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**ORIGINAL**

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**CALIFORNIA OFFICE OF ADMINISTRATIVE LAW  
IN THE COUNTY OF SACRAMENTO**

In re:

**STATE ALLOCATION BOARD,**

**Respondent**

**Title 2, California Code of Regulations  
Section 1859.2 and 1859.21**

**OAL File No. Priority Review:  
2012-1**

**RESPONSE TO THE OFFICE OF  
ADMINISTRATIVE LAW'S (OAL)  
ORDER TO SHOW CAUSE**

The Department of General Services – Office of Public School Construction (OPSC), on behalf of the State Allocation Board (SAB) provides its response to the Office of Administrative Law's (OAL) Order to Show Cause as set forth below:

**PROCEDURAL BACKGROUND**

On April 17, 2012, at the request of the Senate Rules Committee, the OAL initiated a priority review pursuant to Government Code section 11349.7 and Senate-Assembly Joint Rule 40.1 on the State Allocation Board (SAB) Form 50-04, *Application for Funding*, specific to *item 22*, known as the "60% Commensurate" (60%) regulation. Item 22 is incorporated by reference in the California Code of Regulations, title 2, sections 1859.2 and 1859.21. The OAL's review focused on the 60% commensurate regulation's compliance with the regulatory standards pursuant to Government Code section 11349.7 as follows: (1) Necessity; (2) Authority; (3) Clarity; (4) Consistency; (5) Reference; and (6) Nonduplication.

On July 16, 2012, the OAL made a determination that the 60% regulation met the Authority, Clarity, Consistency, Reference and Nonduplication standards of Government Code section 11349.1. In addition, the OAL found that the 60% regulation met an element of the Necessity standard pursuant to Government Code section 11349.1 in that the OAL's rulemaking records contain substantial evidence of the necessity for a rule in the nature of the 60% rule.

OAL, however, issued the SAB an Order to Show Cause (OSC) as there was no information in the rulemaking record relating to the specifics of the 60% rule. OAL required the SAB to provide a written response on two issues:

- "1) the selection of 60%, as opposed to any other percent, as the minimum percent of total grant amount provided by the State and the district's matching share that the work in the plans and specifications must cost[,] in the estimate of the architect of record or design professional for the project; and
- 2) the exclusion from the cost estimate of those items excluded, i.e., planning, tests, inspection, and furniture and equipment."

#### **HISTORY OF THE 60% COMMENSURATE TEST**

On or about August 27, 1998, the Governor approved Senate Bill No. 50 (SB 50) entitled the Leroy F. Greene School Facilities Act of 1998, codified as Chapter 12.5 of the Education Code. SB 50 eliminated the then existing school facility program also known as the Lease Purchase Program (LPP) and created a new type of school facility program called the School Facilities Program (SFP). SB 50 mandated the SAB to cease approval of LPP applications after November 4, 1998. In practice, the SAB had to have the SFP up and running by November 4, 1998.

Under SB 50, school districts have two ways to receive facility funding: (1) new construction funding pursuant to Education Code section 17072.20; (2) modernization funding pursuant to Education Code section 17074.10. Program integrity was inherent in the new construction funding statutes since erecting a school building required the expenditure of actual hard construction costs. As to modernization of school buildings, however, the program funding needed minimum protections because of a lack of clarity as to the type of work acceptable under the modernization program.

## MODERNIZATION GRANTS

During the SFP implementation period, several districts applied for the modernization per pupil grants. The OPSC's review of the districts' applications showcased the problem that the districts' scope of work, composed mostly of low-level maintenance work, were not commensurate with the millions that they would receive in modernization funds. Moreover, the OPSC found that districts with low-scoped modernization projects created two significant program integrity issues: (i) the circumvention of the SFP requirement to have their plans and specifications approved by the Department of General Services – the Division of State Architect (DSA) (Education Code section 17072.30); (ii) the line-jumping in front of other districts with full-scoped projects. (Declaration of David Zian.)

Meeting the requirements of Education Code section 17072.30 became an issue during the early part of the SFP implementation period when school districts submitted plans and specifications for modernization containing only a minimal amount of hard construction or modernization related costs. Because of the minimal scope of work, these projects resulted in getting through the DSA review more quickly or altogether bypassed the DSA review and approval period, hence circumventing, in some respects, the SFP statutory mandate.

