

STATE ALLOCATION BOARD

1130 K Street, Suite 400
Sacramento, CA 95814
<http://www.dgs.ca.gov/opsc>



Date: July 25, 2005

To: Interested Parties

Subject: **NOTICE OF THE STATE ALLOCATION BOARD
IMPLEMENTATION COMMITTEE MEETING**

Notice is hereby provided that the State Allocation Board Implementation Committee will hold a meeting on Friday, August 5, 2005 (9:30 am - 3:30 pm) in the East End Complex, located at 1500 Capitol Avenue, Rooms 72.149B & 72.148C in Sacramento.

The Implementation Committee's proposed agenda is as follows:

1. Discussion of the proposed regulatory amendments to address Financial Hardship Equity Issues as directed by the State Allocation Board on May 25, 2005.

A copy of the State Allocation Board item is posted on the OPSC Web site at www.opsc.dgs.ca.gov under the "What's New" section.

2. State Relocatable Classroom Program (Tentatively Scheduled)
Discussion of the State Relocatable Classroom Program changes as a follow up to the State Allocation Board Meeting on July 27, 2005.

Any interested person may present public testimony or comments at this meeting regarding the issues scheduled for discussion. Any public input regarding unscheduled issues should be presented in writing, which may then be scheduled for a future meeting. For additional information, please contact Ms. Linda Martinez at (916) 445-3159.

A handwritten signature in cursive script that reads "Mavonne Garrity".

MAVONNE GARRITY, Chairperson
State Allocation Board Implementation Committee

MG:LM:lm

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**Implementation Committee
2005 MEETING CALENDAR**

Friday, September 9, 2005

1500 Capitol Ave. Rms. 72.149B & 72.148C
Sacramento, CA

Friday, November 4, 2005

1500 Capitol Ave. Rms. 72.149B & 72.148C
Sacramento, CA

Friday, October 7, 2005

1020 N Street (Leg. Off. Bldg.), Room 100
Sacramento, CA

Friday, December 2, 2005

1500 Capitol Ave. Rms. 72.149B & 72.148C
Sacramento, CA

Meeting times are scheduled from 9:30 am to 3:30 pm with a 1-hour lunch break.

Meeting times, dates and locations are subject to change.

STATE ALLOCATION BOARD
IMPLEMENTATION COMMITTEE
August 5, 2005

Financial Hardship Equity Issues

PURPOSE

To discuss the Financial Hardship Equity Issues and proposed regulatory amendments.

BACKGROUND

A report on Financial Hardship Equity Issues was presented to and accepted by the State Allocation Board (SAB) at the May 3, 2005 meeting. The report discussed several situations of inequity and possible remedies. The SAB requested that the report be taken to the Implementation Committee for further discussion. The SAB also requested that the Implementation Committee discuss possible negative impacts to school districts currently in the financial hardship program.

DISCUSSION

At the July 8, 2005 Implementation Committee meeting, the OPSC presented potential solutions and recommendations for the observations indicated in the report based on previous comments from the Implementation Committee and audience. Proposed regulatory amendments have been drafted to implement Staff's recommendations (See Attachment A).

Observation One: Under current regulations, after the initial request for financial hardship status is granted, no further encumbrances of existing capital facility funds are approved by the OPSC, and all prospective capital facility revenue is deemed available on the subsequent financial hardship review. The regulations provide for an exception to this requirement if the district does not file a financial hardship request for a period of three years from the date of the district's latest financial hardship adjusted grant apportionment.

Under this three-year provision, some districts receive SFP financial hardship approval for up to 100 percent State funding of their projects, and then later issue Certificates of Participation (COP) or other funding mechanisms that are not recognized as district contribution towards their previously funded SFP projects. If districts wait to file subsequent SFP funding applications until after the three years lapse from the date of their last adjusted grant funding apportionment, the COP or other district funds are exempt from contribution to the previous or future SFP projects.

