Maximizing the Value of Public Assets

EdFund

The Administration proposes to sell California's student loan guarantee agency-EdFund-which would generate approximately $1 billion in one-time revenue to the state. In 1996, the Legislature authorized the California Student Aid Commission to establish a non-profit public benefit corporation to provide student loan guaranty services under the Federal Family Education Loan (FFEL) Program. Subsequently, EdFund was created in 1997 as a performance-based organization that was exempt from certain state employment and procurement requirements, which enabled it to compete with other guarantor organizations throughout the country. EdFund guarantees not only California student loans, but loans to students in other states as well. In fact, over half of all loans guaranteed by EdFund are held by non-California students. EdFund is the second largest guarantor in the nation and currently maintains a loan portfolio in excess of $27 billion.

EdFund is an inherently valuable asset because the student loan guarantee business is a fundamentally attractive financial venture. The student loan guarantee business is not a core mission or competency of government. Recognition of this fact led to spinning off the loan guarantee business from a state government operation to a quasi-governmental, private non-profit that is now EdFund. However, selling this non-governmental entity to a private company could produce a significant one-time financial benefit to the state without adversely affecting students. There are many student loan guarantee firms throughout the country that compete vigorously with each other. Nearly all of them are private firms, not governmental entities. Potential buyers of EdFund will be attracted to the opportunity of acquiring EdFund's substantial loan guarantee portfolio and brand name. In addition, potential buyers may be attracted by the indications of recent analyses that there could be significant opportunities to increase the current efficiency of EdFund and diversify into other compatible lines of business such as loan servicing and collections, thereby generating higher revenues and profit margins. The May Revision assumes that EdFund would sell for at least $1 billion. However, that gross revenue to the state would be offset by the loss of some operating revenue currently provided by EdFund to fund certain student aid activities. Consequently, the May Revision shifts this lost revenue stream of $20.3 million a year to the General Fund, resulting in a net one-time benefit to the state of approximately $980 million.

This proposal would not adversely affect students' access to loans or the interest rates they pay for loans (which are set by the federal government). EdFund does not set loan interest rates or charge students fees. Its revenues come primarily from the banks that they do business with and the federal government.

Improving the Lottery's Performance

In 1984, the voters approved the establishment of the California Lottery. Net lottery proceeds are currently used to supplement funding for education. Projected revenues of the lottery for 2007 are about $3.2 billion in sales, with approximate net proceeds to education after prize payouts and operating costs of about $1.1 billion.

Compared to the other 40 states with lotteries, California's lottery is an underperformer. Per capita average sales of all the states is $158, and the average of the ten most populous states is $190. In contrast, California's is only $81 in average per capita sales. Clearly, there is room for a greater return on the public's support of the lottery.

The Administration proposes that the Lottery be leased to a private concessionaire who could bring sales up to at least the national average, and in so doing produce a significant financial benefit to the state while holding education harmless. Various banking and investment firms have evaluated the concept in several states of turning over lottery operations to private concessionaires. Those analyses uniformly conclude that operating a state lottery would be an attractive proposition to the investment community, especially in cases like California where there is so much potential capacity to improve lottery performance. Although the estimates of the net value to the state of entering into such a concession arrangement range broadly depending upon the assumptions used, it appears clear that the value is many billions of dollars under virtually any set of assumptions. Ultimately, the market will determine the lottery's value when the state engages in a rigorous competitive process of bidding and negotiations with potential concessionaires.

The Administration is not proposing a detailed plan for utilizing lottery concession proceeds at this time. That decision is one that needs to be jointly made by the Executive and Legislative branches, and discussions on that point have not yet begun. Nevertheless, the Administration does believe that there should be two priority uses for those funds:

- First and foremost, the proceeds must be used to guarantee, at a minimum, that education receives the same dollar level of funding that it received in the highest year of lottery funding. This guarantee alone will enhance the lottery's financial benefit to education, since the lottery currently is an inconsistent provider of funding. Lottery proceeds have risen and fallen over the years, and so have not been a predictable source of funding. A basic principle of any structure for utilizing concession funding should be to guarantee a steady, more predictable funding source for education.
- Secondly, any one-time proceeds should be used to retire existing state debt. Retiring debt should be a priority because it frees up money that is currently used to pay annual debt service, thus turning a one-time funding source into a more flexible ongoing funding source.

Operating a lottery is not a part of the core mission or competency of government. It is a sales, marketing and technology business. Turning the operation of the lottery over to a private concessionaire that specializes in these activities would not only be a good business move for the state, it would be good policy, since it removes an operational distraction from the state's core mission of providing public services. However, the state would retain underlying ownership of the lottery and would continue to regulate it in the interest of public protection.