SANTA MONICA-MALIBU UNIFIED SCHOOL DISTRICT

Review of Revenue Options for District Reorganization

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School Services of California INC.™
An Employee-Owned Company

History

- In October 2017, School Services of California, Inc., (SSC) conducted an analysis of different revenue sharing options and the extent to which the options could mitigate financial disparities for a reorganized Santa Monica-Malibu Unified School District (SMMUSD) into two districts:
  - Santa Monica Unified School District (SMUSD)
  - Malibu Unified School District (MUSD)
- SSC reviewed a revenue neutrality formula developed by the Malibu Unification Negotiating Committee (MUNC) that would provide supplemental mitigation payments from MUSD to SMUSD for a period of 12 years following separation
- SSC presented an alternative for sharing property tax and other local revenues intended to transition both districts to complete financial independence once SMUSD becomes a basic aid district
  - Financial independence occurred approximately 10 to 13 years after reorganization, at which point supplemental payments from MUSD to SMUSD would cease

New Analysis

- SMMUSD subsequently requested that SSC explore additional options to provide longer-term protection for SMUSD
  - Develop a model to allocate revenues between SMUSD and MUSD over a 50-year period under two scenarios
    - All revenues shared
    - Only property tax revenues shared
  - Examine the impact of establishing an endowment for SMUSD
  - Outline the process to convert Malibu area schools into a charter school

50-Year Shared Revenue Arrangement

Long-Term Effect of Reorganization

- Our analysis presumes that SMMUSD separates into two unified school districts – SMUSD and MUSD – in 2018-19, with a revenue equalization arrangement for 50 years after reorganization
- Our model of revenue sharing over a 50-year period only extends ***existing*** conditions into the future, and should not be considered a prediction of future events
    - Grows property tax revenues for each district at 6% annually
    - Fixes average daily attendance (ADA) at 2018-19 levels
    - Allocates two-thirds of base property tax revenues to SMUSD and one-third to MUSD; 100% of post-redevelopment agency revenues go to SMUSD
    - Increases other local revenues by 2% annually

Shared Revenues

- For this analysis, we include the following discretionary revenue sources:
  - Local Control Funding Formula (LCFF)
    - Property tax revenue
    - State aid
  - Other Local Revenues
    - Parcel tax (Santa Monica and Malibu)
    - Supplemental use tax (Santa Monica)
    - Grants from city government (Santa Monica and Malibu)
    - Ground lease revenues (Santa Monica and Malibu)
- We assess two options: Sharing all discretionary revenues equally, and sharing discretionary revenues excluding other local revenues

50 Years of Revenue Growth

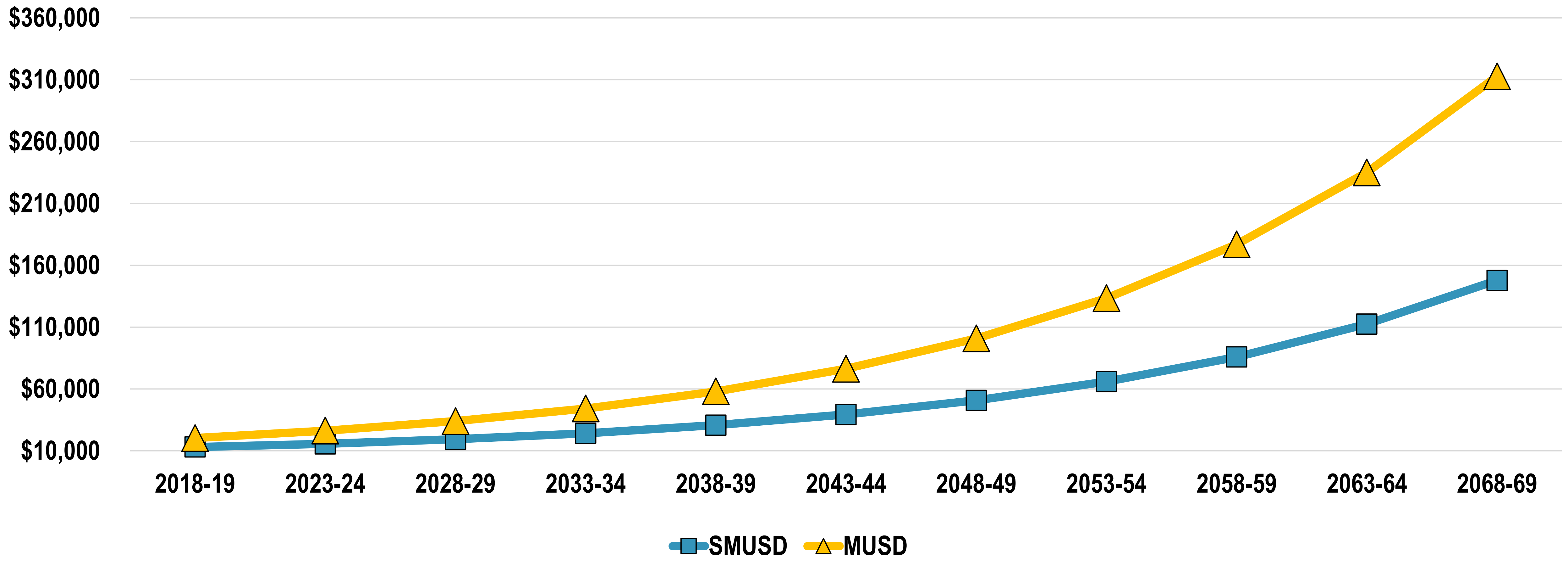
- Both school districts are basic aid for most of the 50-year period
  - MUSD would become a basic aid school district immediately upon reorganization
  - SMUSD receives some additional state funding as a state aid district until 2019-20, becoming a minimum state aid district in 2020-21, and a basic aid district in 2024-25
- Over the long term, the primary driver of revenue increase is annual property tax growth for both school districts
- Absent revenue sharing, SMUSD will receive less discretionary revenue per ADA in all years after reorganization than either MUSD or an un-reorganized SMMUSD

