

BOWIE, ARNESON, WILES & GIANNONE

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
ATTORNEYS AT LAW

ALEXANDER BOWIE*
JOAN C. ARNESON
WENDY H. WILES*
PATRICIA B. GIANNONE
ROBERT E. ANSLOW
BRIAN W. SMITH
JEFFREY A. HOSKINSON
MEGAN V. WATT
J. MATTHEW SAUNDERS
DANIELE SHERIDAN
PAUL W. LEE

4920 CAMPUS DRIVE
NEWPORT BEACH, CALIFORNIA 92660
(949) 851-1300

(800) 649-0997
FAX (949) 851-2014

REF. OUR FILE
4014.42

*A PROFESSIONAL CORPORATION

MEMORANDUM

PRIVILEGED AND CONFIDENTIAL

ATTORNEY-CLIENT PRIVILEGE

ATTORNEY WORK-PRODUCT PRIVILEGE

TO: Ms. Janet Bernard, Interim Superintendent
Del Mar Union School District

FROM: Bowie, Arneson, Wiles & Giannone

DATE: May 23, 2008

RE: Use of Surplus Proceeds

The Del Mar Union School District ("District") has inquired as to how the District may utilize the potential proceeds from the sale of the Shores Property to benefit the District. The District, at least in the past, has also inquired as to whether, and to what degree, such funds may be used to acquire revenue generating properties, including the possibility of new District facilities that may be used jointly for District purposes and for the purpose of generating income for the District.

Summary Conclusion

The District generally must utilize funds from the sale of surplus property for capital outlay and nonrecurring (over a five year period) maintenance. In certain circumstances, discussed below, the District may utilize surplus proceeds for one-time general fund expenditures, with the approval of both the District's Board of Trustees ("Board") and the State Allocation Board ("SAB"). As discussed in greater detail below, however, utilization of the procedures which may allow for use of funds for one-time general fund expenditures will have negative implications on the ability of the District to obtain State funding for school construction projects over a 10-year period.

BOWIE, ARNESON, WILES & GIANNONE

Ms. Janet Bernard, Interim Superintendent
Del Mar Union School District
May 23, 2008
Page 2

Based on such restrictions, the District will be able to use surplus proceeds by either directly utilizing the funds for a purpose allowed under Section 17462, or investing the surplus funds in a manner consistent with statutory investment regulations, discussed further below. Such regulations prohibit the District from investing in real estate, simply for the purpose of generating income. The District may, however, acquire buildings needed for District purposes, and thereafter lease surplus space therein to generate income until such space may be necessary for District purposes. Provided the proceeds generated from the lease are not associated with a lease with an option to purchase, the Education Code does not restrict how the District may utilize lease proceeds.

For the District's convenience, we have included an additional discussion at the conclusion of this memorandum, discussing various specific examples of uses that have been, to our knowledge, proposed, at least for discussion purposes, by the District.

Analysis

A number of statutory limitations are involved in responding to the District's inquiry as to how the District may utilize funds from the sale of surplus property, how it may invest any surplus funds derived from the sale, and how the District may utilize facilities acquired with such funds to the extent the facilities acquired are in excess of the District's needs. In particular, the District is limited by (1) Education Code Section 17462, which restricts the manner in which the District may utilize proceeds from the sale or lease, with an option to purchase, of surplus property, and (2) Government Code Section 53600 *et seq.*, which defines the manner in which the District may invest surplus public funds.

1. *Education Code Section 17462*

A. General Limitations

Education Code Section 17462 ("Section 17462"), as amended by Senate Bill 1415 ("SB 1415") effective January 1, 2007, limits the use to which funds derived from the sale of surplus property, or the lease of surplus property with an option to purchase, may be put by a school district. With respect to sale proceeds, school districts generally must use such funds for capital outlay expenditures of the district, or for costs of maintenance of school district property that the school board determines will not recur within a five-year period. (§ 17462(a).) With respect to proceeds from a lease with an option to purchase, school districts may deposit such funds into a restricted fund account to be used for routine repair of district facilities, as defined by the SAB for up to a five-year period. (§ 17462(a).)

We note that it is well-established that interest generally follows principal, and in fact becomes part of the principal, unless legally separated from it by law or statute. (*Pomona City School District v. Payne* (1935) 9 Cal.App.2d 510, 516; 71 Opn.Cal.Atty.Gen. 181, 183.) As

BOWIE, ARNESON, WILES & GIANNONE

Ms. Janet Bernard, Interim Superintendent
Del Mar Union School District
May 23, 2008
Page 3

there is no statute directing interest from surplus property proceeds be treated differently, not only are the proceeds from the sale of surplus property subject to the limitations discussed herein, but also any interest earned therefrom becomes a part of those proceeds and is subject to the same limitations. (See *Overland v. Superior Court* (2005) 126 Cal.App.4th 131, 138.) This rule was specifically applied to proceeds of surplus property received by a school district in an opinion of the California Attorney General in 1988, wherein the Attorney General specifically concluded that interest from the proceeds of the sale of surplus property were subject to the same restrictions as the proceeds. (71 Opn.Cal.Atty.Gen. 181, 182-183.)