The problem of line-jumping came about when school districts with minimal modernization work were in line for funds much sooner than school districts with full-scoped modernization projects. During this period, it was a common occurrence for DSA approval on full-scoped projects to take as much as six (6) months, thereby allowing minimal-scoped projects to get approximately six (6) or more months' head start on funding appropriations. Many school districts with full-scoped modernization projects recognized the need to address the fundamental imbalance that allowed other school districts with minimal-scoped projects to jump ahead of the funding line.

To operate the program, SB 50 authorized the SAB to establish and publish any procedures and policies in connection with the administration of the SFP that the SAB deemed necessary (Education Code section 17070.35, subdivision (b).) Pursuant to section 17070.35, as well as in light of the OPSC's findings that integrity issues existed for the modernization program, the OPSC recognized that there was a need to set the

minimum hard costs construction thresholds as well as to answer the question of what a viable modernization project entailed. (Declaration of David Zian.)

In order to address all of these program integrity issues, the OPSC reviewed hundreds of bids representing approved hard construction costs that the school districts submitted under the LPP program (Declaration of David Zian) and found minimum thresholds for modernization hard costs to be at or around sixty to eighty (60-80) percent of total project costs. Hard costs are defined in the State Administrative Manual (SAM) section 6899 as actual construction costs. Soft costs are defined as including "...costs for all pre-construction phases, plus construction support expenses" (SAM section 6854).

With these findings, the OPSC took an item to the State Allocation Board Implementation Committee (Imp Committee). Several different stakeholders comprised the Imp Committee, including representatives from several school districts as well as the OPSC. The committee agreed that there was a need to assess the viability of a modernization project and that "project viability" required the school districts to approximate construction spending in order to qualify for funding. (Declaration of David Zian.)

Although available data showed modernization hard costs to be at a range of approximately sixty to eighty (60-80) percent of total construction costs, there was accord during the committee discussions for school districts to subscribe to the lower percentage of sixty (60) percent in order for these districts to have maximum flexibility in availing of the modernization funds. In effect, school districts' eligibility for modernization funds would depend on having modernization hard costs to be at about sixty (60) percent of total project costs.

### **NEW CONSTRUCTION GRANTS**

At the SAB meeting on or about June 23, 1999, the then OPSC Assistant Executive Officer (AEO), Bruce Hancock, put forward a recommendation for a change to the regulations to incorporate a similar commensurate requirement to the new construction grant eligibility.<sup>1</sup>

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<sup>1</sup> According to the AEO, a need for a regulatory change was in order so as for the "...the cost of a new construction project to have a relationship to the amount of grants..." The AEO suggested that the work  
The SAB's Response to the Office of Administrative Law's Order to Show Cause

The SAB unanimously approved the 60% commensurate regulation change to include new construction applications. (Transcript of the SAB Special Consent Agenda dated June 23, 1999, Attachment C, p.148.)

### **REVIEW OF SAMPLE PROJECTS**

In order to provide additional data, the OPSC recently reviewed a sample of randomly selected modernization projects that were bid during 1996 through 1999 under the LPP. It found that approximately sixty-eight (68) percent of total project costs were hard costs expenditures, whereas approximately thirty-two (32) percent of total project costs were soft costs expenditures. Similarly, a review of sample SFP projects that began in 1999 and were closed-out (audited) in 2003 and 2004 indicated hard costs to range at about fifty-seven to seventy-seven (57-77) percent and soft costs to range at about twenty-three to forty-three (23-43) percent of total project costs. (Declaration of Lisa Jones.)

- I. THE SELECTION OF 60% AS OPPOSED TO ANY OTHER PERCENT, AS THE MINIMUM PERCENT OF THE TOTAL GRANT AMOUNT PROVIDED BY THE STATE AND THE DISTRICT'S MATCHING SHARE THAT THE WORK IN THE PLANS AND SPECIFICATIONS MUST COST IN THE ESTIMATE OF THE ARCHITECT OF RECORD OR DESIGN PROFESSIONAL FOR THE PROJECT.**
  - A. THE SAB HAD A RATIONAL BASIS FOR THE SELECTION OF THE 60% COMMENSURATE RULE.**

### **Modernization Grants**

As discussed in the History section of this response, the OPSC's review of several districts' applications presented a three-pronged problem to the modernization program: (i) district submission of plans and specifications with scopes of work composed mostly of low level maintenance work that was not commensurate with the

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in the plans and specifications should represent sixty (60) percent or more of the total grants because applications submitted during the implementation period had costs representing only a very small portion of the grants with the remaining money claimed as savings for use in other areas not approvable under the program. [Transcript of the SAB Special Consent Agenda dated June 23, 1999, Attachment C, p. 148.]

millions that would be received in modernization grants; (ii) the circumvention of the SFP requirement to have their plans and specifications approved by the DSA; (iii) the line-jumping in front of other districts with full-scoped construction projects.

