ATTACHMENT C

STATE ALLOCATION BOARD
SUBCOMMITTEE ON PRIORITIES IN SCHOOL CONSTRUCTION FUNDING
CASH MANAGEMENT, PART II
March 1, 2011

PURPOSE

To present for discussion, options for implementing a new cash management system.

DESCRIPTION

The second meeting of the Subcommittee on Priorities in School Construction Funding/Cash Management (Subcommittee) seeks to continue the discussion on cash flow management and how to make apportionments moving forward. This meeting also introduces new issues including remaining bond authority and the Fiscal Crisis Regulations concerning the Charter School Facility Program (CSFP), the Critically Overcrowded Schools (COS) program, and Financial Hardship projects on the Unfunded Approvals list.

AUTHORITY

See Attachment A.

BACKGROUND

It has been almost nine months since the initial priority funding round was approved by the Board in an effort to combat the State's fiscal crisis. Since that time two priority funding rounds have taken place and multiple Subcommittee meetings have been held to discuss the Board's options moving forward with the ultimate goal of helping alleviate the burden placed on school districts by the State's current financial status.

On February 8, 2011, the Subcommittee met to discuss options for management of available cash on hand, cash from future bond sales and residual cash made available via rescissions and closeouts. Staff presented options centered on the forward progression of priority funding, the Unfunded Approvals list, and cash leveraging.

As several Subcommittee members were unable to attend the February 8th meeting, no votes were taken and no recommendations were ultimately decided upon. This item will summarize the Subcommittee meeting held on February 8, 2011 as well as introduce new issues concerning available bonding authority and the fiscal crisis regulations. All topics Subcommittee topics (new or old) are open for additional consideration and potential action by Subcommittee members.

Items Discussed at the February 8, 2011 Subcommittee Meeting

Below is a summary of each proposal discussed by the Subcommittee at its February 8th meeting as well as responses to the proposals from the Subcommittee and stakeholders. The original discussion item is included in its entirety as Attachment B.

Option 1: Modified Priority Funding – create an additional Unfunded Approvals "Priority List" detailing projects that are willing to request funds as soon as cash is available.

This option would create two separate Unfunded Approvals lists. The current Unfunded Approvals list would go unchanged. The major modification to the priorities in funding system under this option would be the creation of a second Unfunded Approvals list (Priority List) for applications ready to

submit a *Fund Release Authorization* (Form SAB 50-05) within 90 days of apportionment regardless of when cash is available, allowing the Board to make apportionments on a flow basis.
Discussion:

When discussing this option, Subcommittee members and stakeholders expressed a general desire to keep the priority funding process as simple as possible to avoid confusion while maintaining an efficient method of apportioning cash that would be released quickly. While some comments were heard on the proposed two list system, a Subcommittee member proposed to reduce the 18 month time limit on fund releases to 90 days on a permanent basis.

The Subcommittee member suggested that it may be time for a more permanent cultural change within the School Facility Program (SFP). Although the priority funding system has been successful, it would be less confusing and require less steps for both school districts and the State if the Board opted to cease using the priority funding system and return to making regular apportionments. The SFP regulations could be permanently modified by the Board to reduce the time limit on all fund releases to 90 days. It was requested that Staff include this concept for discussion at the second Subcommittee meeting.

Considerations for the regulation change option:

Benefits

- 90 day timeline promotes projects moving forward, good to continue
- Would help to provide a seamless system for cash distribution (flow basis possible, partial funding easy to do, no extra steps necessary as in priority funding rounds)
- Would help to limit the amount of time spent by districts and Staff in the preparation and process of requesting/making priority funding apportionments
- Does not require the creation of additional “lists” which may be confusing, particularly if another unfunded list is created by the Board if bonding authority is exhausted
- Has the potential to free up bond authority from those projects on the unfunded list that may never move forward (apportionments will be made, if the new time limit passes and a fund release is not requested the project will be rescinded and authority will return to the program – currently projects that do not request priority funding can remain on the list indefinitely)

