

REPORT OF THE EXECUTIVE OFFICER  
State Allocation Board Meeting, May 28, 2008

SITE SALE PROCEEDS REGULATIONS

PURPOSE OF REPORT

To request:

1. Adoption of proposed regulatory amendments to clarify the use of site sale proceeds under Senate Bill 1415 (Chapter 810, Statutes of 2006 (Scott)) for a one-time funding of an under-funded health or retirement program.
2. Authorization to file the proposed regulations with the Office of Administrative Law (OAL).

DESCRIPTION

On August 2, 2007, the State Allocation Board's (SAB) adopted regulations went into effect to allow for the use of site sale proceeds for a one-time expenditure. The SAB requested the Attorney General (AG) provide an informal opinion regarding whether, under the regulation, funds used to address the fiscal insolvency of a district's health and/or retirement program would be considered a one-time expenditure or an ongoing expenditure. The AG provided an informal opinion stating that, with appropriate amendments to the regulation, the SAB may allow the use of site sale proceeds to fund, on a one-time basis, a district's under-funded health or retirement program. Please see Attachment B for the AG's informal opinion.

AUTHORITY

Education Code (EC) Section 17462(a) states in part that:

...the proceeds from the sale or lease with option to purchase may be deposited in the general fund of the district if the school district governing board and the SAB have determined that the district has no anticipated need for additional sites or building construction for the ten-year period following the sale or lease with option to purchase, and the district has no major deferred maintenance requirements. Proceeds from the sale or lease with option to purchase of school district property shall be used for one-time expenditures...

EC Section 17462(c) states:

The SAB, in consultation with the department, shall adopt regulations that govern the use of proceeds pursuant to this section for one-time expenditures and define ongoing expenditures for purposes of subdivision (a).

SFP Regulation Section 1700 defines one-time and ongoing expenditures as follows:

"One-time Expenditures" means costs paid by the general funds of a school district that are nonrecurring in nature and do not commit the school district to incur costs in the future, and are exclusive of Ongoing Expenditures.

"Ongoing Expenditures" means costs paid by the general or special funds of a school district in support of employee salaries, benefits and other costs that are associated with ongoing and sustained operations and services.

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## STAFF COMMENTS

In order to address this issue, a proposed regulatory amendment was first presented at the March 7, 2008 Implementation Committee meeting. Based on committee and subsequent discussions with the California Department of Education and SAB Legal Counsel, the proposed regulation was narrowed in scope in order to focus on precisely which type of one-time payment would be allowed: a payment toward reducing a district's existing unfunded liability for post-employment benefits other than pensions that was determined using actuarial measurement methods as defined in the Governmental Accounting Standards Board Statement 45 (GASB 45).

GASB 45 established accounting and reporting requirements for State and local government employers that provide post-employment benefits other than pensions. In general, GASB 45 guides districts to account and report for the annual cost of post-employment benefits other than pensions in the same manner as districts currently do for pensions. As a result of GASB 45, many districts may discover an 'unfunded liability'.

The more narrowly drafted regulatory language incorporated a reference to GASB 45 and was presented at the May 2, 2008 Implementation Committee meeting. Many committee and audience members still expressed opposition to the proposed regulation because it allowed the transfer of capital funds toward an operational expense. Staff emphasized that districts utilizing this provision would be subject to the ten-year prohibition from participating in any State-funded facilities programs, which will likely cause careful consideration by the districts before choosing this option.

## RECOMMENDATIONS

1. Adopt the proposed regulations as shown on Attachment A and begin the regulatory process.
2. Authorize the Office of Public School Construction to file these regulations with the OAL.

This Item was approved by the State Allocation Board on May 28, 2008.

ATTACHMENT A

**SCHOOL FACILITY PROGRAM  
SURPLUS SCHOOL PROPERTY—USE OF PROCEEDS**  
State Allocation Board Meeting, May 28, 2008

Proposed Amendments to Regulations

Section 1700. Definitions.

For the purpose of the provisions of EC Section 17462, the terms set forth below shall have the following meanings, subject to the provisions of the Act:

"One-time Expenditures" means costs paid by the general funds of a school district that are nonrecurring in nature and do not commit the school district to incur costs in the future, and are exclusive of Ongoing Expenditures.

"Ongoing Expenditures" means costs paid by the general or special funds of a school district in support of employee salaries, benefits and other costs that are associated with ongoing and sustained operations and services except, if approved by the State Allocation Board, a single and one-time payment toward reducing a district's existing unfunded liability for postemployment benefits other than pensions will be considered a one-time expenditure and not an ongoing expenditure if the following conditions are also met: (1) the unfunded liability was incurred prior to January 1, 2007, (2) the unfunded liability has been determined using actuarial measurement methods as defined in Governmental Accounting Standards Board Statement 45, and (3) the payment is consistent with any plan made by the district according to Assembly Bill 1802, Chapter 79, Section 43(a)(6)(A), Statutes of 2006 (Committee on Budget), as amended by Senate Bill 1131, Chapter 371, Statutes of 2006 (Committee on Budget and Fiscal Review), or a similar plan adopted by the district's governing board.