Comments: In association with the above observation there was considerable discussion at the previous two Implementation Committee meetings regarding the inadequacy of the grants for financial hardship districts. Many asserted that the grant inadequacy was the catalyst for the after the fact COP borrowing. In essence, the post COP borrowing was necessary to complete the project but subjected the school district to potential over-expenditure penalties when future audits of the project occur. In addition, there was discussion relating to the cumbersome financial hardship paperwork requirements and review process that provides a six month financial hardship approval period. Several audience members maintained that the six month financial hardship approval is too short and should be increased. Based on these comments staff has formulated recommendations detailed below.

Staff Recommendations Observations #1:

- A. Amend the SFP regulations to require districts to be subject to all governing financial hardship rules until a 100 percent complete final expenditure report is submitted on their last funded SFP/Financial

Hardship project. This would include annual reviews of the financial hardship school district's finances until the project reaches closeout. Note: The annual financial hardship review and the review at the time of project closeout might necessitate adjustments to the financial hardship grant and an increase in the district contribution to a maximum of 50 percent of project costs.

- B. Amend the SFP regulations to provide that on a case-by-case basis financial hardship districts be allowed to supplement SFP grants through local funding mechanisms to enable the construction of a complete school containing minimum essential facilities as specified by CDE and SFP regulation 1859.82 (b). The local funding mechanism may only be used to generate the amount needed to complete the school facility project in accordance with the original scope of the project. Any local funding mechanism which exceeds that amount would be deemed available for the district contribution. Note: At the most recent Implementation Committee meeting there was concern raised regarding the use of developer fees to complete a school. Staff has determined that it would be inequitable to exclude developer fees as a potential funding source used to complete a project
- C. Amend the SFP regulations to increase the financial hardship renewal period from 6 months to one year. To accommodate this new approval period, a review of the financial hardship school district's finances will be performed by the OPSC on an annual basis. At annual review, if the district is ready to proceed with the next phase of a previously approved project or a new project, the district will be required to submit documentation re-establishing their eligibility for the financial hardship program and current financial statements. If the district is not ready to proceed with the next phase of a previously approved project or a new project they would only need to supply current financial statements.

Observation Two: Existing law permits school districts to garner SFP new construction eligibility based on augmentations to their enrollment projections. The anticipated pupils that will reside in dwelling units indicated on approved tentative subdivision maps are used for this augmentation. This ability allows schools districts to plan ahead and build schools before or in time of the students' arrival. Because the districts can file for eligibility before the housing units are built, their SFP funding application and financial hardship review precedes the collection of developer fees which occurs later as the construction permits are issued. This results in the OPSC not being able to recognize the developer fees that could be used for the districts' matching share of their SFP projects.

Comments: At the previous two Implementation Committee meetings much of the discussion, regarding this observation, was overlapping with comments made under Observation One. There was general consensus that many of the timing issues explored in Observation One directly related to the issues detailed in Observation Two.

Staff Recommendation Observations #2:

Same as Staff Recommendation A from Observation One.

Observation Three: One of the ways to qualify for financial hardship is to have a current school facility related indebtedness of at least 60 percent of a districts' total bonding capacity. It has become an apparent pattern that some districts are securing a COP or other debt instrument in order to just meet the 60 percent threshold and then encumber those funds before submitting a financial hardship request.

Comments: At previous meetings, the Implementation Committee and audience had serious concerns with Staff's original proposal to raise the financial hardship bonded indebtedness requirement from 60 percent. An alternative Staff proposal was developed as outlined below.

Staff Recommendation Observations #3:

Staff recommends leaving the current 60 percent threshold in place and requiring any debt instrument utilized to meet the 60 percent threshold, which is dated within one year prior to the financial hardship request, to be available as district contribution to the financial hardship projects (after a phase-in period as detailed in Attachment A).