50 Years of Revenue Growth

- After reorganization, SMUSD will have less discretionary revenue per pupil than MUSD and less than an un-reorganized SMMUSD
- Annual 6% property tax growth compounded over a 50-year period grows exponentially
- The differential effect of compounded growth between lower (SMUSD) and higher (MUSD) starting points is increasing financial distance

50 Years of Growth

Figure 1: Discretionary Revenues Per ADA – All Sources



Scenario 1: Sharing All Discretionary Revenues Equally

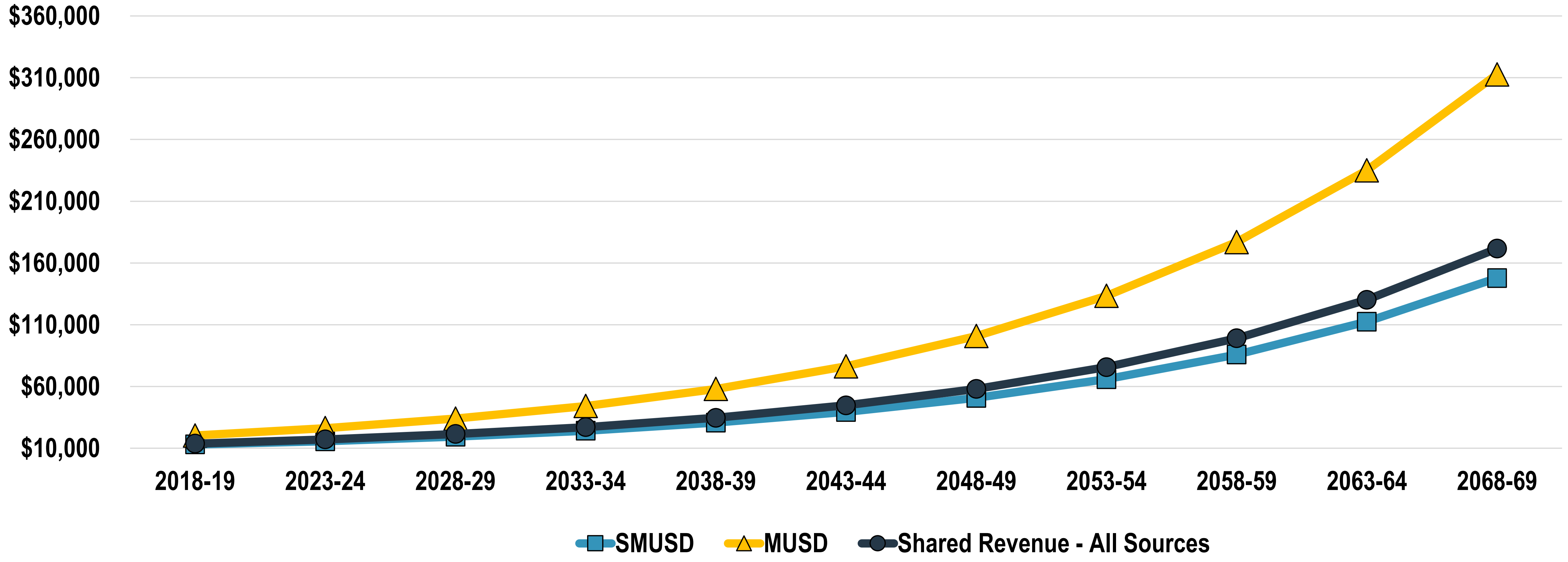
- Revenue sharing means that MUSD would make annual payments to SMUSD, in an amount needed to equalize revenues per pupil between the districts
- SMUSD student ADA is almost six times larger than MUSD – 8,767 compared with 1,483
  - Therefore, it will take about $6 per ADA from MUSD to achieve a $1 increase per ADA in SMUSD
- Scenario 1 equalizes LCFF (property tax and state aid) and other local revenues so that revenues per ADA are equal for both districts