Other Issues

- Stakeholders commented that the current priority funding process actually allows districts closer to 120-150 days to prepare to submit a fund release request (30 days for certification filing period + time from end of filing period to apportionment + 90 day fund release timeline). Some stakeholders suggested that a permanent regulation change reflect the additional preparation time to keep consistent with the current timelines in priority funding
- The issue of districts who are on the unfunded list but have not submitted requests for priority funding was discussed. Subcommittee members suggested that one option is for the Board to address on a case by case basis, those projects that cannot meet a 90 day timeline that received unfunded approvals prior to priority funding
- The issue of changing the rules on projects that have already received approvals was also discussed.
    - Consider new timelines only for those projects that have received an unfunded approval after new regulations are in effect
    - Consider new timelines for all projects receiving an apportionment after the new regulations are in effect regardless of when the unfunded approval was made
        - The majority of the projects currently on the unfunded approvals list were approved after the Board started moving towards a 90 day timeline, so the concept is not new
        - An unfunded approval is not the same as an apportionment nor is it a guarantee of future funding, thus the Board has flexibility in the terms of how the apportionment is provided– the Board could declare that to get the

apportionment districts must adhere to the new regulation (not a big departure from making apportionments in priority funding rounds).

- Consider allowing districts who are currently on the unfunded list and will not be able to submit a fund release request if the regulation is changed to address the Board on a case by case basis so that an exemption may be granted (this would require additional regulations to outline the process for making the exemption request, and should only be limited to those on the unfunded list within a certain timeframe such as prior to Board adoption of the new regulations)

Conclusion:
The permanent regulation change proposal was a concept that subcommittee members wanted to pursue at the second meeting. The concept of creating two lists received little support due to the potential for confusion.

Option 2: Priority Funding – continue to use the current model, with clarification on timing of new rounds

This option would keep the current priority funding method intact but specific rules should be determined concerning the frequency of priority funding rounds, minimum cash thresholds and the timing of priority funding rounds in relation to bond sales. Existing regulations allow the Board to establish priority funding rounds at Board meetings. The Board could direct staff to place new rounds on the agenda when a certain dollar threshold is reached, or when bond sales are anticipated. The Board could also set the threshold or timelines in regulation.

Discussion:

- Stakeholders believe that the current priority funding system is viable
- While priority funding has been successful, concerns have been raised about the amount of time/work is involved for districts and staff
- A stakeholder suggested contacting districts on a monthly basis to see if they would be ready to submit within 90 days if residual cash is available

Other issues:

- As part of the discussion of option one, a stakeholder posed an alternative option for using the current priority funding system. The goal of the option is to move the Unfunded Approvals list forward by starting the 18 month timeline on all applications on the Unfunded Approvals list, but freeze the timeline with three months left on the clock. Applications frozen at three months must then submit priority funding requests when money is available.

Conclusion:
Revisit this issue at the March 2011 Subcommittee meeting.

Option 3: Cash leveraging model

This model balances the need to have cash available with the rate at which it is being drawn down by districts by providing apportionments in excess of available cash.

Discussion:

- This option was determined to be extremely risky and would provide increased liability for the State
- Opposed by the Department of Finance

Conclusion:
The Subcommittee members suggested that this option not be pursued. This option is only represented as no votes were taken at the previous meeting.

Selective Ordering Based on the Ability to Provide Full Apportionments

This section outlined the possible steps available to make apportionments when the remaining available cash is not enough to fully fund the next project in line. Options included waiting until there is enough money to fully fund the next project, offering partial funding or moving past projects in line that can not be fully funded in favor of the next project that can be fully apportioned out of the remaining cash. This is a situation that can occur under either priority funding option presented above.

Discussion:

- List integrity is a fundamental issue
- Partial funding of projects would be acceptable
- In the future, this subject can be revisited to see if it is possible to find a feasible way to make selective ordering work, but may not be necessary if a permanent regulation change was made to reduce the time limit on fund releases.

Conclusion:
Views were split on the validity of moving past projects on the Unfunded Approvals list in order to make full apportionments, however it was determined that this is an issue that may be looked at in the future.

New Topics for Subcommittee Consideration

Remaining Non New Construction Bonding Authority

In the past, the Board and the legislature has considered options for the transfer of bonding authority and funds from programs with an abundance of bonding authority to programs of need. Some transfers can be made by Board action while others require legislative action with approval of two-thirds of the legislature. With new construction authority close to depletion, there have been questions related to whether the Board currently has options to transfer authority form other programs. Below are some programs within the SFP that have additional bond authority remaining, along with the action necessary to transfer the authority to new construction.

