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SCHOOL FEES:

DO'S, MUSTS AND DO NOTS

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I. INTRODUCTION

The following is intended as an overview of the requirements for the levying and collecting of school fees (“School Fees”) and includes: (i) the adoption and justification of statutorily authorized School Fees; (ii) establishing a “nexus” and addressing issues related to declining enrollment and redevelopment projects; (iii) properly managing School Fee expenditures; and (iv) proper reporting of School Fees in the Annual and Five Year Reports.

School Fees are generally insufficient to fund the school facilities necessitated by new development, even when coupled with available State of California (“State”) funding. The actual cost to provide school facilities to the students generated by new development in most instances is greater than the resulting School Fees levied against that development.

II. BRIEF HISTORY ON SCHOOL FEES

In 1986, the California Legislature enacted Assembly Bill 2926 (“AB 2926”), Chapter 887 of the Statutes of 1986 (Government Code Sections 53080, *et seq.*, and 65995, *et seq.*). In part, AB 2926, for the first time, granted school districts the authority to impose school fees upon new development projects to help fund the construction of public school facilities. Pursuant to AB 2926, Government Code Section 53080¹ authorized school districts to levy school fees on new development projects, subject to the limits imposed by Government Code Section 65995(b). As established in 1986, a cap of \$1.50 per square foot on new assessable residential construction was authorized. AB 2926 school fees are adjusted biannually for inflation by the State of California, State Allocation Board. (Government Code Section 65995(b)(3).) These fees are commonly referred to as “Level 1 Fees.”

On November 3, 1998, the California voters approved Proposition 1A, the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998. The approval of Proposition 1A resulted in the provisions contained in Senate Bill 50 (“SB-50”) of the Leroy F. Greene School Facilities Act of 1998 becoming effective. Included within the provisions of SB-50, was the authorization for school districts to levy “alternative school fees” or what have become known as “Level 2 Fees” and “Level 3 Fees”. (Government Code Section 65995.5, 65995.6 and 65995.7.) (Level 1 Fees, Level 2 Fees and Level 3 Fees are collectively referred to herein as “School Fees”).

III. JUSTIFYING THE LEVY OF SCHOOL FEES

A. Fee Justification Studies, Level 1 Fees and Commercial/Industrial Fees

In order to levy School Fees, a school district must prepare a report justifying the levying of such School Fees. A Fee Justification Study (“FJS”) is prepared to serve as the basis for justifying the adoption of statutory Level 1 Fees, pursuant to Education Code Section 17620 and Government

¹ Government Code Section 53080 was renumbered as Education Code Section 17620 pursuant to Senate Bill 1562 (Chapter 277, Section 3).

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Code Section 65995. The Level 1 Fee, on a K-12 basis, is presently \$3.36 per square foot of assessable space of a new residential dwelling unit (“DU”) and \$0.54 per square foot of covered and enclosed new commercial/industrial construction (“Commercial/Industrial Fees”) located within the boundaries of a K-12 school district. The Level 1 Fees, if justified, may be levied in the maximum amount by a unified school district or, must be divided among the applicable non-unified school districts (elementary school district(s) and high school district).

The Level 1 Fees and Commercial/Industrial Fees may be increased for inflation by the State Allocation Board (“SAB”) on a bi-annual basis. The next increase will likely be approved in January, 2016.

1. Applicable Law and Timing of Adoption of Level 1 Fees and Commercial/ Industrial Fees

In preparing an FJS for Level 1 Fees and Commercial/Industrial Fees, school districts should be aware of the applicable statutory provisions, which include Education Code Sections 17620 and 17621, as well as Government Code Sections 65995, 66001 and 66016 *et seq.* Because the SAB approves increases in the Level 1 Fees and Commercial/Industrial Fees every two years, the FJS must likewise be prepared or updated by supplemental documentation every two years by school district staff or by a consultant retained by the school district. In order to save costs, some school districts have not completed an entirely new FJS every two years, but rather, have utilized a memorandum update of their most recent FJS. Caution should be given that any documentation supporting the increase or levying of Level 1 Fees must be adequate and sufficient to support the authority for the levying of the fees. In any FJS or supplement thereto, consideration must be given to establishing the necessary “nexus” findings as set forth by the court in *Shapell Industries, Inc. v. Governing Board of the Milpitas Unified School District* (1991) 1 Cal.App.4th 218.

