

DEVELOPER FEES: A SCHOOL LESSON IN JUSTIFICATION

SUMMARY

California school districts may impose development fees on new residential or remodeling projects, commercial and industrial construction. These fees are intended to provide funds for the construction or reconstruction of school facilities to accommodate increasing enrollment within school district boundaries resulting from new development. California law specifies the purpose and restrictions for the fees and has procedures for their implementation, accounting and use.

Acting on a citizen complaint, the 2013-2014 San Luis Obispo County Grand Jury (Grand Jury) investigated the justification, collection, accounting and expenditure of developer fees collected from Cayucos. Two school districts serve the pupils of Cayucos: Cayucos Elementary School District (Cayucos Elementary) and Coast Unified School District (Coast Unified) in Cambria where they attend Coast Union High School. Both districts receive a portion of developer fees from construction within Cayucos. The Grand Jury found that Coast Unified and Cayucos Elementary are operating under an expired contract for regulating the distribution of developer money between them. Furthermore, a review of records indicated there have been several instances of questionable use of developer monies in that they did not appear to be directly linked to expanding enrollment. Examples of projects include a district office, a boardroom, and use of funds at locations other than Coast Union High School. This report reviews the manner in which Cayucos Elementary and Coast Unified justify the use of developer funds for projects and how these monies are managed and reported.

AUTHORITY

California Penal Code section 925 authorizes the Grand Jury to investigate and report on the operations, accounts and records of a county officer, department or function.

PROCEDURE

The Grand Jury reviewed the following data from both Coast Unified School District and Cayucos Elementary School District:

- Annual audits.
- Accounting records, including financial statements, ledgers, and invoices.
- Justification Studies.
- Cayucos Elementary School District February 2014 Report investigating Coast Unified School District's developer fee program.
- Training manual: *Developer Fees - Do's and Don'ts*, Miller Brown and Dannis.
- District board agendas and minutes.

The Grand Jury interviewed:

- The complainant.
- Cayucos Elementary school staff members.
- Coast Union school staff members, including former employees.
- The superintendents of Coast Unified and Cayucos Elementary school districts.
- The San Luis Obispo County Superintendent of Schools.

Grand Jurors toured Cayucos Elementary School, Coast Union High School and their district offices.

BACKGROUND

In the mid-1980s, the California legislature sought to assist school districts that were impacted by expanding student enrollment due to increased community developments. The implementation of developer fees was intended to improve existing or add new facilities, thus alleviating the burden of accommodating growing enrollment. The California Education Code,¹ in conjunction with the California Government Code,² enable school districts to impose fees on construction or reconstruction of residential, commercial and industrial development. To establish or change the rate of the fees, a school district must complete a justification study demonstrating how future residential and commercial development will impact enrollment within its boundaries. The effective rate within a district can only be increased when the district school board has completed and adopted in open session a new justification study. The State Allocation Board adjusts the developer fee rates in January of even-numbered years. The districts must account for the collection of the fees and maintain a developer fee account that is separate from other monies. The developer fees are to be expended on the construction or reconstruction of school facilities that accommodate students generated from new enrollment.³ This is subject to various limitations,⁴ such as, the fees cannot be used for computers, furniture, school supplies such as books or maintenance since these do not represent construction or reconstruction of school facilities.

According to the San Luis Obispo County Superintendent of Schools and the superintendents of both districts, the California Education Code is interpreted permissively. Namely, if an item is not specifically addressed in the code, then a broader interpretation may be permissible. There exists little to no oversight in this process since the California courts have interpreted the adoption of the justification studies and the use of the funds as legislative acts. Since this involves the principle of separation of powers, courts will not substitute their judgment for the

¹ Cal Education Code §§ 17620-17626.

² Cal Government Code §§ 65995 – 66008.

³ Cal. Government Code § 65995(e),

⁴ Cal. Education Code § 17620(a)(3).

collective decision-making of a school board. The Superintendent of Schools also noted these programs adopted by local school districts are not supervised on a county level.