Scenario 1: Sharing All Discretionary Revenues Equally

- Figure 2 shows the payment per ADA from MUSD and the revenue per ADA that the payment generates for SMUSD needed to equalize discretionary revenues from all sources for both districts
- It compares equalized revenues per ADA with the baseline revenues per ADA for each 5-year data point over the 50-year period of revenue sharing
- It graphically shows the ADA-driven difference in revenue reduction for MUSD and revenue increase for SMUSD to reach the point of equalization
- Over time, SMUSD becomes increasingly dependent on revenue neutrality payments to sustain discretionary funding at an equitable level
- Increasing SMUSD dependence on revenue neutrality payments over the long term emphasizes the importance of preparing for the day when revenue sharing ends and financial independence begins

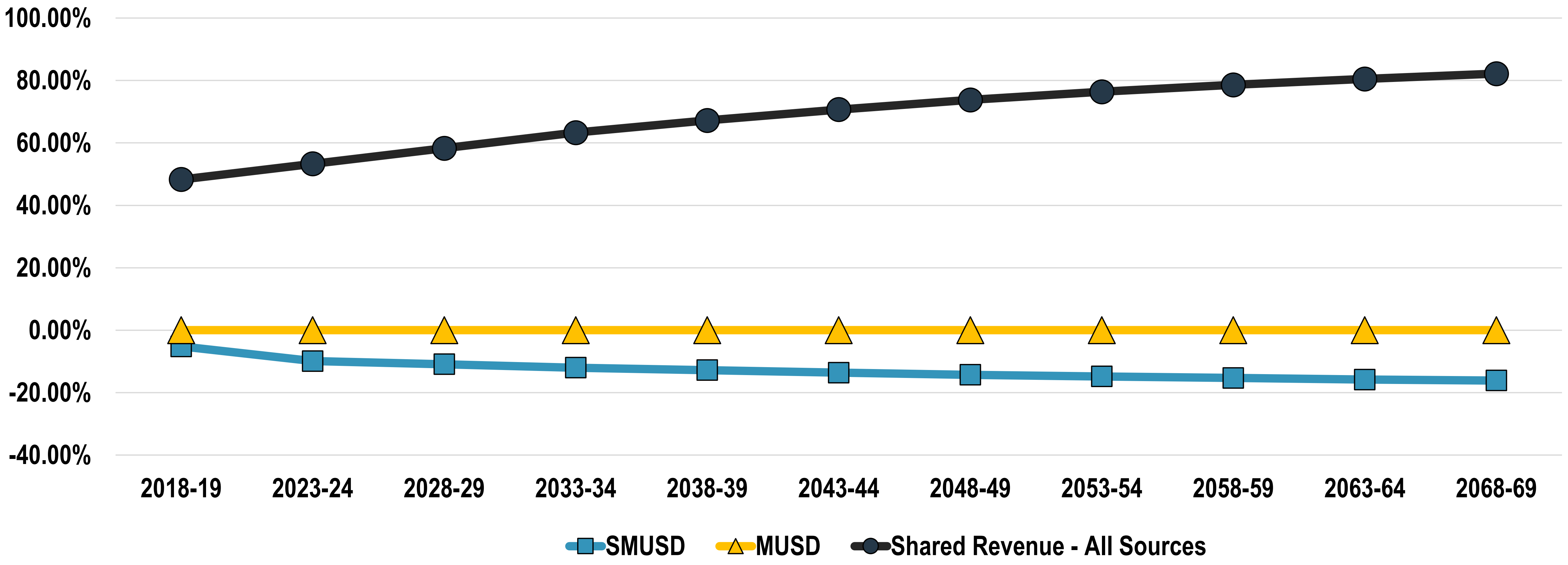
Scenario 1: Sharing All Discretionary Revenues Equally

Figure 2: Discretionary Revenues Per ADA – All Sources



Divergence from Equality Increases Over Time

Figure 3: Shared Property Tax & Other Local Revenue Per ADA – SMUSD & MUSD Percent Divergent