2. Preparation of an FJS for Level 1 Fees and Commercial/ Industrial Fees

As mentioned above, the FJS must make determinations in satisfaction of the requirements of Government Code Section 66001 and establish a nexus between the type of development in the particular school district and the amount of fees to be levied upon such development based upon the need for such fees. The specific findings required are as follows:

- a. Identify the purpose of the fee;
- b. Identify the use to which the fee is to be put;
- c. Determine how there is a reasonable relationship between the fee’s use and the type of development project on which the fee is imposed; and
- d. Determine how there is a reasonable relationship between the need for the public facility and the type of development on which the fee is imposed.

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In accordance with the ability to impose Level 1 Fees and Commercial/Industrial Fees, the FJS should include separate analyses with regard to the proposed residential development and commercial/industrial development. Therefore, each such analysis shall be discussed separately.

3. Residential Development Analysis

The residential development portion of the FJS should include an analysis of the extent to which a nexus can be established in the school district between residential development, the need for school facilities and the amount of Level 1 Fees per square foot that may be levied for the needed school facilities.

In particular, such analysis should include information regarding school facilities capacity and enrollment, housing projections, student generation, facility needs, facility costs within the school district and the need for the school district to levy School Fees to meet the need for new school facility costs. Housing projections should be broken down into the appropriate residential land use designations, such as single family detached or multi-family attached DUs. Moreover, DUs should be separated into mitigated (i.e. those DUs which are part of a community facilities district or a mitigation agreement and thus have already mitigated their school facility cost impacts on the school district) and unmitigated DUs within the school district. The school district will need to determine by utilization of its student generation factors the projected number of students anticipated to occur from the proposed future development. After examining the school district's existing capacity to accommodate these projected students, the number of unhoused students can be determined and the amount of school facilities to accommodate these unhoused students can be calculated along with the resulting costs of providing such facilities.

Finally, the school facility cost impacts for each type of DU can be calculated on a per square foot basis. Many times, the facility cost impact per square foot exceeds the maximum Level 1 Fee authorized by law, which is currently \$3.36 per square foot of assessable space. This facility cost impact per square foot therefore illustrates that the school district is justified in collecting the maximum amount of Level 1 Fees prescribed by law per square foot.

4. Commercial/Industrial Development Analysis

The commercial/industrial development portion of the FJS must establish a nexus in the school district between the categories of commercial/industrial development specified by Education Code Section 17621(e)(1)(A) and the need for school facilities, the cost of school facilities and the amount of Commercial/Industrial Fees per square foot that may be levied for school facilities. Relevant commercial/industrial development categories include, retail, office, research and development, industrial/warehouse/manufacturing, hospital and hotel/motel development. In establishing this nexus, the various categories are analyzed to project an estimated number of employees that will have children that will impact the school district's school facilities. The employment impacts per category are used to estimate the facility cost impacts and to justify the levying of the Commercial/Industrial Fees.

5. Adoption Process and Additional Recommendations

The procedure for adopting an FJS, and thus the Level 1 Fees and Commercial/Industrial Fees, involves holding a public hearing after a public review period during which time the completed FJS must be made available to the public for at least ten days. In addition, applicable mailing, posting and publishing notice requirements must be met. Because the SAB does not usually approve and announce the increased fee amounts until its meeting in late January, we recommend scheduling the public hearing in mid-February. After the public hearing has been conducted and the appropriate resolution and FJS are adopted, the Level 1 Fees will not take effect until sixty days after adoption, unless an urgency resolution has been adopted. Up to two urgency resolutions may be adopted. These provide interim authorization for the adopted Level 1 Fees and Commercial/Industrial Fees to be levied for thirty days per urgency resolution. Each urgency resolution, if applicable, should be adopted as part of a noticed public hearing and requires a 4/5ths vote of the governing board of the school district. Specific findings must be made regarding a current and immediate threat to the public health, welfare or safety.

As a general matter, we recommend that this adoption process be completed separately from any proceedings related to the adoption of a School Facilities Needs Analysis (“SFNA”) (discussed below). In particular, the SFNA adoption process varies substantially from the Level 1 Fees and Commercial/Industrial Fees adoption process and undertaking both proceedings simultaneously can easily create confusion and frustration. Once adopted, the school district should file a copy of its FJS, resolution, boundary map and any other related documentation relied upon in adopting the Level 1 Fees and Commercial/Industrial Fees with all the relevant local planning agencies responsible for issuing building permits within the school district.