Observation Four: At times when SFP funding is unavailable, districts are permitted to obtain temporary or so-called "bridge", financing to proceed with their building or modernization projects until State funds became available. The intent was to "bridge" the period of time without State funding and to retire the debt instrument once the districts receive reimbursement from the State. However, some districts are choosing to accept the reimbursement from the State but utilize the funds for other capital facilities purposes rather than retire the debt instrument used to fund the SFP project. The districts maintain the debt, enabling the district to continue to meet the 60 percent indebtedness and request financial hardship status for their other SFP projects.

Comments: The Implementation Committee and audience generally accepted the staff proposal to automatically assume that the bridge financing debt instrument has been retired and the financial hardship indebtedness level adjusted down, as appropriate.

Staff Recommendation Observations #4:

On current and future bridge financing instruments, recognize the State reimbursement amount as being applied to the debt and determine the corresponding revised percentage of indebtedness.

On prior bridge financing instruments reimbursed by the State, any amount that exceeds the amount necessary to retire the original debt shall be deemed available (See Attachment B for a sample of this adjustment).

For future State reimbursement on bridge financing, no subsequent refunding instruments will be recognized and the funds generated will be considered available for district contribution to SFP projects. Staff proposes to amend the SFP regulations to accommodate this adjustment (See Attachment A).

Observation Five: Districts control the timing for their initial financial hardship submittal in order to encumber available funds prior to their review. As a result, the OPSC cannot recognize these funds as available for contribution towards their SFP financial hardship projects. This permits the districts to utilize available funds for other district priorities and then receive up to 100 percent State funding for their SFP project(s).

Comments: Staff believes that the current regulations encourage school districts to encumber Capital Project Funds just prior to entering the SFP Financial Hardship program. Although it was suggested at the last Implementation Committee meeting, staff believes it would not be appropriate or feasible for the SAB to evaluate claimed encumbrances on a case by case basis.

Staff Recommendation Observations #5:

Staff proposes to amend the SFP regulations to include phase-in language and, on a prospective basis, provisions to disallow encumbrances dated within one year prior to the financial hardship request.

Attachment A

Proposed Regulations for Financial Hardship Equity Issues

Section 1859.81. Financial Hardship.

Except for Joint-Use Projects, a district is eligible for financial hardship to fund all or a portion of its matching share requirement after demonstrating Compliance with subsection (a) and (c). ~~both of the following:~~

- (a) The district is financially unable to provide all necessary matching funds for an eligible project. To determine this, an analysis shall be made of the district's financial records by the OPSC including data and records maintained by the CDE and the County Office of Education. The analysis shall consist of a review of the district's latest Independent Audit regarding funds available from all capital facility accounts, including, but not limited to, developer fees, funds generated from capital facility certificates of participation, federal grants, redevelopment funds, sale proceeds from surplus property, the appraised value of facilities approved for replacement pursuant to Section 1859.82, bond funds either encumbered, unencumbered or authorized but unsold, and savings from other SFP projects. For Financial Hardship requests filed prior to September 1, 2006, all funds thus identified shall be deemed available as matching contribution unless the funds are that have not been expended or encumbered by a contractual agreement for a specific capital outlay purpose prior to September 1, 2005. For Financial Hardship requests filed on or after September 1, 2006, all funds identified shall be deemed available as matching contribution unless the funds are expended or encumbered by a contractual agreement at least one year prior to the initial financial hardship request. prior to the initial request for financial hardship status shall be deemed available as a matching contribution. The initial and successive financial hardship approvals will be valid for one year. Subsequent to the initial approval, districts will be required to submit annual financial hardship data pursuant to this section until the 100 percent final expenditure report has been submitted for the last financial hardship New Construction Adjusted Grant or Modernization Adjusted Grant funding apportionment. Any additional funds found available from these annual reviews of the district's finances shall necessitate an adjustment to the financial hardship grant and an increase in the district contribution to a maximum of 50 percent of project costs for the project(s).

Any new bridge financing mechanisms entered into after January 1, 2006 will be considered repaid once complete reimbursement from state funding is provided and the prospective indebtedness threshold will be adjusted appropriately. In addition, all funds from any financing mechanism utilized to retire debt after the state reimbursement funds are received will be considered available as district contribution toward their project(s).

