APPLETON *PARTNERS*, INC.

California Local Credit Distinctions
August 2012

City officials of San Bernardino, California filed for bankruptcy protection due to their significantly strained financial position. This is the third California city to file for bankruptcy protection in almost as many weeks. Stockton, CA and Mammoth Lakes, CA have both filed recently. In light of these developments, we felt it was important to highlight some distinctions among the different types of debt issued at the local level and emphasize the legal provisions that would make a school district bond or community college district debt stronger than a city general obligation pledge.

City and County General Obligation Bonds

- Bonds are secured by the full faith and credit of the city or county
- To the extent other revenues are not legally available, the issuer pledges to levy ad valorem taxes upon all taxable property within the city or county
- Levy amount can be unlimited or limited as to rate or amount, sufficient to pay debt service
- General Obligation bonds are not secured by any specific revenue source, and therefore is not bankruptcy remote

We look to well-established, developed, and economically vibrant cities and counties that have good economic and demographic prospects going forward, relatively high resident wealth indicators, strong management, and good imbedded financial policies and practices.

School District Bonds

- The Bonds are general obligations of the School District, secured by an obligation to annually levy ad valorem taxes upon all taxable property within the District, without limitation as to rate or amount for the payment of debt service
- School District debt requires voter approval
    - Per California's State Constitution, authorization to issue bonds requires 55% approval by eligible voters within a school district
- The security pledge is separate and distinct from the city or county's general obligation pledge
- Revenues are collected and deposited into a separate account outside of the city or county general operating fund

School District debt is secured separately and can be stronger than a city's general obligation pledge due to the voter-approval of a specific increase in property taxes to service the payment of debt for a specific need or project of the School District. Payment does not compete against other obligations or funding requirements.

Community College District Bonds

- The Bonds are general obligations of the Community College District, secured by an obligation to annually levy ad valorem taxes upon all taxable property within the District, without limitation as to rate or amount for the payment of debt service
- Community College District debt requires voter approval
    - Per California's State Constitution, authorization to issue bonds requires 55% approval by eligible voters within a community college district
- The security pledge is separate from a city or county's general obligation pledge

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Similar to School Districts, Community College District debt can be stronger than a city's general obligation pledge due to the voter-approval of a specific increase in property taxes to service the payment of debt for a specific project. Payment does not compete against other obligations or funding requirements.

Appropriation Bonds

- The municipal entity agrees to include lease payments, which are typically equivalent to debt service payments, as a legislatively appropriated item in the annual fiscal budget
- Appropriation debt is not considered "debt" of the municipal entity, so it does not need voter approval
- Certificates of Participation (COPs):
  - Bonds are secured by a pledge of annual appropriation that is sufficient to service debt
  - Certificates of Participation (COPs) represent a share of lease payments and compete with other general fund obligations and priorities for funding
- City or County Lease:
  - Lease payments on a municipal owned facility provide the revenue stream for the bonds
  - Lease structures are typically stronger than COPs due to the direct revenue stream that provides the lease payments

We generally avoid appropriation debt of local entities based on a weak security pledge, the risk of non-appropriation, and the lack of priority in distressed situations.

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