B. School Facilities Needs Analyses and Level 2 and Level 3 Fees

1. Description/Purpose and Applicable Law

With the adoption of SB 50 and Proposition 1A in 1998, school districts that satisfy two of the four statutory requirements of Government Code Section 65995² have the option, upon meeting certain requirements, of adopting Level 2 Fees or Level 3 Fees (sometimes referred to as “Alternative School Facility Fees,”) in accordance with Government Code Sections 65995.5, 65995.6 and 65995.7. Each school district, unified or not, has its own Level 2 Fee or Level 3 Fee. Additionally, non-unified school districts do not share such amounts with other applicable non-unified school districts as do overlapping non-unified school districts with regard to Level 1 Fees and Commercial/Industrial Fees. As illustrated below, the preparation requirements for Level 2 and Level 3 Fees differ significantly from the FJS preparation requirements. Moreover, the Level 2 and Level 3 Fees, which are individually calculated for each school district, apply solely to residential construction within a school district and are not statutorily set by the SAB as is the Level 1 Fee.

² SUHSD presently meets only one of such statutory requirements.

2. Eligibility to Adopt Level 2 Fees and Level 3 Fees and Timing of Preparation of SFNA

In order to adopt Alternative School Facility Fees, a school district must satisfy two of the four prerequisites of Government Code Section 65995.5, and then prepare and adopt an SFNA, following the specific mandates regarding the contents of the SFNA as well as procedures required for its adoption. Specifically, a school district must first make a timely application for State Funding to the SAB, which includes the completion and filing of Forms SAB 50-01, 50-02 and 50-03. Such forms may be completed by school district staff and/or with the assistance of a consultant. Subsequent to making such application, the school district must also either receive an eligibility determination (“ED”) from the SAB regarding its application or will be deemed to have received such ED after the passage of one hundred twenty days without a response from the SAB. In addition, the school district must meet two of four of the following specific requirements which relate to: (i) the percentage of “substantial enrollment” of the school district’s multi-track-year-round education; (ii) meeting specified debt capacity requirements; (iii) holding a local general obligation bond election within the past four years which received at least fifty percent plus one of all votes cast and; (iv) the percentage of relocatable classrooms within the school district. A school district which meets these various requirements may commence the process of preparing or revising an SFNA and adopting the Alternative School Facility Fees. It is important to note that an SFNA is only valid for a one year time period. Therefore, school districts need to schedule their next annual SFNA in sufficient time to avoid a lapse in the Alternative School Facility Fees. Should such lapse occur, school districts would be able to levy Level 1 Fees, provided the school district has an FJS in place.

3. Preliminary Considerations

If a school district meets the above-described eligibility requirements, it may proceed to prepare an SFNA and adopt Alternative School Facility Fees. School districts may desire to obtain an estimate of the potential amount of its Level 2 Fee prior to preparation of the SFNA. For example, if a school district’s Level 2 Fee is less than the current Level 1 Fee, a school district will not need to adopt an SFNA unless, there is a reasonable possibility that school districts would be able to levy Level 3 Fees. For those school districts that cannot justify a Level 2 Fee, they should still monitor the current status of the issues relating to availability of State funding for new construction in the event the possibility of levying Level 3 Fees exist.

4. Preparation of an SFNA

As mentioned above, the format of an SFNA will vary significantly from that of an FJS. Because the SFNA contains significantly more statutorily prescribed information than the FJS, we recommend that the statutory requirements be strictly followed and referred to within the SFNA. Specifically, the crucial consideration is to provide the information required in Sections 65995.5, 65995.6, 65995.7 and 66000 *et seq.* of the Government Code. In preparing the SFNA, the school district should work closely with its consultant and legal counsel to ensure the SFNA is prepared thoroughly and in accordance with statutory requirements. Moreover, a school district should plan ahead and give itself sufficient time to complete a potentially lengthy preparation and adoption process.

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The following is a partial summary of specific items recommended to be considered in the preparation of an SFNA:

- a. In order to satisfy the nexus requirements of Section 66000 *et seq.* of the Government Code, costs of school facilities at elementary, middle and high school grade levels based on a school district's school facility planning policies should be included in the SFNA as an exhibit or attachment to the SFNA.
- b. The SFNA should include a factual discussion to serve as the basis for satisfying two of the four statutory requirements which are prerequisites to adopting Alternative School Facility Fees. These criteria are found in Government Code Section 65995.5(b)(3)(A)(B)(C) and (D).
- c. The SFNA should include an analysis of the historical Student Generation Factor ("SGF") of new residential DU constructed in the previous five years in the school district, or the city or county in which the school district is located.
- d. A school district should make a determination as to probable future DU by product type in the next five years. This determination will be based on information from the relevant cities, counties and planning agencies. Future DU in a community facilities district or covered by a mitigation agreement should not be considered, although the SFNA should identify the total projected DU in the next five years and then distinguish such mitigated units from non-mitigated units.
- e. The SFNA should identify and consider existing or unused seating capacity by looking at current student enrollment in relation to "Existing School Building Capacity" as defined in Section 17071.10 of the Education Code. The Existing School Building Capacity should be what the school district has determined and set forth on its SAB Form 50-02.
- f. The SFNA should identify and consider any surplus sites as well as any local funding sources other than fees, charges and dedications imposed on residential construction which are available for school facility construction purposes. The amount of local funds must be deducted in the calculations for determining the Alternative School Facility Fees. The school district need not commit all or any specific portion of such identified amounts to the needs occurring in the next five years. Instead, a school district, in its discretion, may make an allocation of such amounts to meet the existing needs in its education system to fund future development outside of the period identified in the next five years. In addition, local funding sources might include unencumbered general obligation bond funds. In those instances in which the bond funds were designated to meet existing school facility needs, they may not be appropriately utilized for future new development impacts.

