June 19, 2007

Honorable Judge Rodney S. Melville
Superior Court, Santa Maria Division
312-M East Cook St.
Santa Maria, CA 93455

Board of Supervisors' responses to Fiscal Year 2006-2007
Grand Jury Report on "Certificates of Participation"

Dear Judge Melville:

During its regular meeting on June 19, 2007, the Board of Supervisors (Board) adopted the following as the Board's response to the relevant findings and recommendations in the Fiscal Year 2006-2007 Grand Jury Report entitled "Certificates of Participation in Public Finance: Is more Scrutiny Needed?"

Finding #1:
Projects funded by COPs are not subject to a well-regulated, mandatory public notice process, and this deficiency can preclude the general public from either registering opposition or participating as investors.

Response: (Partially Agree)
Projects funded by COPs are approved through a well-defined decision-making process adopted by the Board. Issuance of COPs is first considered by the Debt Advisory Committee (DAC) and then, if recommended by the DAC, considered by the Board at a public hearing. Prior notice is given to the public in accordance with the Open Meetings (Brown) Act for both the DAC meetings and the Board of Supervisors hearings. However, as defined by the Grand Jury, "The words "public notice," … should not be equated with such notices as those provided for meetings of city councils or the Board of Supervisors; rather, they are intended to mean a "legal notice" procedure prescribed specifically for COPs." In accordance with the definition, the Board partially agrees with the findings. Issuance of COPs is not subject to a "legal notice" procedure prescribed specifically for COPs; however, the current

procedures provide adequate notice to the public and there is no preclusion of the general public from either registering opposition or participating as investors.

Recommendation #1:
A consistent, mandatory public notice and approval process should be implemented and sale of COPs should not proceed until completion of that process.

Response: ***The recommendation will not be implemented because it is not warranted.***

A consistent approval process and proper, lawful, notice are present in the current procedures utilized for issuance of COPs. Current procedures and practices are sufficient, proper and practicable for issuance of COPs.

COPs are issued in accordance with the following decision-making process approved by the Board:

a) Capital Projects in need of financing are identified through the annual Five-Year Capital Improvement Plan (CIP) process. The CIP is conceptually adopted annually following public capital workshops.
b) Projects with sufficient funding sources are referred to the County Executive Office (CEO) for further analysis of projected impacts to the operating budget, debt feasibility with current countywide outstanding debt, financing options, and community pooling.
c) The CEO works in conjunction with General Services (GS) to compare facility designs with adopted County standards of the Space Utilization Report. The Space Utilization Report validates size and scope of facilities based on a set of parameters adopted by the Board, such as projected growth, number of employees, or industry standard guidelines for space.
d) Once CEO staff completes its analysis, the project is presented to the Debt Advisory Committee (DAC). The DAC reviews project consistency with Board adopted debt policy and projected checklists, and then provides a recommendation to the Board of Supervisors on matters relating to any new potential issuance of debt. DAC meetings are subject to the Open Meetings Act and are noticed at least 72 hours in advance, accordingly.
e) Projects that receive a recommendation for approval are then referred to the Board of Supervisors that holds a public hearing to consider COPs issuance. The Board understands that public participation is crucial for local governments to operate effectively, and thus has held numerous public hearings on COPs. Notices of Board hearings and Agenda are posted at the County Administration Building, in accordance with the Open Meetings Act, and on the County website. The hearings are then televised via the County's public access television station. In addition, access to staff reports on COPs is also provided via weblinks on the County website.
f) If COP issuance is recommended by the Board, the decision is forwarded to Santa Barbara Finance Corporation, a non-profit organization consisting of private citizens that acts as a third-party lessor. Santa Barbara Finance Corporation then reviews the proposal, votes on it, and executes the actual issuance.

Finding #2:
Taxpayers and/or investors may be at risk if standard assurances (e.g. environmental and "escrow") are not consistently required prior to issuance of COPs.

Response: (Agree)
Standard assurances should be consistently required prior to issuance of COPs to minimize any potential risk to investors/taxpayers. The standard assurances are achieved through the COP consideration process adopted by the Board and legal requirements. Voter approval is not required to achieve the assurances based on the distinctive nature of COPs as differentiated from issuance of bonds.

The use of COPs has become a more prevalent type of financing for projects by governments over time. The rise of COPs has been especially prevalent in California since the passage of Proposition 13, which increased the required voter approval percentage for bond debt from a simple majority to two-thirds vote. Issuance of COPs is a viable alternative for governments to finance capital projects needed for everyday operation and was reaffirmed by the California State Legislature. COPs are defined as lease financing agreements in the form of tax-exempt securities similar to bonds. The distinguishing feature of COPs is that the financing mechanism allows for leveraging of County revenues to obtain necessary financing instead of raising new taxes. COPs issuance is secured by demised premises, assets owned by the County. COPs are thus a method of leveraging public assets and borrowing all or a portion of the value of a public agency's equity in those assets in order to finance other assets. The distinctive feature of COPs, in the fact that this type of financing involves leveraging of County revenues and assets, justifies the greater discretion afforded to public officials. By entering into a tax-exempt lease financing agreement a public agency is using its authority to acquire or dispose of property, rather than its authority to incur debt.