For purposes of the above restriction, while the Education Code does not specifically define "capital outlay," it is defined by Black's Law Dictionary to include "[m]oney expended in acquiring, equipping, and promoting a business." Such a definition would clearly include expenditures relating to the acquisition of property and buildings for schools, as well as the acquisition of equipment and hardware to so equip those schools. It is less clear whether the acquisition of real property solely for the purpose of generating income for the District would be included within that definition. The question, however, is otherwise answered by other provisions of the law, discussed below relating to Government Code Section 53600, which do not authorize the District to invest such funds in real property.

B. One-Time General Fund Uses Authorized by Section 17462

Section 17462 also authorizes, in limited circumstances, the District to deposit proceeds from the sale, or lease with an option to purchase, of surplus property into its general fund for use for any one-time expenditure, as defined by the SAB. (§ 17462(a).) The ability to do so, however, is specifically limited to circumstances when the District's Board and the SAB both determine that that the District has (1) no anticipated need for additional sites or building construction for the 10-year period following the sale or lease with an option to purchase, and (2) no major deferred maintenance requirements. (§ 17462(a).)

With respect to what constitutes a "one-time general fund expenditure," the SAB has adopted regulations defining the term with respect to Section 17462. Under the approved regulations, "one-time expenditures" are defined as "costs paid by general funds . . . that are nonrecurring in nature and do not commit the [District] to incur costs in the future . . ." In contrast, "on-going expenditures" are defined by the regulations as "costs paid by . . . general or special funds . . . in support of employee salaries, benefits and other costs that are associated with the ongoing and sustained operations and services." In other words, the one-time general fund expenditure provisions of Section 17462 will allow the District to spend proceeds for general fund purposes as long as the expenditures are not related to, or create, on-going and recurring expenditures for the District.

BOWIE, ARNESON, WILES & GIANNONE

Ms. Janet Bernard, Interim Superintendent

Del Mar Union School District

May 23, 2008

Page 4

Furthermore, it is important to note that if the District were to elect to render the findings necessary to expend surplus proceeds for one-time general fund purposes, such findings will directly impact the ability of the District to seek State funding for necessary school facility construction or modernization during the 10-year period encompassed in those findings. The District will be unable to apply for school facility or modernization funding during the first 5-year period, and strict limitations will apply to any applications that may be made within the second 5-year period. (§ 17462(d).) Specifically, during the second 5-year period, the SAB would have to determine that the District has experienced enrollment growth or a need for additional sites that could not easily have been anticipated at the time the District and SAB rendered their initial findings that the District had no such need. (§ 17462(d)(2).)

C. Section 17462's Impact on Lease Proceeds

As an additional note, Section 17462 does not reference any limitations as to the use of proceeds from the lease of surplus property, when such lease does not include an option to purchase the underlying property. Furthermore, prior restrictions on the use of interest from the proceeds of all leases that previously existed within Section 17462 were deleted by SB 1415. The legislative history supporting SB 1415 reflects that while the legislature initially considered language within the bill that would have stated that "proceeds from the sale *or lease* of school district property [shall] be used in a manner that provides for the long-term financial security of the district," the lease language was modified before the adoption of SB 1415 to include only a "lease with an option to purchase."¹ Such language, coupled with additional clarifications made to Section 17465 that changed any references to "lease" within the section to specifically relate solely to leases with an option to purchase, would appear to reflect a specific intent that school districts not be restricted in the manner in which proceeds from the mere lease of property, without an option to purchase, may be utilized.

2. *Government Code Section 53600*

Government Code Section 53600 *et seq.* defines the manner in which local agencies, including the District, may invest surplus public funds not immediately necessary for the operation of the agency. Allowable methods of investing include investment in bonds issued by the agency, United States Treasury notes, and specified government bonds, among other specifically referenced methods of investment. (Govt. Code § 53600 *et seq.*) Allowable methods of investment, however, do not include the authorization to invest funds in real estate.

The limitation on surplus funds is further supported by a notation in the Legislative Counsel's digest for Senate Bill No. 571 (1989), which authorized the Irvine Ranch Water

¹ SB 1415, as adopted and chaptered, also eliminated the "long-term financial security" language in favor of "one-time expenditures," pursuant to the one-time expenditure provisions and procedures otherwise authorized by Section 17462.

