SENATE COMMITTEE ON EDUCATION
Senator Carol Liu, Chair
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Bill No:	AB 1198		
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Urgency:	No	**Fiscal:**	Yes
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Subject: School facilities: California School Finance Authority: California Credit Enhancement Program

SUMMARY

This bill establishes the California Credit Enhancement Program within the California School Finance Authority (CSFA) to provide lower cost alternatives for public school facilities financing through public-private partnerships.

BACKGROUND

Existing law:

1) Establishes the CSFA Act, and makes findings and declarations regarding the interest of the state and its people for the state to reconstruct, remodel or replace existing school buildings that do not meet structural safety requirements; acquire new school sites and buildings for school districts, charter schools and community college districts; and assist school districts and community college districts by providing access to financing for working capital and capital improvements. (Education Code § 17170 and § 17171)

2) Establishes the CSFA, comprised of the Treasurer or his/her designee, who serves as the Chairperson; the director of the Department of Finance or his/her designee; and the Superintendent of Public Instruction or his/her designee. (EC § 17172 and § 17174)

3) Specifies the powers and authorities of the CSFA, including the authority to issue revenue bonds to provide funds for the financing or refinancing of a single, a series or several projects, or financing of working capital for a single party or several participating parties. Expresses the intent of the Legislature to provide financing only for projects demonstrated by the participating party to be financially feasible, and specifies that revenue bonds are not and shall not be deemed to constitute a debt or liability of the state, obligate the state to pay the principal or interest, or obligate the state to levy or pledge any form of taxation or make any appropriation for their payment. (EC § 17180, § 17183 and § 17185)

ANALYSIS

This bill:

1) Makes various findings and declarations regarding charter school facilities and the programs administered by the CSFA, as specified.

2) Establishes the California Credit Enhancement Program (CCEP) within the California School Finance Authority (CSFA) for the purpose to establish a fund to be used to insure facility bonds issued by the CSFA in order to achieve lower cost alternatives for public school facilities financing.

3) Authorizes the CSFA to leverage its funding for the CCEP so the amount of credit insurance provided pursuant to the program exceeds the amount of funds on deposit in the California Credit Enhancement Account, as proposed to be established by this measure within the existing CSFA Funds.

4) Requires the CSFA to deposit funds and fees identified for the CCEP in this account. Authorizes CSFA to designate and hold separately one or more subaccounts. Specifies that nothing shall be construed to require the CSFA to deposit, or the Legislature to appropriate, funds for the purposes of the CCEP.

5) Requires CSFA to adopt regulations to implement the CCEP and specifies that they may consult with subject matter experts in the development of the regulations, including eligibility criteria for participating public schools, e.g., financial performance, organizational and governance criteria, parameters and procedures for the provision of credit enhancement to eligible financing transactions, and the application process and fee schedule.

6) Provides that a public school that is fiscally sound and that has a good credit rating may participate in the CCEP.

7) Requires the regulations to include a definition of “default” for purposes of the CCEP, and procedures so that, in the event of a default, funds from the California Credit Enhancement Account are paid out only after all other sources of payment and credit enhancement to an eligible financing transaction are exhausted.

8) Specifies that bond insurance, credit enhancement, or other guarantees issued under this program shall not be deemed to constitute a debt or liability of the state and shall not be deemed to be a pledge of the faith and credit of the state other than the authority. Bond insurance, credit enhancement, or other guarantees of the authority shall be payable solely from funds available in the California Credit Enhancement Account.

9) Requires that each bond insurance policy, credit enhancement instrument, or other guarantee of the CSFA issued under the CCEP shall include a statement on its face that neither the State of California nor the CSFA is obligated to pay the principal or interest of the bonds covered by the CCEP.

10) Provides that the issue of bond insurance, credit enhancement, or other guarantees shall not directly, indirectly, or contingently obligate the state or any political subdivision thereof, to levy or pledge any form of taxation, or make any appropriation for their payment.

STAFF COMMENTS

1) ***Need for the bill***. The author's office indicates that "the biggest challenge currently faced by charter schools is finding a suitable facility and funding for that facility. Charter public schools typically do not receive local funding through bonds, as traditional public schools do, and must pay for their facility out of their general operating expenses, taking money out of the classroom to pay for that classroom. As a result, many charter schools turn to private financing and bond transactions in order to pay for a long-term facilities solution." According to the bill's sponsor, the California Charter Schools Association, the purpose of this measure is to establish an account within the California School Finance Authority (CSFA) that can be used as credit insurance or credit enhancement. The credit insurance is used to back the bonds CSFA issues on behalf of charter schools. If a charter school defaults on bond payments, the account set up by this bill will be used to pay the debt. The sponsor indicates that having a source to guarantee bonds will hopefully lead to lower interest rates for the construction or renovation of charter school facilities.

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 (SB 740). 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 for charters to finance their facilities, this bill could provide an additional means to help address their facility needs.

3) ***California School Finance Authority.*** 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 California School Finance Authority (CSFA), bonds are typically sold to large institutional investors, with interest rates ranging between 4.19% to 7.58% over the last four years.

4) ***Other states***. The program proposed by this measure is modeled after similar programs in Texas and Colorado. The Texas Credit Enhancement Program (TCEP) received a $10 million federal grant to establish a credit enhancement program for charter schools to finance the acquisition, construction, repair, or renovation of charter school facilities. As part of this program, debt service reserve funds are held in the State treasury solely to provide security for repayment of the bonds. The funds are not provided directly to the approved charter schools for construction. Colorado has the "Moral Obligation Program." According to the Colorado Department of Treasury Web site, this program enhances the credit of a qualified charter school. A qualified charter school is one that has obtained an investment grade credit rating on a "stand-alone" basis. The enhancement enables these qualified schools to obtain even more favorable financing terms on their capital construction bonds. The program is funded from a separate source of monies from which the Treasury would make bond payments in the case of a default by a charter school.

5) ***Charter defaults***. While the bill requires the regulations to include a definition of “default” for purposes of the program, it does not contemplate in a default situation where CSFA has paid off the remaining debt through this new program, which entity would hold title to the facility. For this reason, **staff recommends** an amendment requiring the CSFA to develop regulations that create options, in the event of a default, to ensure that the first priority of the facility is for the continued use of school purposes. These options may include, but not be limited to, the re-let or sale of the facility to another public school or a mechanism whereby the state has a right of first refusal to purchase the facility instead of it being sold in a foreclosure sale.

6) ***Fiscal impact***. According to the Assembly Appropriations Committee, there would be no direct state costs. There would be cost pressures on the California School Finance Authority Fund absent sufficient funds on deposit in the new California Credit Enhancement Account. CSFA will also have upfront administrative costs to promulgate regulations and create the new California Credit Enhancement Program; however, CSFA is currently supported through fee revenue.

SUPPORT

California Charter Schools Association

OPPOSITION

None received.

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