

SUPPLEMENTAL MEMORANDUM REPORT

To: Dr. Benjamin Drati, Superintendent
Santa Monica-Malibu Unified School District

From: The Malibu Unification Negotiations Committee

Date: July 11, 2017

Subject: Supplement to the Committee’s Memorandum Report of February 24, 2017

This Supplemental Memorandum Report summarizes conclusions and recommendations from the Malibu Unification Negotiations Committee (the “Committee”) that augment the Committee’s Memorandum Report to the Santa Monica-Malibu Unified School District (the “District”) Board of Education (the “Board”) dated February 24, 2017 (the “Original Report”¹). On May 30, 2017, the Board requested the Committee undertake additional work on the Committee’s recommendations regarding the Revenue Neutrality Formula.

The sitting members of the Committee have unanimously approved this Supplemental Memorandum Report.² This memo uses the terms and acronyms that are defined in the Glossary (Appendix E) to the Original Report, and is organized as follows:

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¹ The Original Report can be accessed at www.smmusd.org/superintendent/MalibuUnification/report.html.

² Makan Delrahim who was appointed to serve as one of the Malibu members of the Committee resigned in January 2017 due to an employment change.

BACKGROUND

On December 15, 2015, the Board adopted a Resolution establishing the Committee and directing it to review specific financial issues surrounding a proposed reorganization of the District. The reorganization, if approved by the State of California (the “State”), would create two separate unified school districts: Santa Monica Unified School District (“SMUSD”) and Malibu Unified School District (“MUSD”).

The Committee’s Original Report set forth recommendations for addressing these financial issues. The specific terms and conditions for implementing these recommendations were outlined in an “Agreement” that was unanimously approved by the Committee.

Members of the Committee discussed the Original Report with the Board at meetings held on March 7 and May 30, 2017, with members of the public on March 21, 2017 in Santa Monica, and with the Malibu City Council and members of the public on March 27, 2017. At the March 27th meeting, the Malibu City Council unanimously adopted a resolution to recommend approval of the Committee’s Agreement and communicate this recommendation to the Board.

At its May 30, 2017 discussion of the Original Report, the Board requested that the Committee review its initial recommendations regarding the Revenue Neutrality Formula with guidance provided by the Board and to do so with the participation of the District Superintendent, Dr. Benjamin Drati, District Chief Financial Officer Jan Maez (“District CFO”), and a subcommittee of the Board consisting of Board President Laurie Lieberman and Board Members Maria Leon-Vazquez and Jon Kean.

In response to the Board’s request, the Committee met on June 5, 14, 20 and 28 and reached consensus on the conclusions and recommendations contained in this Supplemental Memorandum Report.

THE ORIGINAL REPORT

Topics Addressed

The Original Report divided the various financial issues the Committee was instructed to address into four Topics (listed below), along with a fifth topic recommended by the Committee to deal with implementation of its recommendations:

- Topic #1: Impact of Reorganization of SMUSD and MUSD Revenues
- Topic #2: Division of the District’s Assets (Fund Balances, Buildings, Land, and School Buses)
- Topic #3: Bond-Related Items and Other Liabilities
- Topic #4: Environmental Liability

Since submitting its Original Report, out of the four financial topics, the Committee has received comments primarily on Topic #1.

The Revenue Neutrality Formula

Early in its initial negotiating process, the Committee adopted a series of guiding principles, which required that any Agreement must:

- Be financially viable for both MUSD and SMUSD;
- Ensure a degree of predictability for both MUSD and SMUSD;
- Enable each district to plan ahead with a reasonable degree of resource certainty;
- Avoid establishing potential negative financial incentives for either new district; and
- Be clear, understandable, legal and enforceable.

The Committee reached unanimous agreement on a formula (the “Revenue Neutrality Formula”) that calculates the Financial Effect of reorganization on SMUSD (the “Delta”) and establishes a schedule of payments to SMUSD from MUSD that, in the Committee’s judgment, would maintain predictable and stable revenue growth for both districts and, in the aggregate, eliminate any significant adverse financial effect of reorganization on SMUSD.

The Revenue Neutrality Formula calls for calculation of the Delta annually through 2029-2030 and requires MUSD to pay in each year that portion of the Delta that would be within its “ability to pay.” Any shortfalls would be accumulated and retired, with interest, over time.