BOWIE, ARNESON, WILES & GIANNONE

Ms. Janet Bernard, Interim Superintendent

Del Mar Union School District

May 23, 2008

Page 5

District to invest no more than 30 percent of its capital facility replacement funds in real estate and interests therein and improvements thereon. (See also Govt. Code § 35912.) In that notation, the Legislative Counsel noted that “[u]nder existing law, local agencies are not generally authorized to invest their funds in real estate.” We are unaware of any changes since such time that have changed the circumstances upon which that statement was based, as reflected by the limitations contained within Government Code Section 53600 *et seq.*

3. *Analysis of Specific Examples Raised by the District*

The District has specifically proposed the option of purchasing a building, with the intention of renting it out in order to generate a revenue stream. To the extent such activity would simply involve the investment in real estate, based on the above discussion, it is our opinion that the District may not utilize the funds obtained from the sale of the Shores Property, or any other surplus property, for such purposes. However, if the District acquired a new office building or similar facilities for District purposes, such a new District office, and square footage of such building exceeded the District’s current need (perhaps to accommodate future growth or need), the District could conceivably lease any excess space until such time as the space is needed for District purposes. Likewise, if the District owned real property no longer necessary for school purposes that it elected to lease without an option to purchase, the District could use the associated lease revenues for general operating expenses.

BOWIE, ARNESON, WILES & GIANNONE

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
ATTORNEYS AT LAW

ALEXANDER BOWIE*
JOAN C. ARNESON
WENDY H. WILES*
PATRICIA B. GIANNONE
ROBERT E. ANSLOW
BRIAN W. SMITH
JEFFREY A. HOSKINSON
MEGAN V. WATT
DANIELE D. SHERIDAN
PAUL W. LEE

4920 CAMPUS DRIVE
NEWPORT BEACH, CALIFORNIA 92660
(949) 851-1300

(800) 649-0997
FAX (949) 851-2014

REF. OUR FILE
4014.42

*A PROFESSIONAL CORPORATION

MEMORANDUM

TO: Del Mar Union School District

FROM: Bowie, Arneson, Wiles & Giannone

DATE: July 25, 2008

RE: Proceeds from Surplus Property

Del Mar Union School District ("District") requests an opinion as to the definition of "proceeds" from the sale of surplus property as provided in Education Code 17462. The District has requested this information to determine whether net proceeds or gross proceeds are necessary to be placed in the appropriate funds.

Issue

Does the term "proceeds" as used in Education Code Section 17462 refer to net proceeds or gross proceeds?

Summary Conclusion

We believe that the term "proceeds" as used in Education Code Section 17462 can be interpreted to refer to net proceeds – the amount realized from the sale of property after reasonable expenses are deducted. While Section 17462 does not define the term "proceeds", there are other sections within the surplus property statutes indicating that proceeds is considered to be a net value.

Analysis

Education Code Section 17462 regulates the use of the funds derived from the sale or lease of surplus property. For instance, in some instances the sale proceeds must be placed in a fund for capital outlay or maintenance expenditures. (Education Code Section 17462(a).) In other instances, the proceeds may be placed in the general fund for the use of any one-time expenditure. (*Ibid.*) Despite the use of the term "proceeds", Section 17462 does not define the term, making it unclear whether proceeds should be considered as a net or gross value.

BOWIE, ARNESON, WILES & GIANNONE

Del Mar Union School District

July 25, 2008

Page 2

The dictionary definition of “proceeds” also offers ambiguous definitions that do not clarify whether the term “proceeds” should be considered net or gross. The Merriam-Webster’s Dictionary defines “proceeds” as: 1) the total amount brought in <the *proceeds* of a sale> or 2) the net amount received (as for a check or from an insurance settlement) after deduction of any discount or charges. (Merriam-Webster’s Collegiate Dictionary 10th Edition.) “Proceeds” is also defined as “[m]oney or property received when collateral is sold, exchanged, or collected.” (www.americanbanker.com/glossary.html.) Lastly, “proceeds” are 1) something that results or accrues, 2) the total amount derived from a sale or other transaction, or 3) the profits or returns from a sale, investment, etc. (www.dictionary.com.) Reasonable arguments could be made that the term “proceeds” could either be considered gross proceeds or net proceeds based on these dictionary definitions.

Despite the lack of clarity from Section 17462 and the dictionary definitions, Education Code Sections 17463.6 and 17463.8 provides a definition for the term “proceeds” for purposes of those sections. According to Sections 17463.6 and 17463.8, “proceeds” means,

- (1) The amount realized from the sale of property after reasonable expenses related to the sale.
- (2) For any transaction that does not result in a lump-sum payment of the proceeds of the transaction, the proceeds of the transaction shall be calculated as the net present value of the future cashflow generated by the transaction.

(Education Code Sections 17463.6(a) and 17463.8(a).) “Proceeds” as defined in these sections makes clear that proceeds should be considered as a net value. Although Sections 17463.6 and 17463.8 are special statutes that apply only to certain school districts (i.e. Santee School District, Capistrano Unified, Oak Grove Elementary School District, Valley Center-Pauma Unified School District), we believe that these provisions can be used to assist in determining the definition for the term “proceeds” used throughout the surplus property statutes. Therefore, because there are sections within the surplus property statutes that define “proceeds” as net proceeds, we believe that the term “proceeds” may be interpreted to mean “net proceeds” under Section 17462.

Conclusion

While Section 17462 does not define “proceeds”, the use of the term in other sections within the surplus property statutes suggests that “proceeds” can be interpreted to mean the proceeds from the sale of property less reasonable expenses related to the sale.