Scenario 2: Sharing Revenues Exclusive of Other Local Revenues

- Locally generated revenues other than the property tax account for a significant share of total discretionary revenue accruing to SMMUSD – 30% in 2017-18
  - Because other local revenues increase by only 2% annually, they are a declining share of total revenue over time, decreasing to only a 6% share in 2068-69
- We analyzed the effect of sharing only LCFF revenues, which are composed primarily of the property tax, and excluding other local revenues (i.e., parcel tax, sales and use tax, city discretionary allocations, and ground lease revenues)
- Both MUSD and SMUSD generate other local revenues that would, under a reorganization, naturally accrue to each district
- A higher amount of existing revenue from other local sources accrues to SMUSD than to MUSD
- Each area has the ability to independently raise revenues in support of the schools

Scenario 2: Sharing Revenues Exclusive of Other Local Revenues

- More locally generated revenues accrue to SMUSD than MUSD on a per ADA basis
- Growing at only 2% per year, other local revenues become an increasingly smaller proportion of total revenues in each district
- Excluding the value of other local revenues increases the revenue neutrality payment from MUSD to SMUSD
- As a proportion of the revenue neutrality payment, the impact of excluding other local revenues declines over time

Scenario 2: Sharing Revenues Exclusive of Other Local Revenues

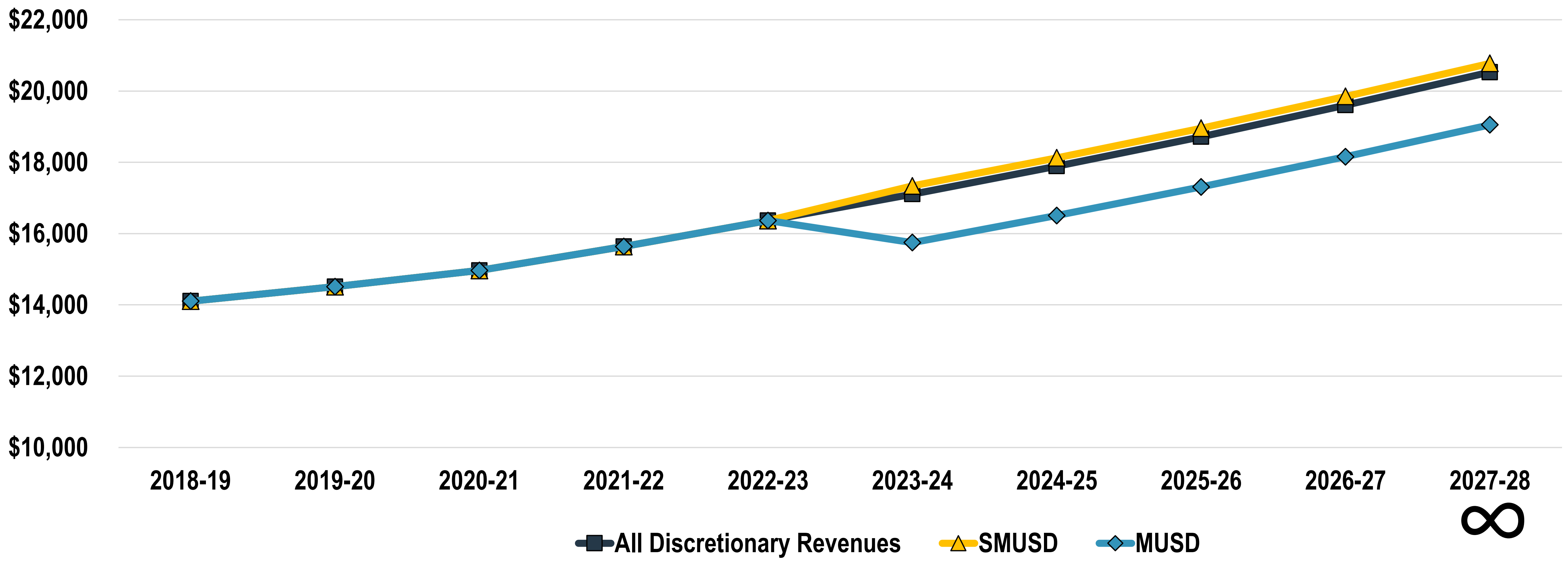
Figure 4: 50-Year Shared Revenues Comparison (Per ADA)				
Year	All Revenues Shared		Excluding Other Local Revenues	
	SMUSD	MUSD	SMUSD	MUSD
2018-19	$1,058	($6,253)	$1,261	($7,454)
2023-24	$1,544	($9,125)	$1,774	($10,485)
2028-29	$2,120	($12,530)	$2,373	($14,031)
2033-34	$2,898	($17,132)	$3,176	($18,777)
2038-39	$3,943	($23,311)	$4,251	($25,128)
2043-44	$5,349	($31,621)	$5,688	($33,626)
2048-49	$7,237	($42,785)	$7,612	($44,999)
2053-54	$9,773	($57,775)	$10,187	($60,219)
2058-59	$13,175	($77,888)	$13,632	($80,587)
2063-64	$17,738	($104,864)	$18,243	($107,844)
2068-69	$23,856	($141,029)	$24,413	($144,319)