- g. As a school district's school facilities costs may well exceed the fifty percent and one hundred percent thresholds of which the respective Level 2 Fees and Level 3 Fees are intended to cover, the school district's SFNA should include a section which sets forth to the best of its ability, the school district's actual anticipated school facility costs. This might be accomplished with the help of the school district's architect, and could be in the form of an exhibit to the SFNA. On this basis, it can be determined what the actual, roughly proportional, and reasonably related school facilities costs are to the school district. In most instances, these costs will be greater than the Level 2 and Level 3 Fees, therefore providing a factual basis that the Level 2 and Level 3 Fees are roughly proportional and reasonably related to, the amounts proposed for levying.

In general, the structure, format and wording of an SFNA should be easily understood. Also, all facts, rationale and reasons leading to conclusions set forth therein should be set forth as opposed to mere unsubstantiated conclusions. When information is derived from other sources or documents, such information should either be incorporated by reference or included as attachments or exhibits to the SFNA. Where information is specifically required by statute, the consultants should not improvise or substitute their own opinions, but follow the mandates and dictates of the applicable statutory provisions.

5. Adoption Process and Additional Recommendations

The SFNA adoption process also requires strict compliance with statutory requirements and differs substantially from the adoption process related to the FJS and the Level 1 Fees and Commercial/Industrial Fees. Government Code Section 65352.2 requires that the a school district notify the planning commission or agency of the cities and county with land use jurisdiction within the school district when the school district is preparing a SFNA, a master plan, or other long-range plan that relates to the potential expansion of existing school sites or the necessity to acquire additional school sites and provide the opportunity for these entities to meet with the District at least 45 days prior to the completion. The cities or county may request a meeting to discuss methods of coordinating planning, design, and construction of new school facilities and school sites or park and recreation facilities. In many instances the meeting is used by the local cities and county to discuss the details of the upcoming SFNA and the Level 2 Fee, rather than coordination of facilities as was the expressed aim of the statute. Regardless, it is important for school districts to give the cities and county the opportunity to meet and confer before adopting the SFNA as failure to do so may affect the validity of the fee. Also, failure to do so affects the ability of a school district to overrule zoning when acquiring a school site.

The final SFNA must be available to the public for thirty days prior to its adoption. Any substantive changes to the SFNA during this period will re-start this thirty day period. Accordingly, we recommend an informal review of the SFNA be conducted prior to commencing the official public review period. This approach may assist the school district in avoiding having to make revisions to the SFNA and commencing an additional thirty day public review period as provided in Government Code Section 65995.5.

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After the appropriate thirty day public review, newspaper publication, posting and distribution requirements have been met, the school district's governing board must conduct a public hearing at which time the governing board must respond to written comments it has received on the SFNA. If a school district receives written comments on the SFNA during the public review period, such comments should be forwarded to legal counsel as soon as possible for review. The governing board should close the public hearing after all comments, oral and written, have been received into the record. The governing board may receive written responses to the public comments drafted by its consultant, staff or and/or legal counsel. To assist in the public hearing process, if necessary, the consultant who prepared the SFNA and/or legal counsel should be present at the public hearing to address questions by the governing board and assist with comment responses. If several written comments have been received, it may be helpful to assemble a transcript of comments received and responded to for use at the public hearing.

Once the public hearing has been closed, comments have been addressed and the governing board desires to adopt the SFNA and Alternative School Facility Fees, it adopts the appropriate resolution and the Alternative School Facility Fees become effective immediately for a maximum of one year. The Alternative School Facility Fees must be justified on an annual basis following the same procedures as herein identified. We recommend that a school district complete relevant affidavits and declarations regarding compliance with the applicable procedural requirements in the event a challenge is made regarding the adoption process. Additionally, upon adoption, all documentation relied upon in adopting the Alternative School Facility Fees, including the SFNA, the adopted resolution and a map of the school district's boundaries should be filed with all relevant cities and counties in which the school district is located.