After the initial request for financial hardship status is granted, no further encumbrances will be approved by the OPSC and all prospective revenue made available to the district's capital facility accounts shall be deemed available as matching contribution on the subsequent financial hardship review, with the exception of:

- (1) Approved interim housing expenditures.
- (2) Funding to pay for previously recognized multi-year encumbrances approved at the initial financial hardship approval.
- (3) Funding that is transferred into a Special Reserve Fund and is used for the express purpose of the Federal Renovation Program when the amount expended out of that fund does not exceed the maximum Federal Renovation Grant amount.

- (4) Funding that is transferred into a Special Reserve Fund and is used for the express purpose of the School Facilities Needs Assessment Grant Program or Emergency Repair Program when the amount expended out of that fund does not exceed the maximum grant amount apportioned.
- (5) All other capital facility funding after the 100 percent complete final expenditure report has been submitted for all of the district's possessive financial hardship New Construction Adjusted Grant or Modernization Adjusted Grant funding apportionment(s) for a period of three years when no subsequent financial hardship request is made during this period. The three year period begins with the date of the most recent financial hardship new construction or modernization adjusted grant funding apportionment.

The financial hardship analysis is subject to approval by the Board.

- (b) From the funds deemed available as a matching contribution, the district may retain \$19,776 per classroom in each enrollment reporting period for the cost to provide interim housing for the currently unhoused pupils of the district. The amount shown shall be adjusted annually in the manner prescribed in Section 1859.71. The number of classrooms needed for interim housing for the currently unhoused pupils shall be the sum of the positive numbers determined in (b)(7) as follows:
 - (1) Determine the current enrollment of the district by grade level as shown on the latest Form SAB 50-01.
 - (2) Determine the New Construction Grants apportioned by grade level for all SFP projects and LPP funded under the provisions of Sections 1859.12 or 1859.13 where the district has submitted Form SAB 50-06 indicating that the project is 100 percent complete.
 - (3) Subtract (b)(2) from (b)(1).
 - (4) Determine the number of classrooms by grade level reported in Part 1, Line 8 on Form SAB 50-02.
 - (5) Multiply the classrooms determined in (b)(4) by 25 for K-6, 27 for 7-12, 13 for Non-Severe and 9 for Severe.
 - (6) Subtract the product determined in (b)(5) from the difference determined in (b)(3) by grade level.
 - (7) Divide the difference by grade level determined in (b)(6) by 25 for K-6, 27 for 7-12, 13 for Non-Severe and 9 for Severe and round up to the nearest whole number.

From the funds deemed available as a matching contribution, the district may also retain \$19,776 per portable toilet unit in each reporting period for the cost to provide necessary interim toilet facilities for the currently unhoused pupils of the district. The amount shown shall be adjusted annually in the manner prescribed in Section 1859.71. The number of toilet facilities needed for interim housing shall be the sum of the positive numbers determined in (b)(7) divided by eight rounded up to the nearest whole number.

If the district's available funds, as determined by the OPSC analysis less costs for interim housing, is less than its matching share, the district will be deemed to have met the requirements of this Subsection.

- (c) The district has made all reasonable efforts to fund its matching share of the project by demonstrating it is levying the developer fee justified under law or an alternative revenue source equal to or greater than the developer fee otherwise justified under law at the time of request for hardship and the district meets at least one of the following:
 - (1) The current outstanding bonded indebtedness of the district issued for the purpose of constructing school facilities in accordance with Education Code Section 17072.35 or 17074.25 as appropriate, at the time of request for financial hardship status, is at least 60 percent of the district's total bonding capacity. Outstanding bonded indebtedness includes that part of general obligation bonds, Mello-Roos Bonds, School Facility Improvement District Bonds and certificates of participation which the district is paying a debt service that was issued for capital outlay school facility purposes.