Scenario 3: Combining Scenarios 1 and 2

- Beginning in 2023-24, each school district retains its other locally generated revenues outside of the sharing formula
  - Sharing is based on property tax and other LCFF revenue only, and continues in perpetuity
- Over a ten-year period, Figure 5 shows revenue sharing under both Scenarios 1 and 2
- It begins with all revenues shared and transitions to sharing with the exclusion of other local revenues after five years

Scenario 3: Combining Scenarios 1 and 2

Figure 5: Scenario 3: Revenue Per ADA Comparison
Combining Scenario 1 (2018-2023) and Scenario 2 (2023-2028)



A Trust Fund – Mitigating the Shock of Financial Independence

Preparing for the End of Revenue Neutrality Payments

- By 2068-69, the revenue neutrality payment will account for an increase to total SMUSD discretionary revenues of 16%
- In 2069-70, revenue neutrality payments would end as SMUSD becomes completely financially independent of MUSD
- Even with year-over-year growth of property tax revenues continuing at 6%, educational services and programs would suffer more than a 10% cut in one year, absent any other action
- A 50-year payment schedule provides an opportunity to set aside a portion of revenues received by SMUSD to help reduce or eliminate the impact of this transition
- To that end, we explored establishing a trust fund that could take over the role of providing supplemental resources for SMUSD

A Trust Fund

- The purpose of establishing an investment trust fund is to accumulate sufficient resources over a 50-year period so that annual withdrawals, beginning in year 51, can sustain district expenditures after revenue neutrality payments end
  - "Sufficient resources" means that average annual investment returns on the fund balance remaining after a withdrawal can be expected to restore the fund so as to sustain similar annual withdrawals to supplement district expenditures in perpetuity

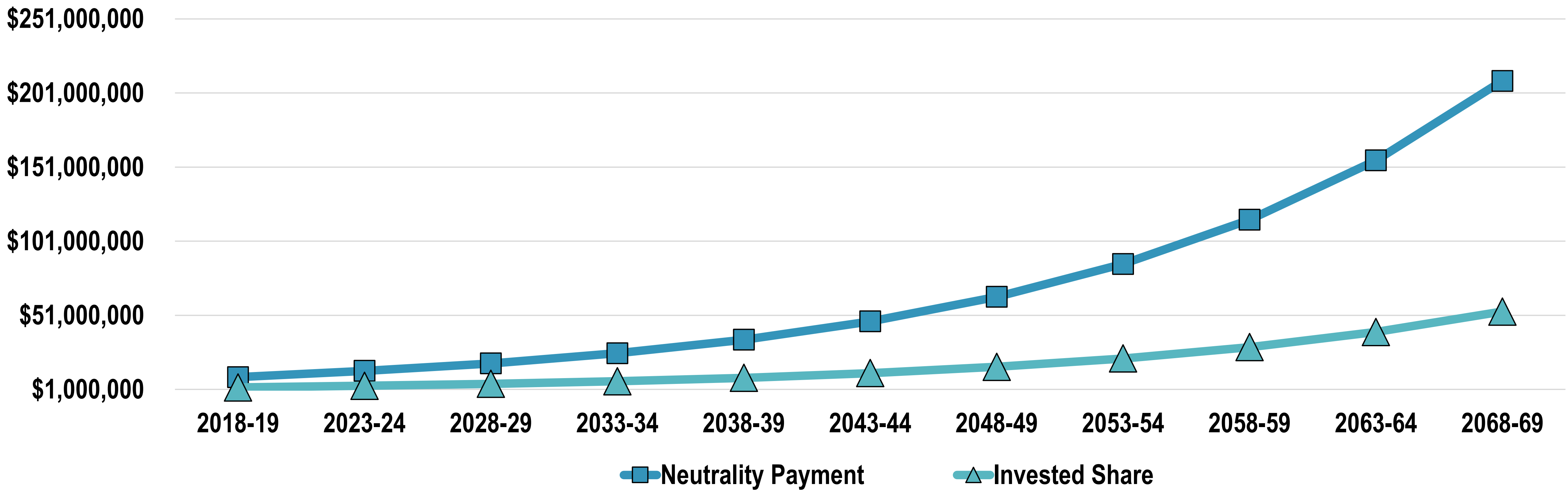
A Trust Fund

- What percentage of the annual revenue neutrality payment would need to be invested in the trust fund each year to meet investment objectives?
  - The amount of annual investment needed in the trust fund is dependent on the average annual rate of return on invested funds and the withdrawal amount the fund must support after the final year of investment
  - In our example, we use a moderately aggressive return rate of 6%
    - A lower average rate of return will require higher annual investments to meet fund objectives
  - The annual withdrawal is set equal to the year 50 revenue neutrality payment less the amount invested in the trust fund that year
    - This is the amount of supplemental revenues needed to support current service levels in year 51
  - With these assumptions, our analysis shows that approximately 25% of each years' revenue neutrality payment must be invested