**MUND G. BROWN JR.**  
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**DEPARTMENT OF JUSTICE**



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November 7, 2007

Anne Sheehan  
 Chair, State Allocation Board  
 Chief Deputy Director, Department of Finance  
 State Allocation Board  
 1130 K Street, Suite 400  
 Sacramento, California 95814

RE: *State Allocation Board* – SB 1415 Advice

Dear Ms. Sheehan:

This letter addresses your questions regarding the use of proceeds from the sale of surplus school property.

We find that a one-time payment by a school district from the sale proceeds of surplus school property to fund the district's insolvent health or retirement program:

1. May be a one-time expenditure under Education Code section 17462, at the discretion of the State Allocation Board.
2. Is *not* a one-time expenditure under proposed regulation California Code of Regulations, title 2, section 1700 ("Regulation 1700").
3. Is *not* a one-time general fund purpose under Education Code section 17463.6 or section 17463.8.

**1. The State Allocation Board has the discretion to determine whether a school district may use sale proceeds to fund the district's insolvent health or retirement program.**

**a) Sale proceeds may be used for one-time expenditures from a district's general fund under specified conditions.**

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A school district may sell surplus school property: (Educ. Code, §17455.) When a school district sells surplus school property, Education Code section 17462 requires the district

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to use the sale proceeds for (1) capital outlay or (2) specified maintenance costs. (Educ. Code, § 17462, subd. (a).)

But the school district may also deposit the sale proceeds in its general fund under two conditions. First, both the district and the State Allocation Board must find that the district has no anticipated need for additional sites or building construction for ten years after the sale of the surplus school property. (Educ. Code, § 17462, subd. (a).) Second, both the district and the State Allocation Board must find that the district has no major deferred maintenance requirements. (Educ. Code, § 17462, subd. (a).)

**b) A one-time expenditure is not an ongoing expenditure.**

Section 17462 bans a school district from using the sale proceeds in its general fund for ongoing expenditures. (Educ. Code, § 17462, subd. (a).) But it expressly allows the school district to use the sale proceeds for one-time expenditures. (Educ. Code, § 17462, subd. (a).) Thus, the statute contemplates that payments made from a school district's general fund fall into two distinct categories—one-time expenditures and ongoing expenditures.

**c) The State Allocation Board must define “ongoing expenditures.”**

Though the statute does not define “ongoing expenditures,” it identifies two examples of payments that fall into the ongoing expenditures category—salaries and other general operating expenses. (Educ. Code, § 17462, subd. (a).) For further clarification, Education Code section 17462 directs the State Allocation Board to adopt a regulation that defines ongoing expenditures. (Educ. Code, § 17462, subd. (c).) The State Allocation Board must adopt the regulation in consultation with the Department of Education. (Educ. Code, § 17462, subd. (c).)

**d) The State Allocation Board must use reasonable discretion when defining “ongoing expenditures.”**

A regulation may not alter or amend a statute or enlarge or impair its scope. (*San Francisco Fire Fighters Local 798 v. City and County of San Francisco* (2006) 38 Cal.4<sup>th</sup> 653, 668.) However, courts draw a distinction between quasi-legislative rules and interpretive regulations. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4<sup>th</sup> 1, 10 (“*Yamaha*”).)

A quasi-legislative rule “represents an authentic form of substantive lawmaking: Within its jurisdiction, the agency has been delegated the Legislature’s lawmaking power.” (*Yamaha, supra*, 19 Cal.4<sup>th</sup> at p. 10.) But an interpretive regulation “does not implicate the exercise of a delegated lawmaking power; instead, it represents the agency’s view of the statute’s legal meaning and effect, questions lying within the constitutional domain of the courts.” (*Id.* at p. 11.)

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The Legislature has delegated the power to the State Allocation Board to define "ongoing expenditures" by regulation. (Educ. Code, § 17462, subd. (c).) The resulting regulation will be a quasi-legislative rule and not an interpretive regulation. When a court reviews the validity of a quasi-legislative rule, the standard of review is the rational basis standard. Courts must consider whether the quasi-legislative rule is "arbitrary, capricious or without reasonable or rational basis." (*Yamaha, supra*, 19 Cal. 4<sup>th</sup> at p. 11.) Under the rational basis standard, the State Allocation Board's definition of "ongoing expenditure" must have a reasonable or rational basis.

**e) Whether a one-time insolvency payment is an ongoing expenditure is subject to the reasonable discretion of the State Allocation Board.**

The State Allocation Board could reasonably decide that the insolvency payment is an ongoing expenditure, and thus not a permitted use of sale proceeds. The State Allocation Board could also reasonably decide that the insolvency payment is not an ongoing expenditure under certain circumstances, and thus a permissible use of sale proceeds.

