
SENATE COMMITTEE ON EDUCATION

Senator Carol Liu, Chair

2015 - 2016 Regular

Bill No: AB 1195

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Urgency: No

Fiscal: No

Consultant: Lenin Del Castillo

Subject: California Debt Limit Allocation Committee: American Recovery and Reinvestment Act of 2009

SUMMARY

This bill allows the California Debt Limit Allocation Committee (CDLAC) to administer the federal private activity bond authority and issue federal tax-exempt bond funds to finance public school facilities.

BACKGROUND

Existing law:

- 1) Establishes the CDLAC as the state's allocating agency for the award and administration of the limited federal private activity bond authority, called the Private Activity Volume Ceiling. (Government Code § 8869.80)
- 2) Provides for a separate volume ceiling for qualified public education facilities bonds (QPEFBs), which are designed to provide tax-exempt conduit financing for turnkey private development of public elementary and secondary school facilities. The federal Internal Revenue Code (IRC) requires CDLAC to be authorized by the Governor's proclamation or state legislation to administer and allocate the volume ceiling for QPEFBs. (IRC § 142(k))
- 3) Provides for the establishment of charter schools in California for the purpose, among other things, to improve student learning and expand learning experiences for pupils who are identified as academically low achieving. A charter school may be authorized by a school district, a county board of education, or the State Board of Education, as specified. A charter school is typically created or organized by a group of teachers, parents and community leaders, community-based organizations, or an education management organization. (Education Code § 47605, et seq.)
- 4) Establishes the Charter School Facility Grant Program which is intended to provide assistance with facilities rent and lease costs for pupils in charter schools. (EC § 47614.5)

ANALYSIS

This bill permits the California Debt Limit Allocation Commission (CDLAC) to allocate federal tax-exempt qualified public education facilities bonds (QPEFBs) for the development of public education schools and related improvements by adding

references to its authorizing statute in federal law—Internal Revenue Code (IRC) 142(k), including the following:

- 1) The definition of "private activity bond" to include IRC § 142(k).
- 2) The definition of "state ceiling" to include the amount specified by IRC § 142(k).
- 3) The requirement that any allocation of ceiling is irrevocable upon issuance of bonds, and prohibiting any allocation carry forward without the California Debt Limit Allocation Commission's (CDLAC) approval.
- 4) The requirement on a state or local agency to notify the CDLAC in writing after any election to carry forward an allocation.
- 5) Designation of the Treasurer as the State official to certify that the QPEFBs meets the IRCS requirements.

The bill also makes conforming changes to legislative findings and declarations stating CDLACs purposes.

STAFF COMMENTS

- 1) **Need for the bill.** According to the author's office, "public elementary and secondary schools have limited financing options for the construction or improvement of their facilities. In contrast, private developers have more flexibility in their ability to finance transactions and access to resources. In acknowledgement of these differences, Section 142(k) of the federal IRC created a type of tax-exempt private activity bond that can be used to finance school facilities called QPEFB. These bonds are designed to provide tax-exempt conduit financing for turnkey private development of public elementary and secondary school facilities. The tax-exempt private activity bond proceeds can be used to fund the following project: school buildings, any functionally related and subordinate facility and land with respect to a school building, including any stadium or other facility primarily used for school events, and any property subject to accelerated depreciation under Section 168 of the IRC for use in a school facility. QPEFBs are apportioned to the states but fall outside the current limits the federal government places on private activity bond authority. Federal law requires that each state designate an entity to administer QPEFBs in order to allocate the bonds."
- 2) **Charter school facilities.** Unlike traditional public school districts, charter schools are unable to fund facilities with general obligation bonds approved by local voters. A majority of charter schools lease their facilities and pay the associated costs from their operating budgets, with roughly half of them receiving grants from the Charter School Facility Grant Program. This program provides funding for charter schools in non-district facilities that have a specified percentage of students qualifying for free or reduced-price meals at their school or in the surrounding school attendance area. Eligible schools receive funding for lease payments, building improvements, and maintenance.