IV. NEXUS ISSUES – DECLINING ENROLLMENT, REDEVELOPMENT

Perhaps the most common issue raised by developers when challenging an FJS or SFNA is the claim that the school district has failed to establish a reasonable relationship between the proposed development and the mitigation fee to be imposed on the project. The leading case which sets forth the test to be used to determine if the “nexus” has been established is *Shapell Industries, Inc. v. Governing Board* (1991) 1 Cal.App.4th 218 (“*Shapell*”).

In *Shapell*, the court concluded that “facilities fees are justified only to the extent that they are limited to the cost of increased services made necessary by virtue of the development.” (*Shapell*, supra, at p. 235.) In order to be valid, the school board must show that there is a valid method used “for arriving at the fee in question, one which established a reasonable relationship between the fee charged and the burden posed by the development.” (Id.)

In *Shapell*, a developer brought an action challenging the resolutions adopted by a school district's governing board authorizing the levying of school facility fees on new residential, commercial and industrial development throughout the district. The *Shapell* court established a test to determine if a reasonable relationship existed between the fee charged and the burden imposed by the development. This test requires 3 elements:

1. Since the fee is to be assessed on a per square foot of development, there must be a projection of the total amount of new housing expected to be built within the school district.

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2. In order to measure the extent of the burden imposed on schools by new development, the school district must determine approximately how many students will be generated by the new housing.

3. The school district must estimate what it will cost to provide the necessary school facilities for that approximate number of new students. (Id. at p. 235.)

It is through the FJS and the SFNA that the school district identifies the anticipated burden that new development will cause on the school district's school facilities. Issues pertaining to the nexus requirement are often manifested in one of two scenarios: declining enrollment and redevelopment.

A. Declining Enrollment

Whether as a result of a slowdown in birthrates within California, the economic downturn, or migration to other states, many California school districts are experiencing a decline in enrollment. Assuming a school district does not have sufficient excess capacity to accommodate the impact from new development and assuming the statutory requirements are met, a school district can assess developer fees while experiencing declining enrollment.

B. Redevelopment

Developers often challenge the assessment of fees against projects that involve demolition of existing structures, which are then replaced by new structures. The question often arises, whether fees should be charged against such redevelopment.

In considering a redevelopment project, the school district needs to analyze the "nexus" requirements of Government Code Section 66000 *et seq.* Specifically, Government Code Section 66001(a) requires an identification of the purpose and use of the fees. Government Code Section 66001(a) additionally requires a showing that there is a reasonable relationship between the fee's use, the type of development project on which the fee is imposed, and the need for the school facility.

If residential redevelopment is likely to occur within a school district, we recommend the school district work with the consultant drafting the SFNA or FJS to ensure the report accurately considers redevelopment within the district. In addition, when school districts receive questions pertaining to the levy of School Fees on residential redevelopment, we recommend that they consult with legal counsel to verify that they are charging the correct school fee amount.

To briefly summarize, the California Court of Appeal has applied the Shapell "nexus" analysis to the situation where school impact fees are sought for replacement housing by a school district. (*Warmington Old Town Associates v. Tustin Unified School Dist.* (2002) 101 Cal. App. 4th 840). That case stands for the proposition that although statutes do not require a district to exclude preexisting square footage from the fees for new residential construction, a school district could include the preexisting square footage only if its fee study determined that reconstruction of preexisting square footage contributes to an increase in student population. Thereafter, the California Court of Appeal further clarified its stance regarding school impact fees in connection with

replacement housing in *Cresta Bella, LP v. Poway Unified School Dist.* (2013) 218 Cal. App. 4th 438. The court in *Cresta Bella* upheld the principle of imposing fees on the increased square footage beyond what was previously in place, while also determining that the school district in that case failed to establish the nexus between the preexisting square footage and an increase in student population. Thus, while the statutory scheme governing School Fees does not mandate that the school district provide the developer a credit for the preexisting square footage of the replacement housing, applicable caselaw requires that any proposed imposition of fees on preexisting square footage nevertheless must pass muster under the “nexus” requirement as set forth in *Shapell* and subsequently clarified in *Warmington* and *Cresta Bella*.

Education Code Section 17626 contains an exemption for School Fees for the reconstruction of any residential, commercial, or industrial structure that is damaged or destroyed as a result of a disaster. Disaster is defined as: “a fire, earthquake, landslide, mudslide, flood, tidal wave, or other unforeseen event that produces material damage or loss.” The exemption does not apply for the square footage of the reconstructed structure that exceeds the square footage of the structure that was damaged or destroyed.

