

REPORT OF THE EXECUTIVE OFFICER
State Allocation Board Meeting, May 3, 2005

FINANCIAL HARDSHIP EQUITY ISSUES

PURPOSE OF REPORT

To present a report regarding the trends in financial hardship requests for the School Facility Program (SFP).

BACKGROUND

At the February 2005 State Allocation Board (SAB) meeting, Board members requested information regarding the timing of financial hardship approvals and the equity of the funding distribution. It was requested that the Office of Public School Construction (OPSC) provide information on the trends in financial hardship requests.

AUTHORITY

Education Code Section 17075.15 (see attachment) and the SFP Regulation Section 1859.81(c)(1-4) outlines the requirements for a project to receive financial hardship status. This regulation states that a district must demonstrate reasonable effort to fund its matching share by levying the maximum developer fee justified by law and must meet at least one of the following criteria by having:

- Current school facility related indebtedness of at least 60 percent of its total bonding capacity;
- Accomplished 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;
- An application from a County Superintendent of Schools;
- Total bonding capacity at the time of the request for financial hardship status is \$5 million or less; or
- Other evidence of reasonable effort as approved by the SAB.

DISCUSSION

The financial hardship regulations have been in existence since the inception of the SFP. Originally, the regulations were less specific and had minimal requirements. As the program progressed and more data became available, it was apparent that the regulations required modification to provide more evidence of local financial effort. Those regulatory amendments were approved in December 2001 and were later codified (see attachment). Although these amended regulations and statutes were implemented, it appears that school districts continue to find creative avenues to meet the financial hardship criteria, which may be causing funding advantages.

Over the course of several years of financial hardship reviews, Staff has become aware of several trends as described below. Staff has also identified potential measures to ensure an equitable distribution of financial hardship funds.

1. **Observation:** 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) and other funding mechanisms that are not recognized as district contribution towards their previously funded SFP projects. These districts appear to simply wait to file subsequent SFP funding applications until after the three years lapse from the date of their last adjusted grant funding apportionment. As a result, the COP or other district funds are exempt from contribution to the previous or future SFP projects.

DISCUSSION (cont.)

Potential Measure: Extend the three-year time period currently specified in the SFP regulations to five or more years. This would not eliminate the concern but would minimize the districts' lack of financial contributions. Albeit districts can only manage so many construction projects in any given period of time, most districts could not wait several additional years to build and modernize their facilities. As a result, more funds would be recognized as available towards the districts' share of their projects, thus reducing the demand on State financial hardship funding.

- 2. Observation:** 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.

Potential Measure: Offset the State's financial hardship apportionment to account for the developer fees collected and any other capital facility income received for a specified period of time. Given the SFP eligibility and funding is provided well in advance of the construction of the residential housing, the match period would likewise need to continue for a commensurate period of time.

- 3. Observation:** 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. It would appear that this is occurring so those districts can qualify for financial hardship under the SFP.

Potential Measure: Increase the 60 percent bonding capacity to a higher percentage and do not permit districts to encumber recent indebtedness. Under previous State School Building Aid Fund programs, districts were required to have 90 to 95 percent bonded indebtedness in order to qualify for the State funding for the districts' matching share.

- 4. Observation:** 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, so they continue to meet the 60 percent indebtedness and subsequently request financial hardship status for their other SFP projects without having to use the unpaid portion as district contribution.

Potential Measure: For purposes of determining eligibility for financial hardship funding, recognize the reimbursed amount as being applied to the debt and determine the corresponding revised percentage of indebtedness.

DISCUSSION (cont.)

5. **Observation:** 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.

Potential Measure: Do not recognize any capital project related encumbrances within one year of the initial financial hardship request. Require districts to produce contracts and/or invoices dated one year prior to the financial hardship review in order for funds to be considered encumbered.

The OPSC suggests further exploration into these areas to determine if process, regulatory and/or statutory modifications may be appropriate.

RECOMMENDATION

Accept this report.

BOARD ACTION

This report was accepted by the State Allocation Board on May 3, 2005, with a request that the issues and potential solutions be discussed further by the SAB Implementation Committee. The discussion should also include the adequacy of financial hardship assistance for the construction of small schools.

ATTACHMENT

State Allocation Board Meeting, May 3, 2005

CALIFORNIA CODES
EDUCATION CODE
SECTION 17075.15

17075.15. Source and amount of funding; regulations

(a) From funds available from any bond act for the purpose of funding facilities for school districts with a financial hardship, the board may provide other construction, modernization, or relocation assistance as set forth in this chapter or Chapter 14 (commencing with Section 17085) to the extent that severe circumstances may require, and may adjust or defer the local financial participation, as pupil health and safety considerations require to the extent that bond act funds are provided for this purpose.

(b) The board shall adopt regulations for determining the amount of funding that may be provided to a district, and the eligibility and prioritization of funding, under this article.

(c) The regulations shall define the amount, and sources, of financing that the school district could reasonably provide for school facilities as follows:

(1) Unencumbered funds available in all facility accounts in the school district including, but not limited to, fees on development, redevelopment funds, sale proceeds from surplus property, funds generated by certificates of participation for facility purposes, bond funds, federal grants, and other funds available for school facilities, as the board may determine.

(2) The board may exclude from consideration all funds encumbered for a specific capital outlay purpose, a reasonable amount for interim housing, and other funds that the board may find are not reasonably available for the project.