A majority of the remaining charter schools that do not lease private facilities occupy space provided by school districts. Proposition 39, approved by voters in November 2000, requires a school district to provide a charter school having a projected daily attendance of at least 80 or more students from that district with "reasonably equivalent" facilities to accommodate the charter school's needs. A school district can provide a charter school with existing facilities or use discretionary funds or other revenues, such as local school bond funds, to meet this requirement. A small percentage of charter schools have constructed their own facilities. Given the continuing growth in charter school enrollment combined with limited options to finance facilities, this bill could provide an additional means for charter schools to address their facility needs.

- 3) ***Will it work?*** This bill authorizes a new form of school facility finance, which relies on a public-private partnership agreement. After the issuer sells the bond, the proceeds are loaned to a private for-profit developer, who then uses the proceeds to build the school facility. The facility is then leased to the school on a long-term basis at a cost less than the amount necessary to repay the bonds. The developer attempts to make up the difference by leasing the school facility during off-hours and applying any depreciation deduction from the school to reduce taxable income from other sources. The school's ownership is transferred from the developer to the school when the lease ends.

While qualified public education facility bonds (QPEFBs) were added to the Internal Revenue Code (IRC) as tax exempt facility bonds in 2001, none have yet to be issued. A qualified public educational facility is any school facility which is part of a public elementary school or a public secondary school that is owned by a private for-profit corporation pursuant to a public-private partnership agreement with a State or local education agency. A public-private partnership agreement is required under the IRC for each QPEFB issuance. The IRC defines this as an agreement under which the corporation agree to construct, rehabilitate, refurbish, or equip a school facility, and at the end of the term of the agreement, to transfer the school facility to such agency for no additional consideration, and the term of which does not exceed the term of the issue to be used to provide the school facility. The Treasurer's Office indicates that only Florida and New York have enacted the necessary statutory and regulatory changes, and that the reason for lack of use can be associated with several factors, one of which has to do with the requirement for private ownership and that it is inconsistent with the way in which the current public school system is structured.

- 4) ***CDLAC.*** According to the Senate Governance and Finance Committee, the California Debt Limit Allocation Committee (CDLAC) was created by the Legislature in 1987 to implement the federal Tax Reform Act of 1986. The CDLAC is a three-member body comprised of the State Treasurer as Chair, the Governor, and the State Controller, housed in the Office of the State Treasurer. CDLAC annually determines the ceiling amount under federal law, including any carried forward, and then allocates the annual ceiling to applicants, which include state and local agencies, joint powers agencies, special districts, nonprofit public benefit corporations that only issues student loan bonds, and any other public agency legally empowered to issue debt. No agency can issue tax-exempt private activity bonds without the California Debt Limit Allocation Committee's approval.

- 5) ***California School Finance Authority.*** Schools can apply to the California School Finance Authority (CSFA) in the State Treasurer's Office, which almost exclusively provides financial assistance to charter schools by administering state bond funds, federal and state grants, a revolving loan fund, a credit enhancement grant program, and conduit bond financing. The CSFA was established as a conduit to secure financing for working capital and facilities projects for school districts, charter schools and community college districts. The CSFA operates under the Treasurer's Office. According to the Treasurer's Office, because school districts and community colleges are able to issue general obligation bonds on their own, the CSFA has provided financing mostly to charter schools. Over the last four years, CSFA has issued \$279.6 million bonds for 120 charter school facilities. Charter schools are the obligor and make bond payments through an intercept process whereby the State Controller intercepts or redirects state funds allocated to charter schools to make bond payments. According to the CSFA, bonds are typically sold to large institutional investors, with interest rates ranging between 4.19% to 7.58% over the last four years.

SUPPORT

State Treasurer (sponsor)

OPPOSITION

None received.

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