A Trust Fund

- How large would a trust fund need to be after 50 years of investing to meet fund objectives?
  - The withdrawal amount in year 51 is equal to the *net neutrality payment* in year 50 – in our example, a neutrality payment of $209 million in 2068-69, less 25% invested in the trust fund ($53 million), leaves a net of $156 million
    - This set aside equals about 2% of the District's discretionary funds
  - Assuming an annual rate of return equal to 6%, the trust fund can support a withdrawal of approximately 6% of its balance without diminishing that balance each year
  - The fund balance in year 50 will need to provide a 6% withdrawal amount equal to $156 million, so it will need to be nearly 17 times larger – about $2.6 billion

Figure 6: Trust Fund Investments
6% Rate of Return



A Trust Fund – Final Thoughts

- Establishing a long-term investment fund can cushion the loss of MUSD payments to SMUSD, but it requires that monies otherwise available for district services be sequestered each year to build an endowment sufficient to take the place of those payments after they end
- Existing law limits the investment options of public agencies, including school districts, to vehicles that are intended to provide modest returns at low risk and high liquidity, but a trust fund for this purpose would require quite different operating conditions to meet its goals
- SMUSD would need to make a strong and lasting commitment, as expressed in adopted Board policies consistently supported over time, to the purposes of the fund and its uses
  - There will inevitably be strong pressure to expend those funds for other worthy purposes during the period of fund accumulation

Charter School

Charter Petition

- To establish a charter school, a charter petition must be submitted by one or more persons seeking to establish the charter school
- Options:
  - New start-up charter school – Requires signatures of either at least one-half of the parents or legal guardians of the students estimated to be enrolled at the charter school or at least one-half of the teachers estimated to be employed by the charter school
  - Conversion charter school – Converts an existing public school and requires signatures of not less than 50 percent of the permanent status teachers currently employed at the public school to be converted

Charter School Types

- While the Education Code defines a charter school and how one is created, local educational agencies (LEAs) have established what are commonly referred to as independent and dependent charter schools
  - Not defined in the Education Code
- Regardless of local designation:
  - Authorizing districts are still required to provide oversight to ensure fiscal and academic accountability
  - Each charter school is required to submit a budget, Local Control and Accountability Plan, First and Second Interim reports, and an unaudited financial report

Charter School Types

- Independent charter school
  - Has its own governing board
  - Directly funded by the state
  - No fiscal or legal connection between the charter and authorizing district, with exception of oversight and any contractual obligations agreed to by both parties

- Dependent charter school
  - Same governing board as authorizing school district
  - Receives funding through authorizing district
  - Closer ties to and may overlap services with authorizing district
  - In many cases, treated as another school of the district, though granted more flexibility than traditional schools

Fiscal Considerations

- The LCFF generally allocates funding to charter schools in the same way as to school districts
  - Remaining LCFF funding – supplemental and concentration grants – due to the charter school would be provided by the state
  - Other funding sources (e.g., federal funds, lottery funding, mandate block grant, etc.) would be apportioned directly to the charter school
  - One major area of funding – special education – would be dependent on whether the charter school elects to be a school of the district for special education purposes or apply to a Special Education Local Plan Area as its own LEA

Fiscal Considerations – In Lieu of Property Tax Transfer

- The Education Code requires a sponsoring LEA to annually transfer to each of its charter schools funding in lieu of property taxes equal to the lesser of:
  - The average amount of property taxes per unit of ADA, including the ADA attributable to charter schools, received by the LEA, multiplied by the charter school's ADA
  - The LCFF base grant funding per unit of ADA, multiplied by the charter school's ADA in each of the four grade level ranges
- Basic aid districts are eligible for the Basic Aid Supplement Charter School Adjustment, which provides for partial backfilling of the property tax transferred on behalf of nonresident students

Charter School Conversion Options

- There are two options for the conversion of the schools* currently located within the city of Malibu
- Option 1: Create a separate charter school for each school site each with its own charter petition with a nonprofit entity as the umbrella organization overseeing the four individual charter schools
  - Each school site would have greater independence
  - Funding would be apportioned separately to each site
  - Any available grants or other funding sources could be maximized in that each charter school would be eligible to apply and receive funding
  - However, all reporting requirements would have to be prepared for each independent charter school