- (2) The district had a successful registered voter bond election for at least the maximum amount allowed under Proposition 39 within the previous two years from the date of request for financial hardship status. The proceeds from the bond election that represent the maximum amount allowed under the provisions of Proposition 39 must be used to fund the district's matching share requirement for SFP project(s).
- (3) It is a County Superintendent of Schools.
- (4) The district's total bonding capacity at the time of the request for financial hardship status is \$5 million or less.
- (5) Other evidence of reasonable effort as approved by the SAB.

If the district's request for financial hardship status is denied by the Board, the district may be deemed eligible for rental payments of \$2,000 per year per classroom under the Emergency School Classroom Law of 1979 for a two year period when relocatable classroom buildings are available and the district provides financial documentation that it is unable to afford the full rental amount and any other information satisfactory to the Board that the rental reduction is necessary. The number of classrooms eligible for the \$2,000 rental payments shall be the sum of the numbers determined in (c)(5)(B) as follows:

- (A) Determine the number of pupils by grade level that the district requested a New Construction Grant on the Form SAB 50-04 that were denied financial hardship status.
 - (B) Divide the number by grade level determined in (c)(5)(A) by 25 for K-6, 27 for 7-12, 13 for Non-Severe and 9 for Severe and round up to the nearest whole number.
- (d) Upon case-by-case approval by the SAB, financial hardship districts can spend beyond the SFP grants through local funding mechanisms to enable the construction of a complete school containing minimum essential facilities as specified in Section 1859.82(b) necessary to complete the project as originally approved by the CDE, DSA, and SAB. Any local funding mechanism which exceeds the amount necessary to complete the school as described in this section would be deemed available for the district's matching contribution.

If the district meets the financial hardship requirements in this Section, the amount of financial hardship is equal to the district's matching share less funds deemed available in (a), and as adjusted in (b).

Once a district has been notified by the OPSC that it meets the requirements of financial hardship in this Section, the district may file Form SAB 50-04 under the provisions of financial hardship anytime within a period of ~~480~~ 365 calendar days from the date of the OPSC notification.

If the district does not submit Form SAB 50-04 under the provisions of financial hardship within ~~480~~ 365 calendar days of the OPSC notification of approval of financial hardship status, the district must re-qualify for financial hardship status under the provisions of this Section by submittal of a new request for financial hardship status.

If the district submits Form SAB 50-04 within ~~480~~ 365 calendar days of the OPSC notification of approval of financial hardship and the project(s) has been included on an unfunded list for more than ~~480~~ 365 calendar days, a review of the district's funds pursuant to (a) will be made to determine if additional district funds are available to fund the district's matching share of the project(s).

Financial hardship approval status by the OPSC for a separate design and/or site apportionment does not apply to any subsequent funding for the project(s).

Note: Authority cited: Sections 17070.35, 17075.15 and 17592.73, Education Code.

Reference: Sections 17075.10 and 17075.15, Education Code.

Section 1859.106. Program Accountability Expenditure Audit.

The projects will be audited to assure that the expenditures incurred by the district were made in accordance with the provisions of Education Code Section 17072.35 for new construction projects, Section 1859.120 for Joint-Use Projects, Section 1859.140 for Critically Overcrowded School projects, Section 1859.160 for Charter School projects, and Education Code Section 17074.25 and Section 1859.79.2 for modernization projects. The audit will also assure that the district complied with all site acquisition guidelines as provided in Education Code Sections 17072.13 and 17072.14 and Sections 1859.74, 1859.74.1, 1859.74.2, 1859.74.3, 1859.74.4, 1859.75 and 1859.75.1.