In order to address the problems presented, the OPSC did an analysis of several hundred projects leading to a finding that modernization hard costs were approximately sixty to eighty (60-80) percent of total project costs. The Imp Committee considered these findings and agreed to implement the lower percentage (60%) so school districts would have maximum flexibility in utilizing the modernization grant.

In a review of a sample of randomly selected LPP modernization projects that were bid during 1996 through 1999, as well the review of a sample of the SFP modernization and new construction projects, the OPSC found that the project costs percentages supported the SAB's decision to utilize the lower percentage. The hard costs percentages for both the LPP modernization projects and the SFP modernization and new construction projects ranged from approximately fifty-seven to seventy-seven (57-77) percent, with the SAB choosing a percentage at the lower end of the spectrum.

### **New Construction Grants**

The SAB unanimously approved the recommendation to amend the regulations to incorporate a similar requirement for new construction grants in order that there would exist a relationship between the grant eligibility funding and the cost of construction. (Transcript of the SAB Special Consent Agenda dated June 23, 1999, Attachment C, p. 148.)

### **Conclusion**

The SAB had a rational basis for selecting the 60% commensurate test because it considered data from its own construction projects, as well as input from the Imp Committee, before it implemented the necessary controls for both the modernization and construction grants.

**B. THE LEGISLATURE HAS MADE A DETERMINATION OF REASONABLE NECESSITY IN REQUIRING THE SAB TO ESTABLISH ANY PROCEDURES IN CONNECTION WITH THE ADMINISTRATION OF THE LEROY F. GREENE SCHOOL FACILITIES ACT THAT THE SAB DEEMED NECESSARY.**

Government Code section 11350 subdivision (b)(1) declares that a court may invalidate a regulation if it finds “the agency’s determination that the regulation is reasonably necessary to effectuate the purpose of the statute... or made specific by the regulation is not supported by substantial evidence.”

In this case, it appeared that the substantial evidence test was met pursuant to *Pulaski v. California Occupational Safety and Health Standards Board* (1999) 75 Cal.App.4th 1315, because the Legislature had made a policy determination of necessity when it mandated the SAB to establish and publish procedures and policies deemed necessary for the administration of the SFP [Education Code section 17070.35, subdivision (a) (2).] In *Pulaski*, the Cal-OSHA board (Cal-OSHA) adopted regulation 5110 requiring an employer to institute a program designed to minimize repetitive motion or RMI in the workplace. The groups challenging the regulation argued that Cal-OSHA adopted the regulation without an evidentiary basis for finding that it was reasonably necessary to effectuate the mandate of section 6357. The court found that the Legislature itself had already determined the necessity for the regulation in the area since the legislative mandate codified in statute required that Cal-OSHA “shall adopt standards for ergonomics in the workplace designed to minimize instances of injury from repetitive motion.” The court opined that the Legislature has already made a policy determination that ergonomic standards will reduce work related injury. In addition, the use of the mandatory “shall” in the statute obviated the need for a redetermination of necessity. *Id.*

Similarly, in mandating that the SAB establish procedures it deemed necessary to administer the SFP, the Legislature made a policy determination that were the SAB to establish procedures based on a finding of necessity, the Legislature would likely adjudge those procedures to have met the necessity standard.

As stated under the rational basis section, the SAB made a finding of necessity as to why there was a need for the sixty (60) percent commensurate and how the SAB determined such percentage. The percentage was necessary to maintain adequate control of the SFP. With these findings, the *Pulaski* court would more likely conclude that the SAB satisfied the necessity standard.

**C. THE SAB SUBSTANTIALLY COMPLIED WITH THE NECESSITY STANDARD PURSUANT TO GOVERNMENT CODE SECTION 11349.1 SUBDIVISION (A)(1).**

In as much as the OAL found that the rulemaking files contained substantial evidence of the need for the 60% commensurate test, the SAB had substantially complied with the necessity standard. In *Pulaski, supra*, 75 Cal.App.4th 1315, 1328, the court held that “substantial compliance” with the requirements of the Administrative Procedures Act (APA) means actual compliance in respect to the substance essential to every reasonable objective of the statute; where there is compliance to all matters of substance, technical deviations are not to be given the stature of noncompliance.”