To ensure financial stability, COPs issuance undergoes the process outlined in the response to the Recommendation #1 before approval. Some of the considerations taken into account by DAC, CEO and the Board in the approval process are the nature of the projects to be financed, the stability of revenues for repayment, and useful life of the assets to be financed. For some projects, leveraging of County revenues provides a much more suitable alternative to the unnecessary passage of additional taxes based on the fact that existing revenue streams are already sufficient to undertake the additional necessary projects.

Furthermore, the IRS regulations on how COP funds can be used and covenants of the trust agreements entered into at issuance, provide further guidance and protection for the public, ensuring proper use of COP funds within appropriate timeframe and manner. The regulations are taken into account during the decision-making process prior to issuance of COPs by public officials.

Recommendation #2:
All projects funded by COPs should receive the necessary assurances that are demanded of projects funded by General Obligation and Revenue Bonds.

Response: ***The recommendation will not be implemented because it is not warranted.***

Given the distinctive nature of COPs, as compared to General Obligation and Revenue Bonds that require imposition of additional taxes, the same assurances are not necessary for issuance of COPs. As described in the Response to Finding #2, the historical development of COPs and the general discretion afforded to public officials for budgetary decisions justifies that voter approval is not needed for issuance of COPs. The guidelines and standard procedures approved by the Board as discussed in detail in response to the Recommendation #1, provide adequate assurances for projects funded by COPs.

Finding #3:
The maturity terms of COPs are often comparable to those (20-30 years) for General Obligation and Revenue Bonds, suggesting that COPs may be an inappropriate substitute for such bonds.

Response: (Partially Agree)
The maturity terms of COPs issued by Santa Barbara County are, generally, 20 years. However, the use of COPs rather then the use of General Obligation or Revenue Bonds is appropriate. Issuance of COPs involves leveraging of County revenues rather than passage of additional taxes. COPs are a tool that has been affirmed by the courts and reaffirmed by the California State Legislature to allow governments to more practically finance certain projects needed for operation. Issuance of additional taxes, in fact, may be unnecessary and inappropriate to finance certain projects. In addition, the maturity terms of County COPs do not exceed the useful life of the financed assets.

Recommendation #3:
The use of COPs should be restricted to short-term projects. Long-term projects should be funded with General Obligation or Revenue Bonds.

Response: ***The recommendation will not be implemented because it is not warranted.***

The County follows established guidelines in the decision-making process prior to issuance of COPs. Projects undergo extensive evaluation prior to approval for financing by COPs. Revenue streams and useful life of the assets are taken into consideration during the process. This process approved by the Board is proper and sufficient to ensure that only feasible projects for the type of financing are financed by COPs issuance. Robust distinction between long-term and short-terms projects is not necessary as each project undergoes high level of scrutiny before it is financed by COPs.

Finding #4:
The regulations regarding the sales of COPs and the use of the proceeds from those sales are inadequate.

Response: (Disagree)
The regulations regarding the sales of COPs and the use of the proceeds from those sales are adequate. The IRS regulates tax-exempt terms for COPs. The financial ramifications of

failure to comply with IRS rules, assure compliance and proper oversight of the use of COPs by public officials. The decision-making process approved by the Board assures that all financial considerations are professionally and publicly scrutinized prior to actual issuance of COPs.

Recommendation #4:
COPs should be sold only as needed to fund the specific project for which they were approved, and the funds should not be used for other projects. In particular, COPs should not be sold for the sole purpose of earning interest on the funds.

Response: ***The first part of the recommendation will not be implemented as it is not warranted and the second part of the recommendation has been implemented.***

In regards to the first part of the recommendation, specific projects are identified at issuance of COPs. Project substitution, nonetheless, plays an important role in the fiscal and operations management of the County. The needs of the County may change and project substitution may be in the best interest of the County. If a project is substituted with another project that is significantly different in purpose, the newly introduced project undergoes the same approval process and scrutiny as is described in response to the Recommendation #1. Secondly, the latter part of the recommendation has been implemented: the IRS regulations do not allow issuance of COPs for the sole purpose of earning interest on the funds. Certain requirements on the use of COP funds have to be met in order to receive tax-exempt status. For example, upon issuance of tax-exempt COPs, the issuer must have a reasonable expectation to spend 85% of the net sale proceeds within three years or else must meet other strict percentage requirements.

Finding #5:
Districts and government agencies are not required to give notification of the use of COPs to County or city governments which might be affected.

Response: (Partially Agree)
Special districts and government agencies that participate in the County Treasury can invest COP proceeds in an outside investment. Government agencies that participate in the County Treasury do consult with the County Treasurer.

Districts and government agencies not connected to the County Treasury are not required to give notification of the use of COPs to the County.

Recommendation #5:
Any district or government agency within the County that is planning to issue any COPs should give notification to the County government and any affected municipal government.

Response: ***The recommendation will not be implemented because it is not reasonable.***

The County has appropriate notification and involvement in regards to issuance of COPs by special district and government agencies that participate in the County Treasury. These are the issuances that could have direct impact on the financial status of the County.

It is a State legislative question rather than the County's as to whether a notification should be required from other districts and governmental agencies and, if so, to whom and in what form.

The Board would like to thank the Grand Jury for its Report on "Certificates of Participation."

Sincerely,

Brooks Firestone, Chair
Santa Barbara County Board of Supervisors

Attachment:
Grand Jury Report entitled "Certificates of Participation in Public Financing
Is More Public Scrutiny Needed?"

cc: Grand Jury Foreperson