V. PROPERLY MANAGING EXPENDITURES: ON WHICH TYPES OF PROJECTS MAY SCHOOL FEES BE EXPENDED?

A. Law Governing Expenditures

School districts should be careful to ensure that they are complying with the law governing school fee expenditures.

California Education Code Section 17620 (a)(1) authorizes school districts to use previously collected School Fees for “the purpose of funding the construction or reconstruction of school facilities” subject to limitations set forth in Government Code Section 65995 et seq. In general, Education and Government Code sections require that a school district be able to show a reasonable relationship between the impact of the development and the use of the fees. (See, e.g., Ed. Code § 17621 and Gov. Code § 66001, subdiv. (b).) The school district may not, therefore, use School Fees to fund construction that the school district would or should perform in the absence of the new development. This important policy is set forth in case law as well:

While it is “only fair” that the public at large should not be obliged to pay for the increased burden on public facilities caused by new development, the converse is equally reasonable: the developer must not be required to shoulder the entire burden of financing public facilities for all future users. “[T]o impose the burden on one property owner to an extent beyond his [or her] own use shifts the government’s burden unfairly to a private party” **It follows that facilities fees are justified only to the extent that they are limited to the cost of increased services made necessary by virtue of the development.** (*Shapell* at 234-235 (emphasis added).)

B. Expenditure of School Fees

Education Code Section 17620(a)(1) authorizes the levying of developer fees for the purpose of funding the “construction or reconstruction of school facilities”. The terms “construction and reconstruction” are not specifically defined for purposes of expending School Fees. The term “school facility,” however, is defined as “any school-related consideration relating to a school district’s ability to accommodate enrollment.” (Gov. Code § 65995, subdiv. (e).). Additionally, Education Code Section 17620(a)(5) specifically allows school districts to use developer fees to pay for the costs of performing any study or otherwise making the findings required to levy the authorized School Fees. In addition, an amount up to 3% of the Level 1 Fees collected per fiscal year may be used for reimbursement of administrative costs incurred by the entity collecting the fees.

School districts often inquire as to which expenditures can be made with collected developer fees. The following list addresses several types of expenditures and the use of developer fees.

1. New Construction

Level 1 Fees may be spent on new construction projects that create new capacity to accommodate new students that result from new construction. Level 2 and Level 3 Fees may only be spent on the school facilities identified in the SFNA.

2. Modernization

Level 1 Fees may be spent on modernization projects to the extent the projects add new capacity to accommodate new students that result from new construction.

3. Regular Maintenance/Routine Repair

Pursuant to Education Code Section 17620(a)(3)(A), Level 1, 2 and 3 Fees may not be spent on the regular maintenance or routine repair of school buildings and facilities.

4. Asbestos Projects

Pursuant to Education Code Section 17620(a)(3)(B), Level 1, 2 and 3 Fees may not be spent on the inspection, sampling, analysis, encapsulation, or removal of asbestos-containing materials, except where incidental to school facilities construction or reconstruction.

5. Deferred Maintenance

Pursuant to Education Code Section 17620(a)(3)(C), Level 1, 2 and 3 Fees may not be spent on deferred maintenance. Deferred maintenance projects include: major repair or replacement of plumbing, heating, air conditioning, electrical, roofing, and floor systems, the exterior and interior painting of school buildings, the inspection, sampling, and analysis of building materials to determine the presence of asbestos-containing materials, the encapsulation or removal of asbestos-containing materials, the inspection, identification, sampling, and analysis of building

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materials to determine the presence of lead-containing materials, the control, management, and removal of lead-containing materials, and any other items of maintenance approved by the SAB.

6. Non-Facilities Costs

Pursuant to Education Code Section 17620(a)(5), Level I Fees may be spent on the following non-facilities costs: the costs of conducting an SFNA and FJS, and preparing the Annual and Five-Year Report. In addition, a school district may also retain “an amount not to exceed, in any fiscal year, three percent of the fees collected in that fiscal year pursuant to this section. . . .” The three percent amount is for the reimbursement of administrative costs incurred in collecting the fee. For school districts that levy a Level 2 or Level 3 Fee, the three percent amount is calculated only on the amount of Level 1 Fees collected.

A school district may retain no more than three percent of the Level 1 Fees collected in that fiscal year on residential and commercial/industrial construction for administrative costs in collecting all developer fees. These costs may include providing adequate staff, consultants and legal counsel to oversee and verify compliance. School district personnel who provide these services may be compensated, up to the three percent limit, from developer fees. Presumably, this would not be the sole function of such personnel; thus, a reasonable allocation of their duties relating to the administration of collecting developer fees can be funded through the developer fees fund.