Seismic Mitigation Program (SMP)

As of January 26, 2011 there is approximately $194.8 million in un-used bonding authority under the SMP.

Assembly Bill (AB) 127 authorized up to $199.5 million to be used for seismic mitigation of school facilities. The SMP was approved by the Board at the September 26, 2007 meeting. Since the inception of the program the State has only received four seismic mitigation requests and to date has apportioned $4.13 million in seismic mitigation funds. Three applications have been apportioned and one application is currently in-house.

Due to the lack of participation, the Board approved regulation changes at the August 2009 meeting in an attempt to increase participation. However these updates have not yet produced many additional applications.

Recently, $200,000 was made available from the Seismic Safety Commission to evaluate buildings considered the highest risk to see if they qualified for the program. The results of these evaluations are not yet available, but could generate additional requests for the program in the future.

Based on the language in AB 127 the Board would have the ability to redistribute the bonding authority for the seismic program to other new construction. This change can be made through a policy shift as opposed to a Legislative change.

Overcrowding Relief Grant (ORG)

There is approximately $459.2 million in un-used bonding authority under the ORG program.

The ORG program was originally allocated $1 billion to help districts reduce the number of portable classrooms on overcrowded school sites and replace them with permanent classrooms. To date the Board has approved 6 funding cycles to fund approximately $547.2 in projects. Funding resulted in 1,084 portable classrooms being replaced with permanent classrooms. The program has consistently shown a need but the application requests have not yet exceeded available authority.

AB 127 states that the allocated money "shall" be available for providing new construction funding to severely overcrowded schoolsites. Based on this language, a Legislative change would be required to transfer the funding out of the ORG program.

Modernization
There is approximately $894.4 million in un-used Proposition 1D bonding authority under the Modernization Program.

The Modernization Program provides state funds on a 60/40 state and local sharing basis for eligible improvements to educationally enhance existing school facilities. It is a program in which eligibility is generated by aging buildings on specific school sites. The Modernization Program was originally allocated $3.3 billion and to date the Board has made apportionments totaling approximately $2.4 billion. The program has consistently shown a need.

AB 127 authorizes the amount of $3.3 billion for the modernization of school facilities. Based on this language, a Legislative change would be required to transfer the funding out of the Modernization Program.

Questions:

- Should the Board change the amount of authority available for the SMP?
- Is more research required to determine the need of the SMP?
- Should/can the Board institute a sunset date on the ORG program or SMP prior to making any transfers?

Fiscal Crisis Regulations

Due to the State's fiscal crisis in early 2009, the Board adopted emergency regulations that would allow the Board to make findings that certain apportionments are "inactive" to relieve school districts from meeting various statutory and/or regulatory requirements. The emergency regulations pertained to the New Construction/Modernization Program, the COS Program, the CSFP, and the Career Technical Education Facilities and Joint-Use Programs.

In December 2010 the Board approved an action to grant a six month extension to the "inactive" CSFP, COS and Financial Hardship Re-Review regulations, while allowing the remaining emergency regulations to sunset on January 1, 2011. That item is included for reference as Attachment C.

CSFP
As of this meeting, there are 50 "inactive" charter school preliminary apportionments.

A preliminary apportionment is a reservation of bond authority. Typically, preliminary apportionments have a four year timeline, with a possible one year extension, to convert to a final apportionment. The program was designed to allow applicants to draw down advance design and site acquisition funds off of the preliminary apportionment. This component is necessary because charter schools often do not have access to cash for their projects outside of the funds available within the program. The local match for the project can be provided in the form of a loan from the State. Charter schools do not have the ability to pass local bonds.

Until recently, cash was not available for the advance design and site acquisition amounts available for the preliminary apportionments. Without this component of the program, it was extremely difficult for projects to progress. It was in part for this reason that these projects were declared inactive. In recent months, the Board has made $96 million available to cover these needs. For those projects that received access to cash for both site (as appropriate) and design purposes, the effects of the fiscal crisis have been mitigated and project timelines can resume. The Board can take action to re-activate a preliminary apportionment at any time.

If cash is not available for the site and design needs of a project, the fiscal crisis effects have not been mitigated and re-activating the project timelines could put the project at a disadvantage.