Prior to finalizing the Original Report, the Committee submitted the Revenue Neutrality Formula, together with its projected results through the anticipated payment period, to the Committee’s consulting firm with expertise in school financing, School Services of California (“SSC”) and the District CFO for review and comment. Appendix D of the Original Report contained an illustrative projection of the Revenue Neutrality Formula, which this Supplemental Memorandum Report references as “MUNC 1.0.”

Board and Public Reaction

As noted above, most comments voiced about the terms of the Agreement in the Original Report concerned the recommended Revenue Neutrality Formula. The Board and some members of the public raised concerns about the effect of the Revenue Neutrality Formula on SMUSD, because the Committee’s illustrative revenue projections in its Original Report (“MUNC 1.0”) predicted that the Delta would not be fully paid each year by MUSD. Because no objections were raised to the Committee’s recommendations outlined in the Original Report concerning the other financial topics addressed, the Board did not request the Committee to address those issues any further.

THE BOARD'S MAY 30, 2017 MEETING.

Update to the Revenue Neutrality Formula Projections

At the Board's May 30th meeting at which the Original Report was discussed for a second time, the Committee reported that new information had changed certain assumptions adopted by the Committee in generating the Revenue Neutrality Formula projections contained MUNC 1.0. These changes are explained below. In addition, Attachment #2 to this Supplemental Memorandum Report contains the updated illustrative projections of the Revenue Neutrality Formula, which are referred to in the balance of this Memo as "MUNC 2.0."

Adjusted MUSD revenue and "ability to pay" calculation. In consultation with the District CFO, the Committee reviewed:

- Revenue and budget projections for MUSD previously prepared by WestEd;
- MUSD revenue projections by SSC; and
- More recent changes to Malibu schools expenditure trends.

Based on this review, the Committee updated the estimate of revenue MUSD would require in the first year of reorganization as well as the estimate of the Beginning Balance in its Unrestricted General Fund post-reorganization. This resulted in an approximately \$3 million/year increase in MUSD's "ability to pay." The Committee also determined that an annual budgeted revenue growth rate (the Cost-of-Living Adjustment or "COLA") of approximately 3.5% would be needed by MUSD in order to avoid program cuts, as compared to the 2.67% COLA assumed in MUNC 1.0.

Therefore, the Committee adjusted the MUSD "ability to pay" calculation in MUNC 2.0 to permit annual budgeted revenue to grow at a rate of 3.5% before making Delta payments to SMUSD. Additionally, to mitigate the fixed growth rate cap over a sustained time period and avoid establishing a negative incentive toward seeking additional school funding, any local revenues generated by MUSD that are not included in the Revenue Neutrality Formula would not be included in the "ability to pay" calculation.

Updated Redevelopment Agency Funds. The District CFO reported to the Committee that funding (both already received and anticipated) from several categories of property tax-related payments to the District from the former Santa Monica Redevelopment Agency (the "RDA") has been and is projected to be approximately \$4 million per year higher than SSC and the Committee had assumed in developing MUNC 1.0. Therefore, the District, which is currently in Minimum State Aid status, would have higher revenues than originally anticipated and would

likely be classified as a Basic Aid district beginning as early as 2018-2019, which is several years earlier than projected in the Original Report.³

Although SMUSD would also likely reach Minimum State Aid and Basic Aid status several years earlier than originally projected, until SMUSD reaches Minimum State Aid (projected in MUNC 2.0 to be 2021-2022), the additional property tax revenue from the RDA would serve only to offset a portion of State LCFF funding and reduce the amount of total State Aid provided to the separate districts after reorganization. As a result, the Delta which was originally negative to minimal in the first five years under MUNC 1.0, would increase to \$4 million in the first year of reorganization. This increase is mostly mitigated in MUNC 2.0 by the increased MUSD “ability to pay,” as described on the previous page.

In sum, when compared to the projections contained in MUNC 1.0, the MUNC 2.0 projections show that between 2018-2019 and 2029-2030 (the period during which the Delta is calculated), the increased RDA funds and MUSD’s payments result in an incremental \$53 million in revenue for SMUSD. (When MUSD’s payments beyond 2029-2030 are included, the amount of incremental revenue for SMUSD is even higher.)