VI. PROPER REPORTING – ANNUAL AND FIVE YEAR REPORTS

A. Applicable Law

The preparation and adoption processes of the FJS and SFNAs discussed above relate to the varying amounts of fees a school district may impose on residential and/or commercial/industrial development within the boundaries of a school district. Once such reports have been adopted and the applicable fees are being collected, school districts also have certain responsibilities with regard to reporting the actual amounts of School Fees collected over a specified period of time. Specifically, school districts must comply with “Annual Reporting” as well as “Five-Year Reporting” requirements, and make certain findings, as set forth in Government Code Sections 66006 and 66001, respectively. The fees collected by school districts which are subject to these reporting requirements include both Statutory School Fees and Alternative School Fees (collectively, “Reportable Fees”). Although Reportable Fees do not by definition include mitigation payments received by a school district pursuant to a mitigation agreement for purposes of the Annual Report, information regarding mitigation payments collected by a school district may need to be included in the Five-Year Report findings, where consultants prepare such studies, as further discussed below. Unlike the FJS and SFNA preparation processes, the Annual Reporting and Five-Year Reporting processes are ones which many school district business officials prepare in-house from information within the school district’s files and with the assistance of legal counsel.

B. Preparation of an Annual Report

As indicated by its name, the Annual Report must be completed every year. However, to ensure that the appropriate requirements are complied with at the appropriate times, (as further

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discussed below with regard to preparation of the Five-Year Report), we recommend that school districts comply with both the Annual Reporting and Five-Year Reporting requirements simultaneously each year, assuming doing so does not create disproportionate burdens on school district staff. For purposes of this discussion, however, we will address the respective Annual Reporting and Five-Year Reporting requirements separately, below.

1. Timing of Preparation

The Annual Reports must be made available to the public within one hundred eighty days after the last day of each fiscal year and fifteen days prior to the public meeting of the school district's governing board to consider and act upon the Annual Report. This means that school districts may begin preparing the Annual Report as early as July of each year, but should plan on beginning the preparation process no later than late October to ensure timely compliance and avoid incurring the penalty of refunding any unexpended amounts (discussed below). We wish to emphasize that although the governing board meeting at which the Annual Report is considered and adopted may occur more than fifteen days after the Annual Report is made available to the public for public review, the Annual Report must be made available to the public pursuant to Government Code Section 66006(b)(1) by the one hundred eightieth day after the last day of each fiscal year.

2. Information to be Reported

The type of information required to be included in the Annual Report generally relates to an accounting of the types and amounts of fees collected by the school district, as well as some information regarding the specific expenditures of the Reportable Fees by the school district during the reported fiscal year. Specifically, the Annual Report must include a description of the type of fees (i.e. the Reportable Fees) collected by the school district, the various amounts which may be collected by the school district, the beginning and ending balance of the appropriate accounts and sub-accounts of the school district, as well as the total amounts collected and interest earned. In addition, the school district must include specific and detailed information relating to each project on which Reportable Fees were expended, including the percentage actually funded by Reportable Fees for each project, the dates for commencement of construction for any incomplete projects for which sufficient funds have been collected, descriptions of any interfund transfers or loans made (including amount, date of repayment and rate of interest) as well as the amount of any refunds made where the administrative costs of refunding unexpended revenues is greater than the amount to be refunded. Such information should be obtained from the school district's internal business records, and for ease in preparation of the Annual Report, we suggest that school district business officials keep a separate file of this information. The file should include all relevant information to assist in making the required findings, and the school district business official may wish to continually monitor individual expenditures made on each project (i.e., to assist with the calculations relating to percentages of Reportable Fees expended on particular projects).

C. Preparation of a Five-Year Report

1. Timing of Preparation

Pursuant to Government Code Section 66001, the Five-Year Report must be completed by a school district every fifth fiscal year following the first deposit into the account or

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fund in which Reportable Fees are deposited. In addition, the Five-Year Report must include certain findings with regard to the portion of the account or subaccount that remains unexpended, whether or not such funds are committed or uncommitted to specific school facilities projects. In addition, Government Code Section 66006 mandates that if the five year findings are not made at the appropriate juncture, school districts must refund any unexpended moneys. In order to avoid possible confusion over the appropriate year in which to make the Five-Year Report findings, due to changes in personnel, for example, and to avoid risking this penalty provision, we recommend that the Annual Report and Five-Year Report be prepared each year. In addition, as the findings of the Five-Year Report, when it is prepared, must be prepared in conjunction with the information made available in the Annual Report, we suggest that all of the appropriate findings be included as the second portion of one comprehensive document.