The inquiry as to why the SAB chose sixty percent (60%) as opposed to any other percentage can be characterized as an inquiry into “technical deviations” and, as such, SAB’s choice of the necessary percentage ought not to be given a stature of noncompliance. *Id.* The SAB considered the sixty percent (60%) requirement and made its determination based on several factors to include but not limited to the problems that arose when the modernization program was placed in practice; the results from the Imp Committee discussions; the results of the compiled construction costs data; the ease of grant approval on school districts. Based on these factors, the SAB made the decision to adopt the 60% commensurate rule.

Furthermore, the construction cost ratio does have some literary support. An OPSC publication dated April 26, 2000, surveyed 100 schools that bid in 1996 and 1997. The survey found that a range of approximately seventy-eight to eighty (78–80) percent of project costs pertain to hard costs. (Public School Construction Cost Reduction Guidelines (2000), p.101.) An article published in SchoolConstructionNews.com written by Bill Laughlin, AIA, stated that “[n]o two projects

are created equal, but hard costs typically account for approximately 75 to 80 percent of a new school's total project costs." (SchoolConstructionNews.com (2006).) In some reports, the hard cost to soft cost ratio was 70% to 30%. (Proposition O Performance Audit of the Sweetwater Union High School District (2012).)

The OPSC's recent review of a sample of actual LPP and SFP construction projects do support industry standards in that the hard costs percentages for LPP modernization as well as for SFP new construction and modernization projects ranged from approximately fifty-seven to seventy-seven (57-77) percent of total project costs.

Irrespective of the supporting data, however, "...in considering whether the regulation is reasonably necessary, a court will defer to the agency's expertise and is not to superimpose its own policy judgment on the agency in the absence of an arbitrary and capricious decision." (*County of Santa Cruz v. State Board of Forestry* (1998) 64 Cal.App.4th 826; *Agricultural Labor Relations Board v. Superior Court* (1976) 16 Cal.3d 392.) As stated in a previous section, the SAB had substantial basis in deciding to choose the 60% commensurate rule. OAL's inquiry into the SAB's choice of a percentage could run the risk of OAL imposing a policy judgment over that of the SAB's decision-making authority should OAL find the percentage to be "improper."

Therefore, since the rulemaking files have substantial evidence of the need for the 60% commensurate test, the *Pulaski* court would find that the SAB had substantially complied with the necessity standard. Even so, the SAB had substantial basis in formulating the decision to adopt the 60% commensurate rule.

## **II. THE EXCLUSION FROM THE COST ESTIMATE OF THOSE ITEMS EXCLUDED, I.E., PLANNING, TESTS, INSPECTION, AND FURNITURE AND EQUIPMENT.**

According to SAM section 6854, "[p]roject soft costs include costs for all pre-construction phases, plus construction support expenses." The SAM section 6899 also defined "hard costs" to include actual construction costs. The exclusion of planning, tests, and inspection costs were because, in accordance with SAM section 6854, these costs were either pre-construction costs or construction support costs. The exclusion of

furniture and equipment from the cost calculation was because the OPSC found that furniture and equipment, unless affixed to the structure, do not contribute to the erection of a building structure. Moreover, furniture and fixtures could be relocated to nonteaching stations or relocated to other facilities.

## REFERENCE STANDARD

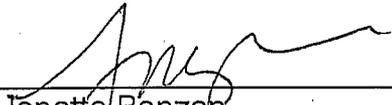
OAL stated in its Priority Review 2012-1 that it finds that the Reference citations listed for the regulation that incorporates the 60% rule meet the standard for Reference in Government Code section 11349(e) but were incomplete. A more complete list of Reference citations could include Education Code sections 17070.35 and 17070.63 in support of title 2 CCR section 1859.21 as well as including Education Code section 17072.20 as a reference citation for 2 CCR section 1859.2.

As changes to Authority or Reference citations listed after a regulation was passed may be made by state agencies without regulatory effect pursuant to title 1, CCR section 100 (a)(5), the OPSC, on behalf of the SAB, acknowledges the OAL findings. The OPSC will address in the near future, the additional statutory citations in support of title 2, CCR sections 1859.2 and 1859.21.

Dated:

9/14/2012

Respectfully submitted:

  
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