Regular school funding derives primarily from property taxes; however, this revenue declined due to the economic downturn of 2008. Approximately 85% of these funds are used for district employee salaries and benefits.⁵ Regular maintenance of the schools is also from the general funds. School bond measures are the main source of building funds, and these typically cover the cost of a major building project including its architectural and construction costs.

NARRATIVE

Cayucos is a community served by two school districts: students from Cayucos attend kindergarten through eighth grade at Cayucos Elementary, and then feed into Coast Union High School in Cambria. As such, any development in Cayucos is subject to developer fees imposed by both school districts.

Fee Splitting Agreement

If a property development is subject to fees from different districts, the districts involved must have an agreement on splitting the fees received.⁶ Developer fees collected from construction in Cayucos are split between Coast Unified and Cayucos Elementary, at 35% and 65%, respectively. The contract between the two districts arranging for the fee splitting was last renewed in 2008 and expired in 2010. The two districts continue to divide the fees as if the contract were still in effect.

The expired contract states that fees collected by Coast Unified are to be used at Coast Union High School; this interpretation of the contract is shared by the superintendent of Cayucos Elementary and the County Superintendent of Schools. However, even though this

⁵ General Fund Statewide Percentages 2012-2013. Retrieved April 23, 2014, from www.ed-data.k12.ca.us.

⁶ Cal. Education Code § 17623.

understanding of the contract was acknowledged by a resolution of the Coast Unified board dated April 10, 2008, the interim superintendent of Coast Unified stated that he believed the developer fees could be used on projects unrelated to the high school.

In the 2014 Justification Study adopted in March by Cayucos Elementary, the Grand Jury noted the fee split between the two districts is explained to be “one-third/two-thirds”,⁷ and computations of developer fees to be generated are based on that amount and not the prior contracted 35/65 split. Without a new contract with explicit language regarding the nature of the fee split, there is no clear understanding of how these two districts intend to divide future development fee revenue.

Collection of Developer Fees

Once the county approves a building or remodeling project in Cayucos, associated fees must be paid and a permit is issued. Developer fees are currently paid at the Coast Unified District Office in Cambria. Coast Unified enters the receipt of the check in its ledger and deposits the check into a local bank account. After the check clears, a check for 65% of the funds received is sent to Cayucos Elementary. Both school districts then separately deposit the funds into the county treasury.

In September 2013, the Cayucos Elementary District School Board voted to have the fees collected locally at the Cayucos District Office; yet, Coast Unified District School Board declined to change how the transaction had been traditionally conducted. The County Office of Education then offered to have the fee collected at its administrative offices and disbursed according to the expired contractual agreement. To date, however, Coast Unified has not accepted the offered arrangement from either Cayucos Elementary or the County Office, and this issue remains unresolved. Unless a mutual agreement can be reached between the districts, developers may have to deliver separate portions of the developer fee to Coast Unified in Cambria and to the County Office of Education.

⁷ “Level 1 – Developer Fee Justification Study for Cayucos Elementary School District, February 2014”, p. 9.

Accounting

Although the fees collected by Cayucos Elementary and Coast Unified are deposited into the general county treasury, each district treats it as a separate account.⁸ Coast Unified maintains detailed ledgers and journals of the developer fees collected and expended. From reviewing the documents, it was fairly simple to see which development project paid the fee and for what expenditures the developer fees were used.

In contrast, the Grand Jury found record keeping of developer fees by Cayucos Elementary to be less straightforward and more difficult to follow. When Cayucos Elementary was initially requested to provide accounting records of the fees, the district responded that it did not maintain specific records of the receipt of the development fees. Cayucos Elementary requested Coast Unified to provide the data, even though it was learned that Coast Unified sends a copy of its developer fee ledger to Cayucos Elementary each year. Ultimately, with the assistance of the County Office of Education, the data were provided.