Questions:

- Should the Board continue to extend the CSFP fiscal crisis regulations?
- Should the Board continue to extend the Financial Hardship Re-Review regulations?
- Should preliminary apportionments be re-activated once the advance funding cash has been received by the applicant?
- Should all preliminary apportionments be re-activated regardless of whether cash is available for advance fund releases?
- Under an inactive status, what should happen if cash became available for advance fund releases yet the CSFP applicants do not request it or request it and cannot meet the time limit to access it?
    - Of the $50 million made available most recently, only $47.5 million was requested.
    - If the applicants cannot meet the timelines to access cash made available for them, is that considered “waiving” the opportunity and is the preliminary apportionment then subject to re-activation?
- Some charter schools have asked for special consideration for cash for construction in addition to cash for design and site acquisition (carve out specific to charter projects on the unfunded list). Does this issue need to be resolved prior to re-activating the preliminary apportionments?
    - Some charter schools are looking for assurances that construction funds will be available if they proceed with converting preliminary apportionments.
    - Raises an issue of list integrity, would not be consistent with traditional First In-First Out approach.

COS

At the October 2004 meeting, Proposition 55 COS Preliminary Apportionments were made for 496 projects for a total of $1.8 Billion. As a result of the fiscal crisis, the Board took action on 344 projects and declared them Inactive Preliminary Apportionments as of December 17, 2008. The projects were declared inactive to protect the statutory time limits on the preliminary apportionments. Since that time, of the 344 projects declared inactive, 311 have met the requirements to convert to a Final Apportionment and have been placed on the Unfunded List, leaving 33 COS Inactive Preliminary Apportionments. If reactivated, these COS Preliminary Apportionments would have approximately ten months to convert or rescind their reservation of bond authority.

None of the districts representing the 33 remaining Inactive Preliminary Apportionments had financial hardship status for their projects, and therefore are not waiting for State funds to move the

project through the design and site acquisition stages of project development. These projects proceed in a similar manner as typical new construction projects. Re-activating these projects would subject them to the same requirements as other new construction projects.

New construction projects can qualify for a Separate Site Apportionment for Environmental Hardship when the best site available requires extensive clean up. The COS projects are provided similar consideration for these purposes with an advance fund release from the Preliminary Apportionment. Not all COS projects require this advance fund release, but of the 33 Inactive Preliminary Apportionments remaining, 11 projects (at one site) have been approved for a separate site apportionment for Environmental Hardship. As of this meeting, the 11 projects have not requested and advance fund release for site acquisition.

Questions:

- Should the Board continue to extend the COS fiscal crisis regulations?
- Should all preliminary apportionments without environmental hardship funding requests be re-activated? Should preliminary apportionments be re-activated once the advance funding cash has been received by the applicant?
- Should all preliminary apportionments be re-activated regardless of whether cash is available for environmental hardship advance fund releases and then have 10 months to convert their project or provide them a date certain to convert their project (July 1, 2011)?
- Under an inactive status, what should happen if cash became available for environmental hardship advance fund releases yet the COS applicants do not request it?

Financial Hardship Re-Review

At the May 2010 meeting, the Board adopted Regulations to waive the unfunded financial hardship re-review requirement for projects added to the Unfunded List due to the State's inability to provide AB 55 loans. In December of 2010 the Board approved an action to grant a six-month extension to the Financial Hardship Re-Review regulations.

Although several unfunded approvals have been converted to apportionments with the funds made available through the first two priorities in funding rounds, as of this meeting, there are 76 projects with financial hardship status remaining on the unfunded list.

Until the Board adopts a different cash management system, projects with financial hardship status will still remain on the Unfunded List (Lack of AB 55 Loans) until bond sale proceeds become available, which may trigger a re-review if this regulation is allowed to sunset. Allowing this to occur may not be in keeping with the Board's original intent in approving this regulation change and may cause school districts to have to go through additional reviews before accessing an apportionment. However, if the Board adopts the position that the fiscal "crisis" is in fact over and that methods of making apportionments have now changed, it may be appropriate to allow this regulation to sunset and consider a return to the original process.

Question:

- Should the Board continue to extend the Financial Hardship Re-Review regulations?