*Juan Cabrillo, Point Dume, and Webster Elementary Schools, and Malibu Middle/High School – which includes grades 6-12

Charter School Conversion Options

- Option 2: Develop a single charter petition and a single charter school operating at multiple sites
  - Would still require the signatures of not less than 50 percent of the permanent status teachers currently employed at each of the four schools*
  - Reduces the administrative costs associated with operating the charter school and complying with reporting requirements in comparison to the first option
  - However, provides less flexibility and autonomy for the individual school sites

*Juan Cabrillo, Point Dume, and Webster Elementary Schools, and Malibu Middle/High School – which includes grades 6-12

Assumptions for Charter School Analysis

- A single, independent charter school with multiple school sites
- Conversion will take place in 2018-19
  - However, given the complexities involved with the conversion of four schools simultaneously, it is unlikely that instruction would begin prior to 2020-21
- 2018-19 projected ADA
  - SMMUSD – 8,767
  - Malibu charter school – 1,483

Fiscal Implications – In Lieu of Property Tax Transfer

- There are two options to determine the amount of in lieu property tax to be transferred from the district to the charter school
  - Option 1: The average amount of property taxes per unit of ADA, including the ADA attributable to charter schools, received by the LEA, multiplied by the charter school's ADA
  - Option 2: The LCFF base grant funding per unit of ADA, multiplied by the charter school's ADA in each of the four grade level ranges
- The difference between Option 1 (the average amount of property taxes per unit of ADA) and Option 2 (the LCFF base grant funding amount per ADA for each grade level) is retained by SMMUSD

Fiscal Implications – In Lieu of Property Tax Transfer

Option 1

Property tax revenues	$89,038,000
Total ADA	10,251
Average amount of property taxes per ADA	$8,686
Charter school ADA	1,483
In lieu due to charter school	**$12,882,437**

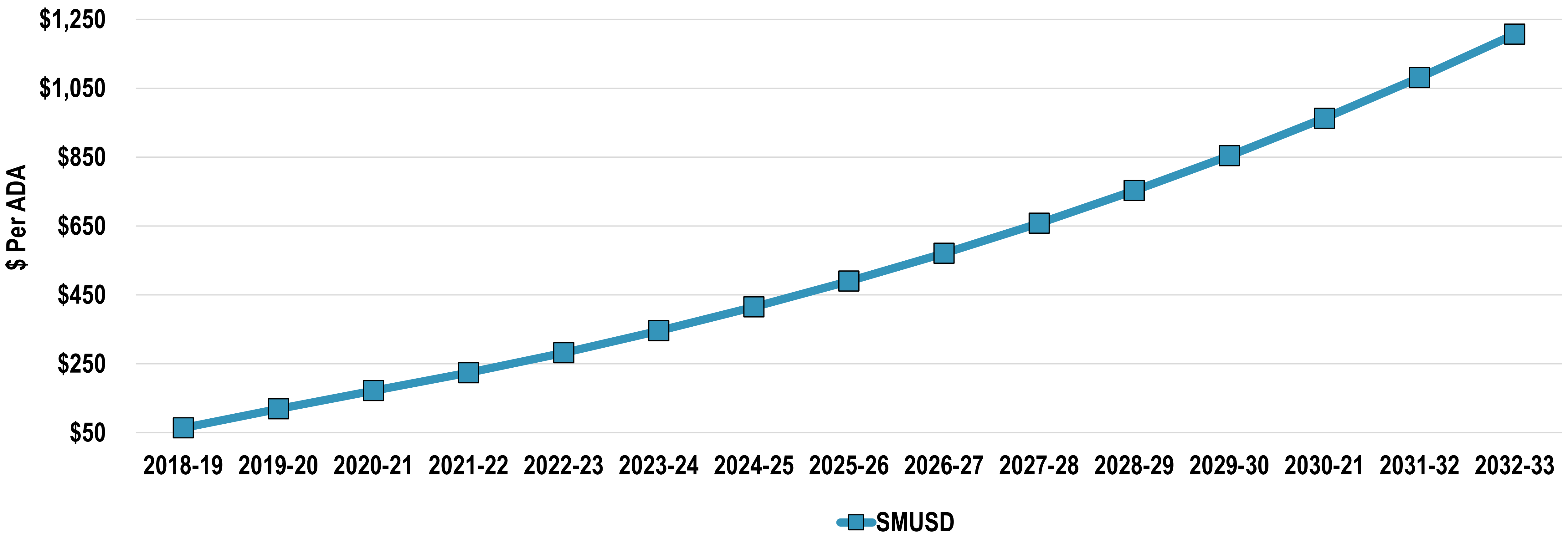
Option 2

Grade	Base Grant Funding	ADA	In Lieu of Property Tax Transfer[1]
K-3	$8,141	355	$2,890,136
4-6	$7,484	377	$2,823,189
7-8	$7,707	188	$1,449,224
9-12	$9,163	563	$5,159,594
	Total	**1,483**	**$12,322,144**