The Government Code requires school districts to provide, every five years, an analysis of the funds in the developer fee account that remain unspent.⁹ This audit must identify the intended use for the unspent developer fees and how those fees will meet the district's school facility needs. If the findings are not made, the district must refund the unspent fees.¹⁰ The Grand Jury asked the superintendents of both districts and their respective staffs for their audits on more than one occasion. Since a five-year analysis from neither Cayucos Elementary nor Coast Unified was provided, there is no evidence that either district is in compliance with this Government Code reporting requirement.

⁸ Developer fees must be accounted for separately, not commingled with other funds, and the district must account for the use of the funds. Cal. Government Code § 66006.

⁹ Cal. Government Code § 66001(d)(1).

¹⁰ Also, the report that Cayucos Elementary commissioned regarding Coast Unified's developer fee program noted that each district should ensure compliance with this section of the Government Code. "Cayucos Elementary School District Developer Fee Report, February 2014", p. 3.

Justification Studies

The levy of developer fees by a school district requires a justification study demonstrating a reasonable relationship between residential, commercial and industrial development in the district with the need for additional school facilities.¹¹ The study must also identify the purpose and intended use of the fee. Before any rate increase can be effective, these studies must be adopted in open session by the locally elected school board. The studies in effect when the complaint was filed were completed in 2008 by both school districts setting the rate to the maximum allowable at that time (\$2.97/square foot).

After this investigation started, Cayucos Elementary, in February 2014, and Coast Unified, in April 2014, initiated the process to adopt new justification studies. When implemented, the new rates will be set to the current maximum allowable: \$3.36 for residential and \$0.54 for commercial/industrial (per square foot). In March 2014, Cayucos Elementary passed a resolution approving the justification study, then approved the higher fee rate which will be effective in June 2014. Until Coast Unified completes the process imposing the same fee, there will be two fee rates in effect for Cayucos development.

SchoolWorks, Inc., an outside consulting firm, prepared both of these studies. Since they are very similar, the 2014 Justification Study for Cayucos Elementary will demonstrate the general methodology used in the reports, and then the comparable data from the 2014 Coast Unified Justification Study will be highlighted.

Cayucos Elementary reports a potential impact of new students from development by multiplying the prior two years of construction data by a forecast model for percentage of students generated per dwelling unit; 10 units were built projecting 5 new students. These 10 units generated \$43,938 in developer fee revenue, so the anticipated amount generated per student is \$8,788.

¹¹ Cal. Government Code § 66001.

The Cayucos Elementary study then reports that the district has “needs that do not fall within restrictive [state] guidelines”¹² and proposes projects totaling \$2,181,500. They include a new science lab, replacement of a portable building with a permanent structure, upgrades to a playground, facilities for an Early Childhood Education Center, installation of a solar electric system and improvements to the district office. The district then divides the total cost of these projects by school enrollment of 200 (although the Grand Jury noted actual enrollment was 206) resulting in a per student total of \$10,900. The justification for increasing the developer fees is that this cost per student for the projected projects is greater than the amount per student (\$8,788) anticipated from the preexisting developer fees. The district then reasons that the increase in developer fees is necessary due to insufficient resources within the operating budget to fund its desired projects, even though it is unclear how specific projects relate to accommodating anticipated enrollment.

The 2014 Justification Study for Coast Unified estimates its needs regarding capital facilities to be \$15,265,000, for a per student cost of \$20,353 based on district-wide enrollment. Significant projects for planned new construction and modernization include replacement of portable facilities at the high school and middle school (\$4.5 million), installation of a swimming pool at the high school (\$2 million) and the construction of a performing arts center (\$2 million), and general maintenance of the facilities. The study recognized that 11 building permits were issued in the past two years generating \$114,722 in developer fees, and 10 new students were anticipated to impact the schools. The developer fee revenue per student using the proposed maximum fee would be \$12,050, and since this is less than the estimated cost per student, the district concludes the new fee rate is justified.

