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Buy Now Pay Later: How San Diego School Districts Were Hoodwinked by Wall Street

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In 2009 then Governor Arnold Schwarzenegger signed into law AB 1388 which eliminated prudent controls over how much debt school districts could enter into. Wall Street bankers then swarmed all over the state promoting Capital Appreciation Bonds (CABs), the equivalent of payday loans for school districts.

One fantastic advantage of these loans was the “buy now, pay later” aspect. School districts could get their money now and not have to raise taxes on current residents. Easy money. There would not have to be any payments made for 20 years. Current residents would be off the hook. But their children and grandchildren would enter an era of crushing debt when the bill became due.

And Wall Street is patient, very patient.

The ticking time bomb could cause crushing property tax increases for later generations or even bankruptcies by municipal governments. For example, San Diego County’s Poway Unified will have to pay $982 million for a $105 million CAB it issued. Poway has a payback ratio of $9.35 paid for every $1 borrowed. The final payout will be almost $1 billion.

This is payday lending for school districts. They end up with shiny new auditoriums and gymnasiums but then the same old cramped classes and underpaid teachers since CABs only apply to capital improvements, not current expenses.

According to Ellen Brown:

Then-State Treasurer Bill Lockyer called the bonds “debt for the next generation.” But some economists argue that it is a transfer of wealth, not between generations, but between classes – from the poor to the rich. Capital investments were once funded with property taxes, particularly those paid by wealthy homeowners and corporations. But California’s property tax receipts were slashed by Proposition 13 and the housing crisis, forcing school costs to be borne by middle-class households and the students themselves.

Buy now, pay later is an old marketing ploy attributable to every commercial enterprise from furniture stores to car salesmen. Nothing down, no payments till 20 whatever. Now school districts have been suckered by easy money and Wall Street salesmen eager to cash in on the public's aversion to tax increases, but, nevertheless, wanting it all -NOW.

Poway won't have to start paying on its loan for 20 years. That payment will be a little more than $30 million, $24 million of which is interest. That should let most of the principals who entered into this disastrous decision off the hook. They will be long forgotten having left a legacy of crushing debt for their children to pay off.

After the first payment Poway taxpayers will have to pay for the next 19 years – until 2051 – about $50 million per year essentially paying off their initial loan every two years for the next two decades.

In a September 2013 op-ed in *SFGate.com* called "School Bonds Are a Wall Street Scam," attorney Nanci Nishimura wrote:

Unlike conventional bonds that have to be paid off on a regular basis, the bonds approved in AB1388 relaxed regulatory safeguards and allowed them to be paid back 25 to 40 years in the future. The problem is that from the time the bonds are issued until payment is due, interest accrues and compounds at exorbitant rates, requiring a balloon payment in the millions of dollars.

Wall Street exploited the school boards' lack of business acumen and proposed the bonds as blank checks written against taxpayers' pocketbooks. One school administrator described a Wall Street meeting to discuss the system as like "swimming with the big sharks."

Wall Street has preyed on these school boards because of the millions of dollars in commissions. Banks, financial advisers and credit rating firms have billed California public entities almost $400 million since 2007.

Poway Unified is not the only San Diego school district that has been lured by the promise of shiny new facilities and no payments for 20 years. Vista Del Mar Elementary is the newest school in the San Ysidro School District. It got the school virtually for free using CABs. The district won't have to make any payments on its CAB for three decades.

But starting in 2041 the district will pay, on average, almost the full cost of Vista Del Mar each year for a decade. By 2050, the San Ysidro School District will have paid out $228.9 million, almost $15 for every $1 the district borrowed. From 2041 to 2050, the district will pay, on average, $22.9 million each year.

According to *inewsource*, Santee School District issued the most expensive capital appreciation bond in San Diego County and the fourth most expensive in California in 2011. Its payback ratio beats San Ysidro's at $16.57 to $1. The district got $3.5 million from that bond, and by 2051 will pay back $58.6 million.

If these school districts cannot pay when their free money time is up and the bill becomes due, public school districts could be sold off to private investors. The conservatives' wet dreams of privatizing everything could become a reality.

After all it was the stupidity of the democratic system of elected school board members which will have gotten them into such difficulty. Hedge fund managers wouldn't have been so stupid and out of touch with financial reality.

What could have happened is that the Federal Reserve could have made low interest loans available to municipalities and school districts, the way it did for GM and AIG during the 2008 financial crisis. But by charter the Fed can only make them available to banks. After all the Fed is owned by the large Wall Street banks and it serves their interests.

By keeping money and debt creation in the hands of Wall Street, the Fed guarantees that Wall Street will continue to reap exorbitant profits while the rest of us labor under increasing debt.

There is a better way for school districts to borrow money. Take the state of North Dakota for example. One might think that North Dakota can afford to spend money on schools because of the oil boom there, but that would be wrong.

Ellen Brown assesses the matter correctly:

One thing that does single the state out is that North Dakota alone has its own depository bank. The state-owned Bank of North Dakota (BND) was making 1% loans to school districts even in December 2014, when global oil prices had dropped by half. That month, the BND granted a $10 million construction loan to McKenzie County Public School No. 1, at an interest rate of 1% payable over 20 years. Over the life of the loan, that works out to $.20 in simple interest or $.22 in compound interest for every $1 borrowed. Compare that to the $15 owed for every dollar borrowed by Anaheim's Savanna School District or the $10 owed for every dollar borrowed by Santa Ana Unified.