[1]Numbers may not total due to rounding

Fiscal Implications

Figure 7: Difference Retained by SMMUSD Per ADA

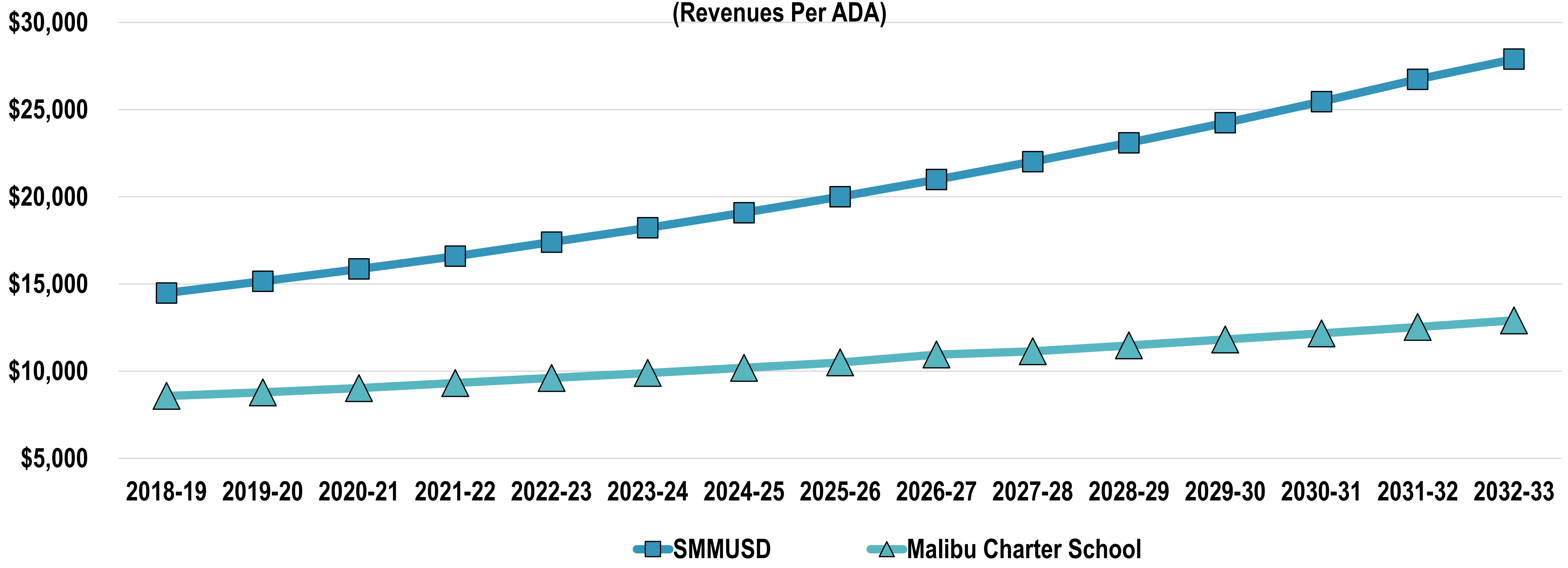


Fiscal Implications and Other Considerations

- SMMUSD is only required to provide the in lieu of property tax transfer and is not required to share any additional revenues
  - Therefore, all other local revenues (e.g., parcel tax measures, ground leases, contributions from city, etc.) would remain with SMMUSD
- SMMUSD with a Malibu charter school would have less total revenues but a higher per-ADA funding amount
- Malibu charter school will be funded on LCFF and increase only by the established cost-of-living adjustment provided in a given year
- Given the scope of the proposed undertaking, it should be made clear that the potential conversion will be a time intensive process
- Many areas besides fiscal (e.g., academics; continuity and transfer of students' records, data, and test scores; parent engagement; etc.) are also critical to the success of the charter school option

Scenario 1: Sharing All Discretionary Revenues Equally

Figure 8: Fiscal Implications of a Charter School
(Revenues Per ADA)



Charter School – Final Thoughts

- **Developing a single charter school with multiple sites in the Malibu community would have lower administrative costs compared to establishing four separate charter schools**
- **Determining the in lieu property tax transfer to the Malibu charter school based on base grant funding allows SMMUSD to retain a greater share of the property tax**
- **Conversion to a charter school will require the support of the parents and/or the teachers in the Malibu community**

Thank you

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