Both justification studies state that developer fees will assist the districts in making classroom space available for the anticipated new students through the construction projects, but neither district discusses the unfilled student capacity of their schools. Rather, the districts recognize that “... without the new construction, [enrollment] declines would have been even more

¹² “Level 1 – Developer Fee Justification Study for Cayucos Elementary School District, February 2014”, p. 12, and “Level 1 – Developer Fee Justification Study for Coast Unified School District, April 2014”, p. 13.

severe.”¹³ Furthermore, the Grand Jury noted that a manual, “Developer Fees – Do’s and Don’ts”, cited in the 2014 study that Cayucos Elementary commissioned to investigate Coast Unified’s use of developer fees, states: a “district is allowed to levy the justified amount even when enrollment is declining, provided that there is no excess capacity for the period of time analyzed in the [study]”.¹⁴ Neither school district factors in its ability to accommodate these anticipated students with space available from excess student capacity. Cayucos Elementary’s justification study maintains current enrollment is “approximately 220” whereas actual current enrollment is 206 students with a capacity of 240 students.¹⁵ Coast Union High School has an enrollment of 247 students with a capacity of 579 students.¹⁶

Expenditures

The complainant interviewed by the Grand Jury provided a list of expenditures from Coast Unified that the complainant believed improper. The Grand Jury reviewed those and other developer fee disbursements from Coast Unified and Cayucos Elementary. The Grand Jury did not investigate the need for the expenditures; rather it focused on these districts’ use of funds from their developer fee accounts.

The following sections highlight select expenditures using developer fee funds from Cayucos development and the relevant code sections. To improve readability, the Grand Jury rounded the dollar values.

Coast Unified disbursements for certain construction projects:

- Replacement of windows at the grammar school (2002-2004) amounting to \$92,000.
- Expenses, in the amount of \$8,800 (2005), relating to a proposed community soccer field at Santa Lucia Middle School. This project was never completed.

¹³ “Level 1 – Developer Fee Justification Study for Coast Unified School District, April 2014”, p. 2, and “Level 1 – Developer Fee Justification Study for Cayucos Elementary School District, February 2014”, p. 2.

¹⁴ Miller Brown and Dannis, *Developer Fees – Do’s and Don’ts*, March 11, 2007, pp. 9-10.

¹⁵ Based on statements by administration and 2014 Cayucos Elementary Justification Study.

¹⁶ Enrollment figures from <http://www.slocoe.org/education/docs/CalPADSSummary13.pdf>, capacity of high school from 2008 Coast Unified Justification Study.

- Expenditures at the new elementary school (2007-2009) for \$8,000.
- Modernization project at Santa Lucia Middle School (2008) for \$4,200.

The Government Code requires school districts to demonstrate a reasonable relationship between the need for the school facility and the type of project requiring the use of the developer fee.¹⁷

None of these expenditures, totaling \$113,000, were for projects at Coast Union High School.

The district cannot truly show a benefit to Cayucos students for improvements to the Coast Union grammar or middle school when Cayucos students do not attend them. As such, the Grand Jury cannot ascertain the reasonable relationship between the fees collected from Cayucos development and expenditures at Coast Unified campuses other than the High School.

Other school projects included were:

- New telephone system installed at the High School (2005) for \$12,000.
- Proposed installation of a solar electric system at Cayucos Elementary for \$320,000.

The Education Code explicitly prohibits the use of developer fees for deferred maintenance, which includes the major repair or replacement of plumbing, roofing, heating or electrical systems.¹⁸ It is unclear how the installation of these two systems, especially the solar electric system, differs from deferred maintenance systems, which is prohibited by the code.

Administrative facilities:

- Conversion of the old grammar school into Coast Unified district offices (2005-2006) at a cost of \$505,000.
- Proposed (2014) \$150,000 improvement to Cayucos Elementary School District Office.
- Remodel of an unused cafeteria at the newly converted Coast Unified district office to create a district boardroom at a cost of \$60,000 (2009-2011).