Growth Rate of Assessed Property Values. The annual growth rates of assessed real property values are key assumptions in calculating revenue projections for the District, SMUSD and MUSD. One Committee member discovered a mistake in the calculations received from SSC and used in the MUNC 1.0 projections. This error was corrected in MUNC 2.0.⁴

Summary of How MUNC 2.0 Changes Affect Revenue Projections.

Using the structure of the Revenue Neutrality Formula recommended in the Original Report, the changes described above are projected to have the following general effects on the illustrative Revenue Neutrality Formula projections set forth in MUNC 1.0. As noted above, Attachment #1 to this Supplemental Memorandum Report contains the updated MUNC 2.0 projections.

Duration and Amount of Payments. Under MUNC 2.0, there are no longer any early years in which no Delta payment would be required. Instead, annual payments to SMUSD from MUSD would begin in 2018-2019 and continue to 2034-2035, with payments totaling about \$90,000,000. This amount equals 100% of the annual Delta calculations, plus interest.

³ For an explanation of the relevance of the State’s Local Control Funding Formula (LCFF) and the significance of a school district reaching Minimum State Aid and Basic State Aid status, see the definition of LCFF in the Glossary (Appendix E) of the Original Report.

⁴ Keygent, the District’s facility bond financial advisor, also provided the CFO and MUNC a different time series of historical assessed value growth rate estimates for the District, SMUSD and MUSD. As noted below with respect to next steps, this should be reconciled with SSC’s approach.

Payments as a Percentage of Annual Deltas. In years in which MUSD is not able to pay the full Delta amount, the revenue projected to be received per ADA by SMUSD will be no less than approximately 98% of the amount it would have received if the District had not reorganized. Even during the additional five years of interest payments, SMUSD revenues will remain within the same 98%.

Annual Revenue Growth Rates. The MUNC 2.0 projections show:

- SMUSD: With the exception of the first year in which MUSD is projected to no longer be required to make payments to SMUSD (2034-2035), SMUSD's revenue, including MUSD payments, is projected to grow at a steady annual rate of between 3.2% and 4.3% once SMUSD becomes a Minimum State Aid district in 2021-2022. This growth rate is projected to resume immediately after 2034-2035.
- MUSD: During the first 17 years following reorganization, MUSD's annual revenue growth rate from the included sources, after deducting payments to SMUSD, is capped at 3.5%. Once the payment period ends, MUSD's revenue is projected to grow at a rate slightly below SMUSD's.

Minimum and Basic Aid Status for SMUSD. As a result of the various adjustments described above, MUNC 2.0 projects that SMUSD will reach Minimum State Aid status in 2021-2022 and Basic Aid status in 2025-2026, several years earlier than was projected in MUNC 1.0.

Reduced Amount of Additional State Funding. MUNC 1.0 projected that reorganization would require approximately \$46.0 million in additional State funding because SMUSD would reach Minimum State Aid and Basic Aid status many years later than the District. The adjustments included in MUNC 2.0 are projected to reduce that amount to approximately \$4.0 million. This reduction is expected to ameliorate potential State objections to reorganization as to this financial issue.

Cost Ratio Approach

On May 30th, the Committee also reported that it had considered an alternative Revenue Neutrality Formula based on the fact that the cost per ADA for operating Santa Monica schools, (excluding general administrative overhead), has historically been less than for operating Malibu schools, due to differences in school site proximities and school enrollment in the two communities. Therefore, it might not be necessary for MUSD to pay the full annual Delta in order to protect against any negative financial effect on a separate SMUSD.

The Committee advised the Board that it had not had an opportunity to fully analyze this approach. The next step would need to include analyzing the impact of general administrative overhead costs, which would involve making certain assumptions about expenditures of SMUSD and MUSD post-reorganization.

Board Action

After extensive discussion, the Board:

- Agreed to “tolerate the concept that even if a Delta exists, payment of the Delta from MUSD to SMUSD could be less than 100%” and that there could be an end date to Delta calculations.
- Requested that the Committee report back with any revisions it might have to the recommendations in the Original Report, including use of the Cost Ratio analysis if the Committee deemed that approach to be appropriate.
- Established a Board subcommittee to attend the Committee’s meetings and directed the Superintendent and District CFO to participate in the Committee’s deliberations.
- Directed District staff to determine whether SSC or some other outside expert in school finances “should be engaged to conduct a peer review of [the Committee’s] new calculations and projections and could also act as a bridge during the transition between [District CFOs].”⁵

COMMITTEE CONCLUSIONS AND RECOMMENDATIONS

Conclusions and Recommendation on the Cost Ratio Approach

In order to examine the Cost Ratio Approach, the Committee reviewed the following data compiled by the District:

- School-by-school budget data for the four fiscal years 2014-15 through 2017-18; and
- Aggregate Department costs on a District-wide basis for the same four fiscal years.

