

*GRIFFITH & THORNBURGH, LLP*  
*MEMORANDUM*

**TO:** Brian Sarvis, Eric Smith and David Hetyonk  
**FROM:** Craig Price and Joseph Sholder, Legal Counsel  
**SUBJECT:** Education Code § 17463.7 and the Use of Surplus Property Proceeds  
**DATE:** February 2, 2010

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We have been asked to discuss the ability of the District to sell surplus property and to use the sales proceeds for general fund purposes pursuant to newly-enacted Education Code §17463.7.

**BACKGROUND**

Education Code § 17463.7 was enacted on July 28, 2009. Its provisions govern the ability of school districts state-wide to use proceeds from the sale of surplus school district real property and personal property located on the real property for general fund purposes. It alters existing law which limited school districts to using funds from the sale of surplus property for capital projects or maintenance costs, and which prohibited school districts from depositing those funds into their general funds except under very limited circumstance. See Ed.Code §17462(a).

Although § 17463.7 was recently passed, the legislature has previously passed similar bills which, unlike § 17436.7, only apply to specific districts. The provisions of § 17463.7 largely track the provisions of these special bills. See Ed.Code § 17463.6 (Santee, Valley Center-Pauma and Capistrano School Districts); § 17463.8 (Oak Grove Elementary School District).

There are differences between the special bills and § 17462(a) and § 17463.7. The most significant differences are the definitions in § 17463.8 of the term “one-time general purpose” and a similar definition in the implementing regulations for § 17462(a). This is a key term used but not defined in § 17436.7. The construction of “one-time general purpose” in § 17436.7(a) may dramatically limit the purpose for which surplus property proceeds may be used.

There are no judicial or attorney general opinions discussing the provisions of § 17463.7 or the special bills or the regulations to § 17462. Therefore, there is no definitive guidance as to what some of its ambiguous or complex provisions mean.

**TRANSACTIONS TO WHICH § 17436.7 APPLIES**

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1. Sales versus other types of transactions.

Section 17436.7 applies to the “sale” of surplus property. See § 17436.7(a). Thus, it doesn’t apply to dispositions of real property other than by the sale of that property. For example, transactions like long-term ground leases don’t apply.

2. The timing requirement.

Section 17436.7(g) contains a sunset provision which repeals § 17436.7(a) on January 1, 2012 unless legislation extending it is enacted before that date. The statute is silent on one issue that has already received discussion: whether property sold before § 17436.7’s enactment qualifies. The consensus of opinion is that it does.

Perhaps a more important issue is whether the sales proceeds only have to be deposited into the general fund by the January 1, 2012 deadline or whether they also have to be expended before that date. Since this statute is no longer effective after that date, the answer would appear to be that the funds both have to be deposited into the general fund and expended by that date.

3. Eligible surplus property.

Section 17436.7(a) contains two requirements governing the type of surplus property that qualifies under the statute. First, the surplus property must be “real property together with any personal property located on the property . . . .” The personal property reference presumably refers to mobile buildings and similar property which are used on the property.

Second, and perhaps more importantly, the property has to be “purchased entirely with local funds . . . .” Id. The term “local funds” isn’t defined, but presumably this requirement would, for example, exclude property purchased with funds obtained from the state or federal government. Property acquired with local tax or bond money would qualify. See Ed.Code §16331 (discussing the sources of local funds to match state assistance).

4. Other eligibility requirements.

Section 17436.7(d) and (e) contain two additional eligibility requirements.

First, before the funds can be deposited into the general fund and spent, the governing board of the district needs to certify that (1) the district has no “major deferred maintenance requirements not covered by existing capital outlay resources;” (2) that the sale of the property “does not violate the

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provisions of a local bond act;” and (3) that the property isn’t “suitable to meet projected school construction needs for the next 10 years.” See § 17436.7(d).

Second, before the funds can be deposited into the general fund and spent, the governing board must present a plan “for expending one-time resources” at a regularly scheduled meeting. The plan must identify the source and use of the funds and explain why the expenditure wouldn’t result in “ongoing fiscal obligations for the district.” See § 17436.7(e).

5. The uses to which the proceeds may be put.

Perhaps the most important provision in § 17436.7(a) concerns the permissible uses of the sales proceeds. This section provides that they may be used for “any one-time general fund purpose.” This term isn’t defined in the statute.