The Education Code allows “for the construction or reconstruction of school facilities”¹⁹ which the Government Code defines as “any school-related consideration relating to a school district’s ability to accommodate enrollment.”²⁰ The Education Code does not allow the use of developer

¹⁷ Cal. Government Code § 66001(a)(3).

¹⁸ Cal. Education Code §§ 17620(a)(3)(C), 17582(a).

¹⁹ Cal. Education Code § 17620(a)(1).

²⁰ Cal. Government Code § 65995(e).

fees for construction of items that the district would or should perform in the absence of new development.²¹

The Coast Unified conversion of the old grammar school to the district office created an off-campus facility with multiple meeting rooms and offices. At the time of this report, the district was only using about 50 percent of the facility. Some of the remaining space was leased out to other institutions such as Cuesta College and CAPLSO. It is not clear to the Grand Jury how this directly benefits high school students anticipated from new development. Likewise, it is also uncertain how the improvement to Cayucos Elementary's district office is connected to the accommodation of future enrollment from development. Similarly, the subsequent conversion of the cafeteria to a boardroom at the Coast Unified School District facility does not appear to benefit the high school students from new development nor conform to the requirements of the code.

CONCLUSIONS

The Grand Jury recognizes that funding for school facility infrastructure is complex since the majority of school resources are used for salaries and benefits. Although funding was restricted by reduced state budget allocations in recent years, Cayucos Elementary and Coast Union appear to be doing an admirable job of providing for their students. Grand Jury members who toured both facilities found the schools to be well maintained and managed by professional staff. Still, financial constraints do not remove the burden that is placed upon school districts regarding the proper justification and use of developer fee funds.

Both Cayucos Elementary and Coast Unified are operating under a fee splitting agreement that expired in 2010. Neither Cayucos Elementary nor Coast Unified seem willing to compromise and negotiate a new contract. For now, it appears that Coast Unified will collect its share of developer fees in Cambria, and the portion of the fees designated for Cayucos Elementary will be collected at the County Office of Education.

²¹ Miller Brown and Dannis, *Developer Fees – Do's and Don'ts*, March 11, 2007, p.1.

Neither Cayucos Elementary nor Coast Unified produced data regarding the five-year audit of their developer fee programs as requested by this Grand Jury. Therefore, there remains a question as to whether or not they are in compliance with the Government Code.

The administrations of both districts and the County Superintendent of Schools stated to the Grand Jury that they view the code sections relating to developer fees “permissively” such that expenditure of the fees is deemed appropriate as long as districts can make any connection to students in general. Even allowing for this interpretation, the code contains explicit prohibitions concerning the use of developer fees for construction of items that the district would or should perform in the absence of new development.²² Despite this restriction, Coast Unified justified expenditures of developer fees on a district office and boardroom. The Grand Jury also noted the expenditure of developer fees on the off-campus district office and boardroom was in violation of the fee splitting contract between Cayucos Elementary and Coast Unified designating the funds for Coast Union High School. The replacement windows at the grammar school in Cambria and the study for an off-site soccer field would also violate the fee splitting agreement.

School district justification studies are meant to demonstrate the relationship between the district’s needs and the projected impact from new development. A review of these studies suggests that some projects are included to ensure that district costs exceed the threshold, thereby justifying the increased developer fee rate. An example of this is the inclusion of the solar electrical system installation and the improvements to the district offices in the 2014 Cayucos Elementary Justification Study, estimated at \$320,000 and \$150,000 respectively. If these projects were deemed outside the appropriate use of developer fees, then the estimated cost per student for the new construction projects would decrease to \$8,557.50.²³ If the district used this amount, there would be no justification to increase the fee as the preexisting rate was estimated to generate \$8,800 per potential new student. The 2014 Justification Study for Coast Unified also contains many projects that are within the scope of prohibited deferred maintenance; however

²² Ibid.

