



CALIFORNIA STATE AUDITOR

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FACT SHEET

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The California State Auditor released the following report today:

Conduit Bond Issuers

Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns

BACKGROUND

To provide financing for private businesses and nonprofit organizations to construct privately owned projects that benefit the public, more than 2,600 conduit revenue bonds totaling \$90 billion were issued from 2002 through 2011 by 153 public agencies in California. Eleven state agencies, including the California Health Facilities Financing Authority (Health Financing Authority), issued bonds totaling \$44 billion, the highest dollar volume over the nine-year period—nearly 50 percent. Twenty-two joint powers authorities—legally separate entities created by local governments for the purpose of issuing conduit revenue bonds—such as the California Statewide Communities Development Authority (California Communities) and the California Municipal Finance Authority (Municipal Finance), issued the next highest dollar volume during that time period, while local agencies issued the least amount of these bonds.

KEY FINDINGS

During our review of the business and compensation models of the Health Financing Authority, California Communities, and Municipal Finance, we noted the following:

- Unlike the Health Financing Authority or other public agencies, both California Communities and Municipal Finance rely wholly on private consulting firms to act as staff whose duties involve reviewing and making recommendations regarding bond issuances. The consulting firms receive a percentage of fees associated with each conduit revenue bond issued by the joint powers authorities—raising concerns under the State's conflict-of-interest laws.
 - ✓ One of the consulting firms received an average of \$9.9 million annually over a five-year period and the other, almost \$1 million per year.
 - ✓ The consultants are relying on a 1993 advice letter published by the Fair Political Practices Commission (FPPC) to support their position that they do not have a conflict of interest under the Political Reform Act of 1974 (reform act) when they act as staff on bond issuances. However, neither of these two joint powers authorities has sought independent legal advice on this matter directly from the FPPC.
 - ✓ No court has squarely addressed whether this compensation model violates either the reform act or other State conflict of interest laws, and we believe the legality of this practice is uncertain.
- These two joint powers authorities have used the same consultants since their inception—in 1988 and 2004, respectively—without periodically bidding out the contracts for these services and as a result, have less assurance that they are getting the best value from their consultants.
- The conduit bond issuers generally complied with key federal and state laws regulating the issuance of conduit revenue bonds, reporting requirements, and met other financial disclosures.

KEY RECOMMENDATIONS

We made various recommendations to the Legislature including that it should enact legislation that creates a clearly stated exemption to the reform act if it believes that the compensation model of the joint powers authorities is appropriate. If not, the Legislature should enact legislation that clearly prescribes or limits such a model. Further, we recommend that the FPPC adopt regulations that clarify whether its 1993 advice letter is intended to apply to the factual circumstances presented in this report. We also recommend that the joint powers authorities require the consulting firms that staff their organizations to disclose the amount and structure of compensation provided to individual consultants. Moreover, the joint powers authorities should periodically review and subject contracts to competitive bidding or other price comparisons.