Section 17462 identifies two types of payments as ongoing expenditures—salaries and other general operating expenses. (Educ. Code, § 17462, subd. (a).)

A one-time insolvency payments is not "salary." A health or retirement program is the type of program that is excluded from the definition of salary in other parts of the Education Code. Education Code section 26139 defines a teacher's salary for retirement purposes to exclude "tax-deferred retirement programs" or "other insurance programs that are purchased by an employer for a participant." (Educ. Code, § 26139(b)(7).)

But one-time insolvency payments may fall in the category of "other general operating expenses." The term "operating expense" is not defined in the Education Code. The Legislature left it to the reasonable discretion of the State Allocation Board to determine whether a one-time insolvency payment by a school district is a general operating expense. The board may use its delegated rulemaking power to make the determination. A rational basis could support either determination.

According to one court: "It requires little, if any, 'interpretation' to conclude that 'operating expenses' means the routine expenses incurred in 'operating' something." (*Schabarum v. California Legislature* (1998) 60 Cal.App.4<sup>th</sup> 1205, 1238.) Under this definition, the State Allocation Board could take the approach that any and all payments to fund a health or retirement program are general operating expenses since the district has only incurred the expense as a result of operating the program.

But the State Allocation Board could take the other approach that a one-time insolvency payment is not a *routine* payment to fund a health or retirement program, and thus not a general operating expense. Presumably, school district officials are faithfully exercising their fiduciary duties when making fiscal decisions affecting employee benefit programs. Hence, an employee benefit program becoming fiscally insolvent should be a rare and nonrecurring event for any

school district. If the board takes this approach, we strongly encourage the board to specify in the regulation that the program's insolvency must have been caused by unforeseen events, such as market volatility or faulty actuarial assumptions, and not dereliction of fiduciary duties by members of the school district.

**2. Proposed Regulation 1700 would bar a school district from using sale proceeds for a one-time insolvency payment.**

Under proposed Regulation 1700 (see attachment), a payment from a general fund must meet three criteria to be a one-time expenditure under Education Code section 17462:

1. The payment must be nonrecurring in nature.
2. The payment must not commit the school district to incur costs in the future.
3. The payment must not be made in support of employee salaries, benefits and other costs associated with ongoing and sustained operations and services.

If a payment does not meet all three criteria, it is an ongoing expenditure.

A one-time insolvency payment would not meet the last criterion, which bars payments made in support of employee benefits. Health insurance and retirement benefits are employee benefits. Because a one-time insolvency payment would keep the benefit programs financially intact, the payment would be "in support" of employee benefits.

Because a one-time insolvency payment would not meet all three criteria, it would be a prohibited ongoing expenditure under the proposed regulation.

**3. Education Code sections 17463.6 and 17463.8 bar specified school districts from using sale proceeds for a one-time insolvency payment.**

Under the general rule set forth in Education Code section 17462, a school district may use proceeds from the sale or surplus property for general fund expenses subject to certain conditions and requirements mentioned earlier in this letter. Despite the general rule, the Legislature has created exceptions to the general rule for four school districts—Santee, Valley Center-Pauma Unified, Capistrano Unified, and Oak Grove Elementary. The exceptions are set forth in Education Code sections 17463.6 and 17463.8.

Sections 17463.6 and 17463.8 allow the four school districts to deposit proceeds from the sale of surplus property into their general fund without meeting any other condition except that property must have been originally purchased entirely with local funds. Any sale proceeds that are deposited in the general fund under Sections 17463.6 and 17463.8 must be used for a "one-time general fund purpose."

Anne Sheehan  
November 7, 2007  
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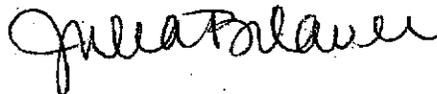
Section 17463.8 defines a "one-time general fund purpose" (1) as a "nonrecurring cost" and (2) excludes "an ongoing expenditure for the purpose of funding employee salaries and benefits or ongoing and sustained program operations and services."

A rule of statutory construction requires that exceptions to a statute be narrowly construed. (*City of Lafayette v. East Bay Mun. Utility Dist.* (1993) 16 Cal.App.4<sup>th</sup> 1005, 1017.) Education Code sections 17463.6 and 17463.8 are exceptions to Education Code section 17462 and thus should be narrowly construed.

A one-time insolvency payment could be described as a "nonrecurring cost" and thus meet the first part of the definition of "one-time general fund purpose." But the payment would fund "employee benefits" and "sustained program operations" and therefore would not meet the second part of the definition under a narrow construction of the statute.

I hope this letter sufficiently addresses your questions. I apologize for the delay in our response to you. If you have any other questions or any concerns, please do not hesitate to contact me.

Sincerely,



JULIA BILAVER  
Deputy Attorney General

For EDMUND G. BROWN JR.  
Attorney General

Attachment: Proposed California Code of Regulations, title 2, section 1700

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