²³ \$2,181,500 (original estimate) - \$470,000 (estimated solar and district office) =
\$1,711,500/200 students (estimated enrollment) = \$8,557.50.

the sum total of its projects are so substantial that even eliminating those, the threshold would probably be met.

The legislative intent of developer fee funds is to allow for school facilities to accommodate anticipated increased enrollment.²⁴ Coast Unified and Cayucos Elementary school districts have the issue of declining or stagnant enrollments that have created unfilled student capacity. The districts do not address how this excess capacity, especially substantial at Coast Union High School, is available, or unavailable, to accommodate these projected new students.

The developer fee legislation does not authorize oversight of the school districts' programs on a county level, specifically by the County Office of Education. The broad interpretation of the code, combined with a lack of oversight, has allowed for a continued increase of developer fee rates as well as the use of the fees to expand beyond their original intent with a nearly limitless threshold of what is permitted.

FINDINGS

- F1. Cayucos Elementary and Coast Unified are not in compliance with California Education Code section 17623 as they are operating without a fee splitting agreement since it expired in 2010.
- F2. The fees for development projects in Cayucos might need to be paid at two separate locations since Cayucos Elementary and Coast Unified cannot agree on having the fees collected at a single site.
- F3. Coast Unified's proportion of Cayucos developer fees has been expended at locations other than Coast Union High School in breach of the fee splitting agreement between the school districts, and also it does not meet the reasonable relationship established by Government Code section 66001(a)(3) between the imposition of the fee on a Cayucos development and the benefit within Coast Unified.

²⁴ Cal. Government Code § 65995(e).

- F4. Neither Cayucos Elementary nor Coast Unified have verified their compliance with Government Code section 66001(d) that mandates five-year audits of the developer fee programs.
- F5. Despite the intent within the justification studies to demonstrate student enrollment growth, the increased enrollment projected by both districts has not been realized as Cayucos Elementary and Coast Unified school districts are both experiencing stagnant or declining enrollment and under capacity of maximum enrollment.
- F6. The Education or Government Code does not provide for administrative oversight of developer fees beyond their local school board. Therefore, school districts have the authority to act independently with no oversight, especially from the County Office of Education.

RECOMMENDATIONS

- R1. Cayucos Elementary and Coast Unified school districts should cooperate and must negotiate a new developer fees splitting contract.
- R2. Cayucos Elementary and Coast Unified school districts should work together, along with the County Superintendent of Schools, to agree on one location for the collection of the fees, so as to not create the need for a developer to travel to two places to pay the respective portion of the fee.
- R3. Coast Unified's proportion of the fees collected from Cayucos development should be used at Coast Union High School on legally permissible items.
- R4. Cayucos Elementary and Coast Unified school districts must complete the five-year audits required under the code.
- R5. The County Office of Education should lobby the state legislature for oversight authority of the developer fee program.

REQUIRED RESPONSES

The Superintendent of Coast Unified School District is required to respond to Findings 1 – 6 and Recommendations 1-4.

The Coast Unified School Board is required to respond to Findings 1 – 6 and Recommendations 1-4.

The Superintendent of Cayucos Elementary School District is required to respond to Findings 1, 2, 4 and 5, and Recommendations 1, 2 and 4.

The Cayucos Elementary District School Board is required to respond to Findings 1, 2, 4 and 5, and Recommendations 1, 2 and 4.

The San Luis Obispo County Superintendent of Schools is required to respond to Findings 1 – 6 and Recommendations 2 and 5.

Presiding Judge	Grand Jury
Presiding Judge Dodie A. Harman Superior Court of California 1035 Palm Street Room 355 San Luis Obispo, CA 93408	San Luis Obispo County Grand Jury P.O. Box 4910 San Luis Obispo, CA 93403