The same term is used in § 17463.8, the special Oak Grove Elementary School District bill. Subsection (f) of § 17463.8 says that the term “one-time general fund purpose means a nonrecurring cost payable from the general or special funds of a local educational agency, not including ongoing expenditures for the purposes of funding employee salaries and benefits or ongoing and sustained program operations and services.”

Also the State Allocation Board has issued regulations defining when a district may use the proceeds from the sale of surplus property for general fund purposes pursuant to § 17426(a) for “one-time expenditures, and may not be used for ongoing expenditures including, but not limited to, salaries and other general operating expenses.” Those regulations define “one-time expenditures to mean general fund costs “that are nonrecurring in nature and that do not commit the school district to incur costs in the future, and are exclusive of Ongoing Expenditures.” SAB Reg. 1700. The regulations define “Ongoing Expenditures” to mean “employee salaries, benefits and other costs that are associated with ongoing and sustained operations and services . . . .” *Id.* One exception to this definition is the one-time use of these funds to reduce a district’s unfunded liability for post-employment benefits other than pensions under certain narrow circumstances. *Id.*

If these definitions apply to the term “any one-time general fund purpose.” in § 17436.7(a), they dramatically limit the uses to which the surplus funds can be put since a significant majority of general fund expenditures are for employee salaries and benefits or ongoing and sustained program operations and services. Given the absence of any legal authority, we can’t definitively opine whether these definitions apply. The fact that the legislature used the definition in § 17463.8(f) but not in § 17436.7(a) could support the view that the legislature didn’t intend for this definition to apply. Further statutory support for this view is found in the first phrase of § 17463.7(a) which says that its terms apply “Notwithstanding any other law . . . .” This view is also bolstered by the fact that § 17436.7(a) was enacted to deal with a fiscal crisis in the schools.

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But even if these definitions don't specifically apply, § 17436.7(a)'s use of the term "one-time" suggests that ongoing expenses like staff salaries and benefits couldn't be paid from the proceeds from the sale of surplus property. And given the requirement discussed in section 3 of this memorandum that the district explain why spending the funds won't cause "ongoing fiscal obligations for the district," using the funds to start a new program would also seem prohibited. One-time expenditures that clearly do qualify would be, for example, the purchases of books, supplies and equipment.

6. The amount that can be spent.

If the district bought the now-surplus property with local general obligation bond proceeds or revenue from developer fees, then the amount that can be used for one-time general fund expenditures is defined by a statutory formula. The application of that formula results in the net gain on the sale being the amount that can be deposited into the general fund. That formula is: the net proceeds of sale (gross proceeds minus sales expenses) minus the purchase price of the property divided by the net proceeds of sale. That percentage is the "maximum that may be deposited into the general fund." See § 17436.7(a). For example, if the net proceeds were \$5,000,000 and the original purchase price was \$1,000,000 the maximum amount that could be deposited into the general fund would be \$4,000,000 (\$5,000,000 minus \$1,000,000 is \$4,000,000, divided by \$5,000,000 is 80%, multiplied by \$5,000,000 is \$4,000,000).

7. Disqualification for hardship funding.

There are statutory adverse consequences to a district that avails itself of the provisions of this statute. First, the State Allocation Board is required to reduce the hardship assistance apportionment awarded to the district pursuant to Ed. Code § 17075.10 et seq. by the amount used for the one-time expenditure. See § 17436.7(b). Second, the district is ineligible for hardship funding from the State School Deferred Maintenance Fund under Ed. Code § 17587 for five years from the date the proceeds are deposited in the general fund.

8. Additional considerations.

The foregoing analysis demonstrates that § 17436.7 doesn't give school districts broad discretion to sell surplus property and use it to plug budget holes caused by the current fiscal crisis. On the contrary, the statute significantly limits the uses to which these funds may be used. Further, the complying with the many requirements of the statute will take significant time and expense.

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In addition, there are non-statutory considerations to consider. First and most importantly, the current real estate market is poor and prices are depressed. A district selling property in this market will not realize the same value that the property will generate in a better market.

Second, given the restrictions on the use of the funds, using them for permissible one-time purposes may not solve a district's underlying financial problems which may be the lack of operational funds due to state cutbacks.

Third, these one-time use restrictions may leave a district with an abundance of proceeds from the sale of the surplus property but with little opportunity to spend those funds on items truly helpful to the district. For that reason, by the time the statute sunsets on January 1, 2012, a district may find itself worse off: it has sold property in a depressed market, has little to show in the way of meaningful general fund expenditures, and now has to re-deposit the unspent funds into accounts solely allocated for capital expenditures.