A review of these data showed:

- The four-year average total budget for the District was \$139 million. Out of this total, \$74 million (or 53.2%) consisted of school-based costs; and the other \$65.1 million (or 46.8%) consisted of Department (District-wide or administrative overhead) costs.
- The four-year average ADA split between Santa Monica and Malibu was 84% to 16%.
- The four-year average per ADA student cost for the District as a whole was \$6,655. For the schools located in what would be SMUSD, the four-year average was \$6,451; and for the schools located in what would be MUSD, the four-year average was \$7,732.

⁵ The Superintendent subsequently reported that SSC has agreed to provide these peer review services.

- The following five areas account for almost three-fourths of the \$65.1 million in four-year average Department costs. The dollar amounts shown in parenthesis represent the four-year average budgeted amount for each activity:

Special Education (\$29.3 million)	Human Resources (\$3.1 million)
Ed Services (\$8.6 million)	Computer Services (\$2.8 million)
Ongoing maintenance (\$4.2 million)	

After investing time reviewing the cost data that were readily available, consulting with the District CFO, and listening to comments from members of the Board’s ad hoc subcommittee, the Committee recommends that the Cost Ratio Approach not be utilized in calculating the Delta. The primary reason for this decision is that calculating an annual Delta based on relative costs would be extremely difficult at best. Also, on an ADA basis, it is not clear when and how much SMUSD would be able to reduce administrative costs to match the reduced enrollment.

Conclusions and Recommendations on MUNC 2.0

The Committee recommends that the structure of the Revenue Neutrality Formula included in the Original Report, with the adjustments identified above (see listing beginning on page 4), be retained as the best approach to achieving the Board’s objectives in line with the Committee’s guiding principles. This recommendation remains part of the Committee’s Agreement even with the recognition that after reorganization, SMUSD will no longer include the more geographically dispersed (and relatively more costly on an ADA basis) schools in the Malibu portion of the current District.

In particular, the Committee continues to support the Revenue Neutrality Formula’s provision for annual Delta calculations beginning with the first fiscal year that reorganization becomes effective (assumed to be 2018-19) through fiscal year 2029-2030, a 12-year period. This time period was selected for the following reasons:

- It represents the length of time that was negotiated by the Committee within the context of the Agreement across all five topics. In its entirety, the Agreement was structured to maximize mutual interests as well as fairly balance the priority interests of both communities.
- It represents the time period provided by SSC in its model of revenue projections that the Committee used during the negotiations and which SSC deemed to be as long as was reasonable to make revenue projections for both districts. Using any longer time period raises significant uncertainty about revenue projection accuracy, as demonstrated by the recent change in the RDA revenue within just the last six months (discussed earlier), which led to a substantial difference in the Delta calculation and a significant reduction in the time before SMUSD would become a Basic Aid district.
- It approximates the length of time a student attends primary and secondary schools in California.

Note: The Committee's Agreement and associated projections assume that reorganization becomes effective in fiscal year 2018-2019. If reorganization becomes effective after fiscal year 2018-2019, but before or during fiscal year 2020-2021, the Agreement provides that the Formula would continue as presented, including the 12 years of Delta calculation. However, if reorganization is delayed beyond fiscal year 2020-2021, the Agreement provides that the Formula will be revisited and open for renegotiation in case the revenue forecasting assumptions or other related TK-12 school finance factors underlying the Formula change. The Committee recommends that any renegotiation be conducted within the context of the basic principles outlined in this Agreement.

With the adjustments referenced above to MUNC 1.0, the illustrative revenue projections for MUNC 2.0 show the following:

- Payments to SMUSD from MUSD will achieve at least 98% of the full Delta each year in which Delta and interest payments are made. The Committee concluded that this result fulfills the Board's direction from May 30, 2017 that payment of the full Delta to SMUSD from MUSD could be less than 100% while also providing a financial arrangement that would enable the reorganization to occur without a significant adverse financial impact on SMUSD. It is clear to the Committee that any requirement for MUSD to pay the full annual Delta every year would be financially infeasible for MUSD.
- Both SMUSD and MUSD will experience annual revenue growth rates sufficient to leave both districts financially viable. With the exception of one transition year (2034-2035), SMUSD revenues (including MUSD payments) will exhibit steady growth of between 3.2% and 4.3% once SMUSD becomes a Minimum State Aid district in 2021-2022.
- MUSD will be a Basic Aid District immediately following reorganization. SMUSD will reach that status in 2025-2026, which is much faster than was projected in MUNC 1.0.