2. Information to be Reported

The additional findings required to be included in the Five-Year Report can be generalized as an expansion of the findings included in the Annual Report and require more detailed information regarding the specific school facility projects of the school district. Such information causes the school district to illustrate the extent to which the Reportable Fees are required to service the school facility needs of the school district and the status of any progress made to satisfy such school facility needs identified by the school district. Initially, we wish to note that the Five-Year Report need not include a comprehensive account of the required findings for the entire previous five year period, but is a “snapshot” of the current fiscal year in which the Five-Year Report must be prepared. However, some school districts prefer to include such a comprehensive analysis in its Five-Year Report.

The specific information to be set forth in the Five-Year Report includes identifying the purpose to which the Reportable Fees are to be put and demonstrating a reasonable relationship between the Reportable Fees and the purpose for which they are charged. In this regard, findings may be made by identifying school facilities needs of the school district which are created by new development within the school district, where sufficient capacity in existing school facilities to accommodate such new students does not exist and establishing that such Reportable Fees do not exceed the costs of providing such school facilities for new students. In addition, the school district must identify all sources and amounts of funding anticipated to complete the financing of incomplete projects, as well as the approximate date on which such funding is expected to be deposited. Such funding is not limited to Reportable Fees, but may include State Funding actually apportioned to the school district pursuant to the Leroy F. Greene School Facilities Act of 1998. In addition, such funding may include general obligation bond proceeds which have been received and are committed to a specific project (or if not committed, include an explanation therefore), community facilities district proceeds, redevelopment funds, mitigation payments, certificates of participation proceeds and other related sources of funding.

In addition, if sufficient funds have been collected for funding any specific public improvement which is funded in whole or in part by Reportable Fees, and the specific public improvement remains incomplete, the school district must identify an approximate date as to when the construction of the public improvement will be commenced. A school district must identify this date within one hundred eighty days of making such a determination. Otherwise the school district is required to refund the unexpended money in such accounts or sub-accounts to the parties who

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paid such funds to the school district pursuant to Government Code Section 66001. As school districts presumably do not generally collect sufficient funds for any specific project, there may be no issue as to any potential refunds; however, a finding or findings to support such a conclusion should be made in the Five-Year Report.

D. Adoption Process and Additional Recommendations

The adoption process for the Annual Reports and Five-Year Reports is similar to that of the FJS and SFNA adoption processes, although a formal public hearing is not required and the requirements vary slightly. The public review period, as mentioned above, is fifteen days prior to a regular meeting of the governing board of the school district, at which the Annual Report and/or Five-Year Report is considered and adopted by resolution. In addition, the school district must comply with a fifteen day mailed notice requirement. We also recommend that a notice of the public meeting be published and posted at least ten days prior to the regular meeting.

In regard to both the Annual Report and Five-Year Report, for easier tracking and reporting purposes of funds collected by a school district, we recommend that school districts establish three to five, separate subaccounts, as applicable, for each level of School Fees (Level 1 Fees, Level 2 Fees and Level 3 Fees) as well as for mitigation payments and Commercial/Industrial Fees collected by the school district. Moreover, school districts should ensure that the expenditures of their various School Fees clearly relate to the accommodation of new students generated as a result of new construction within the school district. In addition, a limited portion of such School Fees may be expended on certain administrative and adoption costs. If a school district expends any of its School Fees on items not related to accommodating students generated from new construction within the school district, the school district should expect to provide justification of the appropriateness, nature and purpose of each such expenditure.

VII. CONCLUSION

As illustrated by the above discussion, California school districts are charged with significant and varying responsibilities in both the requirements they must follow to justify, adopt, expend and report School Fees. Although the individual processes can seem overwhelming, each process should be approached and undertaken separately, while keeping in mind the overall purpose of the combination of the processes and requirements. Approaching each process separately will ease the burden on school district staff of complying with several varying procedures and requirements simultaneously.

In addition, enlisting the assistance of consultants and legal counsel will assist in satisfying the applicable requirements, although school district staff should remain highly involved in each process. Similarly, coordinating with consultants to prepare the FJS, SFNA and related updates may provide school districts with the opportunity to incur less consulting costs, while school district staff may primarily rely on internal efforts to complete the Annual Reporting and Five-Year Reporting requirements. In this manner, all school districts may strive to more easily comply with all applicable reporting requirements in an efficient, thorough and timely manner.