An adjustment in the SFP grant will be made for the following:

- (a) The difference in the value of the site, relocation costs, DTSC fees, and hazardous waste/materials removal costs that were used to determine the New Construction Additional Grant and the actual amount paid by the district for the site, relocation costs, DTSC fees, and hazardous waste/materials removal costs. For applications received on or after January 1, 2004, the adjustment may be made regardless of whether the hazardous waste/materials removal costs were requested on the application for funding.
- (b) For 50 percent of any insurance proceeds collectable by the district for displaced facilities and 50 percent of the net proceeds available from the disposition of displaced facilities pursuant to Section 1859.82(a) or (b).
- (c) For financial hardship districts, any amount beyond what was necessary to provide funding for minimum essential facilities as defined in Section 1859.82(b) necessary to complete the project as originally approved by the CDE, DSA, and SAB. All funds available to the capital facility accounts are permissible funding sources to fund these minimum essential facilities.

When the OPSC receives the final expenditure report from the district on Form SAB 50-06, an audit of the expenditures by the OPSC shall commence within two years of the report. If the district is not notified by the OPSC within the two-year period that an audit will be made, there will be no audit of the project by the OPSC and the expenditures reported by the district shall be deemed appropriate. If the district has been notified that an audit of the expenditures will be made by the OPSC, the OPSC shall complete the audit within six months of the notification, unless additional information requested from the district has not been received.

Districts shall be required to maintain all appropriate records that support all district certifications and expenditures for all costs associated with SFP, Charter School, and Joint-Use projects for a period of not less than four years from the date the notice of completion is filed for the project in order to allow other agencies, including, without limitation, the Bureau of State Audits and the State Controller to perform their audit responsibilities.

The district is responsible to substantiate expenditures from the Joint-Use Partner(s) financial contribution pursuant to Section 1859.127 and from other local sources.

Should the OPSC conduct an audit of the district certifications or the expenditures for the project and make a finding that some or all of the expenditures were not made in accordance with the provisions of Education Code Section 17072.35 for new construction projects, Section 1859.120 for Joint-Use Projects, Section 1859.140 for Critically Overcrowded School projects, Section 1859.160 for Charter School projects,

Education Code Section 17074.25 and Section 1859.79.2 for modernization projects, and Education Code Sections 17072.13 and 17072.14 for projects with additional costs imposed by the DTSC, the OPSC shall recommend to the Board that the apportionment be adjusted based on the audit findings. Upon adoption of the audit findings by the Board, the district must submit a warrant for any amount identified as being owed within 60 days of the Board action. If this does not occur, the OPSC shall initiate collection procedures from the School Fund Apportionment as outlined in Education Code Section 17076.10(c).

Should the CDE make a finding that a project did not meet the standards that were adopted by the CDE pursuant to Education Code Section 17251 (b) and (c) when the district had self-certified that the project met those standards pursuant to Education Code Section 17070.50 (b), the Board may request that the CDE make a recommendation that the apportionment for the project be adjusted based on the CDE finding. Any adjustment in the apportionment shall be based on the percentage of space in the project that the CDE determined did not meet those standards. Upon adoption of the finding by the Board, the district must submit a warrant for any amount identified as being owed within 60 days of the Board action. If this does not occur, the OPSC shall initiate collection procedures from the School Fund Apportionment as outlined in Education Code Section 17076.10 (c).

Note: Authority cited: Section 17070.35, Education Code.

Reference: Sections 17070.35, 17070.50, 17072.13, 17072.14, 17072.18, 17072.35, 17074.25, 17076.10, 17077.40, 17078.52 and 17251, Education Code.

Attachment B

(Observation 4)

Bridge Financing

Example of 60% Indebtedness Qualification Calculation

Bonding Capacity		\$30,000,000
Amount Needed To Meet 60% Threshold		\$18,000,000
Outstanding Indebtedness		\$11,000,000
General Obligation	0	
COP	11,000,000 ¹	
Mello-Roos	0	
	<hr/>	
	11,000,000	
Percentage of Indebtedness		37%²

¹The \$11,000,000 represents the difference between the 2001 Bridge COP of \$13,000,000 and the 2003 Refinancing COP of \$24,000,000.

²Outstanding Indebtedness / Bonding Capacity = Percentage of Indebtedness