A redlined version of the Term Sheet for Topic #1 in the Original Report (part of Appendix C) is included with this Supplemental Memorandum Report as Attachment #2.

Recommendations on Issues for SSC's Peer Review

The Committee recommends that the Superintendent direct SSC to conduct its peer review in a manner consistent with the guiding principles adopted by the Committee and suggests that it undertake the following tasks:

- Review the data and calculations used in the Revenue Neutrality Formula as reflected in MUNC 2.0 to affirm that they are accurate and based on the most current information available. As a part of this task, SSC should resolve the data discrepancies on assessed value of property growth rates between those selected by SSC and those provided to the CFO by Keygent.

- Review the individual elements of the Revenue Neutrality Formula including:
 - The definition of “Delta”;
 - The approach taken regarding MUSD’s ability to pay; and
 - The Agreement’s terms and conditions relating to the length of Delta calculation and conditions under which the length of time would be subject to renegotiation.
- Consider whether there is a way to configure the payments to SMUSD from MUSD to minimize the one-year of relatively lower growth rate projected to occur in SMUSD revenue during the fiscal year after payments end.

ATTACHMENTS

- #1 Revised Appendix D to reflect illustrative Revenue Neutrality projections for MUNC 2.0.
- #2 Redlined Changes to the Term Sheet for Topic #1, Impact of Reorganization on SMUSD and MUSD Revenues

ATTACHMENT #1

Revised Appendix D to Reflect Illustrative Revenue Neutrality Formula Projections for MUNC 2.0

(Note: A more detailed version of MUNC 2.0, including all supporting data and a set of charts illustrating certain results trends, and the corresponding Excel workbook, are available from Committee Member Manel Sweetmore)

SCENARIO MUNC 2.0 : Same Approach as 1.0 but updated info -- Delta Obligation of 12yrs No Taper (MUNC Orig. Agreement) -- RDA: District Projections -- Assessed Value: SSC Projections Corrected

