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TO: Dr. Joe Ovick

FROM: Susan Stuart

DATE: August 10, 2005

RE: August 5, 2005 – SAB Implementation Committee Meeting

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Financial Hardship

This topic was the only issue discussed at the meeting. At the request of the SAB and in response to an issue paper presented by the OPSC, the Implementation Committee was given the task to discuss and develop recommendations for the Financial Hardship (FH) Program.

It was originally the intent of staff to present this item at the August SAB meeting. However, because of the complexity and controversy of the issue, they agreed to hold the item over for one more month to allow another discussion on this topic at the September 2005 Implementation Committee meeting.

The following observations and recommendations were made by staff:

Available Future Capital Facilities Funds/When FH Status Ends
Under current regulations, after the initial request for financial hardship status is granted, no further district encumbrances of existing capital facility funds are approved by OPSC, and all prospective capital facility revenues are deemed available to the State for three years. Staff is concerned that some districts wait until the three-year period is over and then issue COPs, which then can't be captured by the State.

Original Staff Recommendation

> Amend the regulations so that districts are subject to all FH rules until a 100 percent complete final expenditure report is submitted on their last SFP Hardship project. Districts with multiple projects would remain in FH until all FH applications are reported 100 percent complete. Currently, districts are required to file the final SAB 50 –06 (annual expenditure report) for

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three years after the fund release for an elementary school project or four years after the fund release for a middle school or high school project.

Discussion and Revised Recommendation

Members of the committee and audience pointed out that because of litigation and other unforeseen delays, this could mean that a district could be in financial hardship for many years, due to circumstances beyond their control. Staff committed to include language that would give districts other options to the definition of "end of a project", such as occupancy.

Minimum Essential Facilities

Some financial Hardship projects, in order to come within the project budget, must eliminate one or more support facilities, which results in the construction of an incomplete school.

Original Staff Recommendation

Amend regulations to provide that on a case-by-case basis, determined by the SAB, financial hardship districts be allowed to increase grants to finish their schools through local financing, without penalty to their future financial hardship funding. Districts without local financing would have no recourse to increase their grants.

Discussion and Revised Recommendation

There were concerns that the definition of a minimum essential facility (MEF) is limited to the building area identified in current regulations. For instance the allowable area for a multipurpose room or gymnasium might be significantly less than an adequate building as approved in the plans. OPSC indicated that they would consider the building area indicted in the original plans, however, they reserve the right to dispute the facility if it far exceeds the minimum square footage. In response to audience input, staff further agreed that the supplemental funding would not be limited to MEF buildings, but could be extended to site development costs if they are in the plans.

Encumbrances

Staff observed that some school districts are encumbering capital facilities funds within a week of filing their financial hardship request. They provided a chart showing that in 2004/05, 18 districts filed for financial hardship and encumbered 47 percent of their local funds. Although it didn't seem unreasonable to those of us in the audience (many districts have other projects that are not FH and are funded 50/50 or 60/40 with local funds), staff seemed to feel this was money the state should be able to capture.

Original Staff Recommendation

Amend the regulations to state that any encumbrances that were made within one year prior to an FH application would not be recognized and would be captured by the State. This would be a phase-in program beginning September 1, 2005.

Discussion and Revised Recommendation

Discussion was limited, as this issue was clearly not a debatable topic. Several comments were made stating that September 1, 2005 was not sufficient time to phase in new rules, January 1, 2007 was recommended. Staff agreed to October 1, 2005. A few of us in the audience stated that we felt the year prior was too long and that we would express this to SAB members when the regulation moved forward.

Bridge Financing

As previous bond funds have been depleted, regulations permit an FH district to obtain bridge financing until a new State bond is approved. Once the project is funded with new bond funds, the bridge financing loan is repaid. Some districts have not paid off their debt and are using it to meet the 60 percent bonded indebtedness requirement, and therefore can sustain their financial hardship status.

Original Staff Recommendation

The OPSC recommendation was twofold addressing past bridge financing that may be outstanding and future bridge financing.

1. For those past/current bridge financing projects still outstanding, the reimbursement received from the State will be applied against the debt limit (i.e., the debt will count against the district but only in the amount of the original apportionment). The additional debt that may be realized on these prior financings (interest income, debt incurred in excess of project value, etc.) will be treated as available for contribution to an SFP project.
2. In the future if a district uses bridge financing and receives reimbursement, the bridge financing debt will be deemed as repaid. If a District chooses not to retire the debt, the state will not recognize that outstanding debt when calculating its bonded indebtedness.

Discussion and Revised Recommendation

The discussion focused on why districts don't pay off their loans, for instance, if the market offers the opportunity to get a better interest rate. The recommendation is unchanged at this point.

Types of Available Funds
There was a discussion on which types of local funds may be captured by the State. Those discussed were local G.O. bonds, COPs, Mello-Roos funds, developer fees and donations from any source.

Original Staff Recommendation

Staff recommended that all local funds would be subject to the State capture.

Discussion and Revised Recommendation

After a lengthy discussion, OPSC staff acknowledged that there were conditions when local funds might not be considered available. It was acknowledged that staff would have to examine the specific language on income sources before attaching funds. Depending on the final language from staff, it would be wise for districts to evaluate carefully the merits of creating very specific language in bonds, developer fee agreements and for potential gifts.

When developer fees were discussed it was affirmed that in relation to modernization projects, developer fees only could be applied if there was a proven nexus or there was an increase in capacity. However, capacity was defined as an improvement in the facility that would house the students more adequately, not necessarily increase space.

Financial Hardship Districts with Non-Financial Hardship Applications
OPSC staff addressed the situation wherein districts request FH status while they concurrently have an existing non-financial hardship application

Original Staff Recommendation

Provides that the district may encumber funds for the non-financial hardship project after October 1, 2005, but only up to the amount of the SAB noted required local match.

Discussion and Revised Recommendation

Discussion ensued as to the inequity whereby districts with only non-financial hardship projects could expend more than the required match to complete projects. Staff agreed, but it is questionable that the proposed regulation language satisfies this concern. I will provide an analysis on the language after the next Implementation Committee meeting.

Other decisions by the Committee

Life of Financial Hardship Approval

After input from the committee and audience at the July meeting, OPSC agreed to recommend that any financial hardship approval will be good for a one year period instead of the current six month reporting requirement.

Bonded Indebtedness

In the original proposal, OPSC indicated that they would like to see the bonded indebtedness requirement increased (for districts to become eligible for FH) from the current 60 percent to something higher. The final recommendation will keep the debt at its current level.

Modernization

The bulk of the language in the staff proposal related to new construction projects. It was suggested that some of the language should also apply to modernization projects.

We will see the next draft of the revisions to the regulations prior to the next Implementation Committee, and there should be further revisions to the regulations after another Imp Committee discussion. The final forum for input will be to the SAB when the draft regulations are presented to them.