in the Stradling firm, maintained that the attorney general's opinion simply expresses a "policy preference." He estimated that 250 districts around the state took advantage of cash-out refinancing.

However, he conceded that his firm won't be engineering any more cash-out deals. And he emphasized that what was done still stands: "The attorney general is pretty clear in saying the transactions that were done are valid, binding and enforceable."

Even critics of the practice are sympathetic with districts' plight. "Most school districts want to get more things for kids," said Lori Raineri, whose Sacramento firm advised its hundreds of school-district clients against the practice. "It's very tempting."

The Santa Clara Unified School District, one of the clients of Raineri's Government Financial Strategies, resisted that temptation when considering refinancing its bonds. "I'm lucky I took her advice," Assistant Superintendent Jim Luyan said.

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