(d) Further, the regulations shall also specify a method for determining required levels of local effort to obtain matching funds. The regulations shall include consideration of at least all of the following factors:

(1) Whether the school district has passed a bond measure within the two-year period immediately preceding the application for funding under this article, the proceeds of which are substantially available for use in the project to be funded under this chapter, but remains unable to provide the necessary matching share requirement.

(2) Whether the principal amount of the current outstanding bonded indebtedness issued for the purpose of constructing school facilities for the school district and secured by property within the school district or by revenues of, or available to, the school district, which shall include general obligation bonds, Mello-Roos bonds, school facility improvement district bonds, certificates of participation, and other debt instruments issued for the purpose of constructing school facilities for the school district and for which owners of property within the school district or the school district are paying debt service is at least 60 percent of the school district's total bonding capacity, as determined by the board.

(3) Whether the total bonding capacity, as defined in Section 15102 or 15106, as applicable, is five million dollars (\$5,000,000) or less, in which case, the school district shall be deemed eligible for financial hardship.

(4) Whether the application for funding under this article is from a county superintendent of schools.

(5) Whether the school district submits other evidence of substantial local effort acceptable to the board.

(6) The value of any unused local general obligation debt capacity, and developer fees added to the needs analysis to reflect the district's financial hardship, available for the purposes of school facilities financing.

REPORT OF THE EXECUTIVE OFFICER
State Allocation Board Meeting, May 3, 2005

RESIDUAL MODERNIZATION GRANTS

PURPOSE OF REPORT

To present a report to the State Allocation Board (SAB) regarding the utilization of residual modernization grants on school sites other than the site that generated the modernization eligibility.

BACKGROUND

At the February 2005 SAB meeting, the Board requested information regarding remaining modernization grants that were not utilized by the school district for its modernization project and the viability for a district to use these residual grants at other school sites that did not generate the eligibility.

AUTHORITY

Education Code Section 17074.25 states, "A modernization apportionment may be used for an improvement to extend the useful life of, or to enhance the physical environment of, *the school* (emphasis added)."

SFP Regulation, Section 1859.79.2 cites that modernization funding, with the exception of savings, is limited to expenditures on the specific site where the modernization grant eligibility was generated.

SFP Regulation Section 1859.103 states that a district may expend the savings not needed for a project on other high priority capital facility needs of the district. For non-financial hardship districts, SFP Regulation Section 1859.103 further states that the State's share of any savings from a modernization project may be used as a District matching share requirement only on another modernization project.

DESCRIPTION

The SAB, through the SFP, provides modernization funding on a site specific basis for districts with schools that qualify for modernization. To qualify, permanent buildings must be at least 25 years old and portables at least 20 years old. The eligibility is generated on a per building basis.

As a result of the following dynamics, various school districts have residual or additional modernization grants in their modernization baseline:

- Additional buildings on the site become of age (25 and 20 years) after the date when the original modernization baseline was established.
- Buildings that were previously modernized 25 years ago for permanent classrooms or 20 years ago for portable classrooms (i.e., under the Lease-Purchase Program) again become eligible for modernization funds.
- Increased enrollment at the site.
- School districts periodically complete modernization projects without utilizing all of the available modernization eligibility (pupil grants) generated for that site.
- The need to comply with the "60 percent commensurate" requirement, which will occasionally necessitate a reduction in the number of pupils used, to bring the ratio of actual construction work within 60 percent of the project budget. The regulations require school districts to maximize modernization grants by assuring that 60 percent of the grants being requested are being fully utilized for construction costs at the site which generated the grants. Early in the program, the Board was concerned that school districts were generating a substantial amount of savings, which were then being spent on other capital projects and were not being spent on the site that generated the grants.

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DESCRIPTION (cont.)

While a district may believe that they cannot move forward with a project because the amount of residual modernization pupil grants is minimal or because they believe the modernization work has been completed, a district has the ability of receiving additional modernization pupil grants, as described above. If the modernization eligibility was transferred to another site and the need arose to modernize a building at the original site, the district would not have any eligibility to modernize these facilities.

STAFF COMMENTS

A fundamental tenet at the conception of the SFP was that modernization eligibility generated at a specific site represented the actual need at that site. There was an emphasis when the program and regulations were developed that the modernization funds be spent at the site for which the eligibility was generated. It would be inequitable to use modernization grants generated at one site on another site, as buildings that generated the modernization eligibility will not qualify for modernization again for another 20 to 25 years. To allow the transfer of modernization grants from one site to another may benefit some schools while being detrimental to the useful life of the schools where the eligibility was established. In some cases, the schools receiving the "transferred" grants may be in effect receiving a duplication of SFP funds if that campus has already received its maximum modernization eligibility.

It has been claimed that districts have not utilized residual modernization eligibility in their baseline because the eligibility is not enough to move forward with a project. Staff has researched the number of projects that have been submitted to the Office of Public School Construction with less than 200 pupils, and have found that numerous small size projects have been submitted for funding since the inception of the SFP. The findings are as follows:

	Number of Projects	Range of Apportionments
Projects with 100 Pupils or Less*	353	\$2,722 to \$1,158,296
Projects with 101 – 200 Pupils	472	\$147,772 to \$1,979,746

* Smallest Project Funded was for One Pupil Grant (State Apportionment \$2,722)

There are provisions in the regulations that recognize a small project under 101 pupil grants. These regulations provide an additional small project allowance to address the economy of scale costs for a project based on a small number of pupil grants.

RECOMMENDATION

Accept this report.

BOARD ACTION

This report was accepted by the State Allocation Board on May 3, 2005, with a request that the issue be discussed further by the SAB Implementation Committee.