How can the BND afford to make these very low interest loans and still turn a profit? The answer is that its costs are very low. It has no exorbitantly-paid executives; pays no bonuses, fees, or commissions; pays no dividends to private shareholders; and has low borrowing costs. It does not need to advertise for depositors (it has a captive deposit base in the state itself) or for borrowers (it is a wholesale bank that partners with local banks, which find the borrowers). The BND also has no losses from derivative trades gone wrong. It engages in old-fashioned conservative banking and does not speculate in derivatives. ***Unlike the vampire squids of Wall Street, it is not motivated to maximize its bottom line in a predatory way. Its mandate is simply to serve the public interest.***

No exorbitantly paid executives with million dollar bonuses? But that isn't the capitalist way, you say. A bank set up to serve the people instead of the pursuit of private profit? Again, not the capitalist way.

Doesn't that verge on socialism maybe even communism? Why isn't the GOP up in arms insisting that North Dakota be ostracized, maybe even booted out of the union unless they conform to capitalist principles. Oh well, we have a perfect example right here in the good old US of A of how a bank could be set up to serve the people instead of gouging the people. Instead of money sent to Wall Street, money could stay and generate interest right in the same state or municipality or even school or hospital district.

In fact there are movements afoot in many states to do just that. A Connecticut legislator is seeking a study of whether the state should create a publicly held bank as a way to provide a stable source of funding for various projects, among other potential benefits. State Rep. Susan Johnson proposed the bill, which is under deliberation by the Connecticut General Assembly's Banking Committee, co-chaired by Sen. Carlo Leone, D-Stamford. Johnson said she became interested in the concept of a public bank following the financial collapse of 2008 and 2009, when many consumers and business owners voiced frustration with banks for what they felt were restrictive credit policies.

Pennsylvania is doing the same. Across the nation, in Pennsylvania and more than two dozen state legislatures and city councils, **a well organized effort is underway to create a new tool to insure sound municipal finances and economic development: the creation of public banks**; to take hundreds of millions of taxpayer funds out of Wall Street banks, and put them to work locally with our community banks and credit unions for locally directed economic development and jobs creation. The Wall Street banks and their allies are not anxious for the competition for our deposits, and want to keep them to underwrite their speculation in derivatives and commodities.

Even Canada is considering going back to the debt free issuance of money for public benefit rather than private profit. A landmark Canadian federal appellate-court ruling could conceivably lead to the cancellation of Canada's debt-based money system, and its repercussions are expected to be felt by central banks around the world.

On December 12 of 2011, the Committee for Monetary and Economic Reform filed suit to legally restore the former arrangement wherein The Bank of Canada—which, unlike the United States Federal Reserve with respect to U.S. citizens, is owned by the people of Canada—would return to the monetary practices it followed from 1938 to 1974, under the Bank of Canada Act. During those years, the Canadian government borrowed money free of interest from the public Bank of Canada and made significant national progress.

In fact the movement for public banking is becoming so successful that the Big Wall Street banks are pushing back against this movement:

At the beginning of March [2015], responding to the impressive wave of state-level public banking movements in the news, Mark Calabria of the Cato Institute wrote a template that became two different published OpEds. The Denver Post titled Calabria's piece "Colorado would be wise to reject state-owned banking," while American Banker titled the piece "Promises of Public Banks Don't Match Reality." The wording differs in the two pieces, but the message points are the same. In the course of delivering those points, Mr. Calabria distorts other scholars' published research, gets some historical anecdotes wrong, and plays on tired old fears of "government control" while glossing over the rampant, widespread corruption of Wall Street banking.

Although ostensibly associated with libertarian thought, Cato really argues in the interests of its supporters, who, in addition to the Koch family, include American Express, Chase Manhattan, CME Group, and Citicorp/Citibank. Mr. Calabria does not disclose Cato's or his own financial interest in maintaining those corporations' business, which might well be undercut by the *success of both public and community banks. These are not "libertarian" interests in the sense of being genuinely committed to local control or even qualitatively less regulation. These companies know that regulatory systems covering powerful private banks are easier to game, and the rewards are big for those who can play the system. Public banks are regulated too, but their structurally limited power and absolute transparency create substantially fewer incentives for corruption. That Mr. Calabria can't find any anecdotes of corruption from a currently existing public bank nearing 100 years of age (the Bank of North Dakota) is more informative than his* Bill and Ted-*style trip through history.*

Why doesn't San Diego get with the public banking movement? It could have prevented Poway, Santee and San Ysidro among others from being sucked into CABs by Wall Street. **Those municipalities now face devastating property tax increases 20 years from now. Until then all is well. It always is until you actually go over the edge of a cliff.**

Instead of the money leaving San Diego and migrating to Wall Street where it will become grist for the derivatives mill, where hedge fund managers will bet against those school districts and others ever being able to pay it back, the money could have been deposited right here and been made to serve the public rather than private interests.

As it turns out there is a movement afoot to form a public bank in San Diego. Ian Mackenzie is a member of the nationally recognized Public Banking Institute (PBI) (www.publicbankinginstitute.org) a non-profit, nonpartisan public policy organization, engaged in campaigns of public education through the New Economy Academy to create a new economy with public banks at the state, county and city levels. Ian is presently forming a PBI San Diego Chapter and looking for people who want to join the movement. Parties interested in joining with Ian to promote public banking in San Diego can contact him at ianmackenzie24@gmail.com.