Calculations	State Aid	State Aid	State Aid	SM Min Aid	SM Min Aid	SM Min Aid	SM Min Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
1 SMMUSD Revenue	\$139,987,240	\$145,244,949	\$150,659,237	\$156,399,821	\$162,311,336	\$168,490,234	\$174,949,899	\$181,704,435	\$189,114,454	\$196,595,380
2 SMUSD Revenue	\$112,610,966	\$115,987,487	\$119,725,090	\$123,437,612	\$128,049,847	\$132,873,748	\$137,920,276	\$143,200,997	\$149,073,878	\$154,951,580
2 SMUSD Required Revenue	\$116,611,432	\$120,991,181	\$125,501,362	\$130,283,353	\$135,207,732	\$140,354,845	\$145,735,841	\$151,362,469	\$157,535,124	\$163,766,846
3 SMUSD Required Rev/ADA	\$13,381	\$13,883	\$14,401	\$14,949	\$15,514	\$16,105	\$16,722	\$17,368	\$18,076	\$18,791
4 SMUSD Rev/ADA	\$12,922	\$13,309	\$13,738	\$14,164	\$14,693	\$15,247	\$15,826	\$16,432	\$17,105	\$17,780
5 Delta per ADA	\$459	\$574	\$663	\$786	\$821	\$858	\$897	\$936	\$971	\$1,012
6 Delta \$	\$4,000,466	\$5,003,694	\$5,776,272	\$6,845,741	\$7,157,886	\$7,481,096	\$7,815,565	\$8,161,472	\$8,461,246	\$8,815,266
7 Delta \$ Amt to be Paid	\$4,000,466	\$5,003,694	\$5,776,272	\$6,845,741	\$7,157,886	\$7,481,096	\$7,815,565	\$8,161,472	\$8,461,246	\$8,815,266
8 MUSD Payment	\$4,000,466	\$3,991,612	\$3,504,991	\$3,763,487	\$4,040,812	\$4,338,083	\$4,656,477	\$4,997,232	\$5,361,654	\$5,751,115
9 Delta \$ (Deferred) / Catch-up	\$0	(\$1,012,082)	(\$2,271,281)	(\$3,082,255)	(\$3,117,074)	(\$3,143,013)	(\$3,159,088)	(\$3,164,240)	(\$3,099,593)	(\$3,064,151)
10 MUSD Owed to SMUSD	\$0	\$1,012,082	\$3,292,472	\$6,404,359	\$9,579,072	\$12,808,297	\$16,082,659	\$19,391,643	\$22,665,761	\$25,933,903
11 Interest on MUSD Owed Balance		\$0	\$9,109	\$29,632	\$57,639	\$86,212	\$115,275	\$144,744	\$174,525	\$203,992
12 SMUSD Revenue After Payment	\$116,611,432	\$119,979,099	\$123,230,081	\$127,201,098	\$132,090,658	\$137,211,832	\$142,576,753	\$148,198,229	\$154,435,531	\$160,702,695
13 SMUSD Revenue After Payment Growth Rate		2.9%	2.7%	3.2%	3.8%	3.9%	3.9%	3.9%	4.2%	4.1%
14 SMUSD Revenue After Payment / ADA	\$13,381	\$13,767	\$14,140	\$14,596	\$15,157	\$15,744	\$16,360	\$17,005	\$17,721	\$18,440
15 Delta After Payment / ADA	\$0	\$116	\$261	\$354	\$358	\$361	\$362	\$363	\$356	\$352
16 Delta After Payment as % of SMUSD Rev after Pmt	0.0%	0.8%	1.8%	2.4%	2.4%	2.3%	2.2%	2.1%	2.0%	1.9%
17 MUSD Revenue	\$29,379,809	\$30,521,589	\$31,716,317	\$32,962,209	\$34,261,490	\$35,616,485	\$37,029,623	\$38,503,438	\$40,040,577	\$41,643,801
18 MUSD Required Revenue (Budget)	\$26,300,000	\$27,220,500	\$28,173,218	\$29,159,280	\$30,179,855	\$31,236,150	\$32,329,415	\$33,460,945	\$34,632,078	\$35,844,200
19 MUSD Required Revenue / ADA	\$15,054	\$15,581	\$16,127	\$16,691	\$17,275	\$17,880	\$18,506	\$19,153	\$19,824	\$20,518
20 MUSD Revenue in Excess of Cap	\$3,079,809	\$3,301,089	\$3,543,100	\$3,802,929	\$4,081,635	\$4,380,335	\$4,700,208	\$5,042,493	\$5,408,499	\$5,799,600
21 MUSD Minimum Fund Balance	\$1,052,000	\$1,088,820	\$1,126,929	\$1,166,371	\$1,207,194	\$1,249,446	\$1,293,177	\$1,338,438	\$1,385,283	\$1,433,768
22 MUSD Fund Balance (Starting Bal: \$2,700,000)	\$1,779,343	\$1,088,820	\$1,126,929	\$1,166,371	\$1,207,194	\$1,249,446	\$1,293,177	\$1,338,438	\$1,385,283	\$1,433,768
23 MUSD Fund Balance % of Budget	6.8%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%

SCENARIO MUNC 2.0 : Same Approach as 1.0 but updated info -- Delta Obligation of 12yrs No Taper (MUNC Orig. Agreement) -- RDA: District Projections -- Assessed Value: SSC Projections Corrected

Calculations	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	SM Basic Aid	Total
Year	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36		
1 SMMUSD Revenue	\$204,534,743	\$212,836,649	\$221,519,388	\$230,602,219	\$240,105,423	\$250,050,359	\$260,459,518	\$271,356,593		
2 SMUSD Revenue	\$161,218,748	\$167,776,480	\$174,639,921	\$181,825,049	\$189,348,718	\$197,228,711	\$205,483,785	\$214,133,733		
2 SMUSD Required Revenue	\$170,380,452	\$177,296,061	\$184,528,911	\$192,095,043	\$200,011,352	\$208,295,630	\$216,966,613	\$226,044,036		
3 SMUSD Required Rev/ADA	\$19,550	\$20,344	\$21,174	\$22,042	\$22,950	\$23,901	\$24,896	\$25,937		
4 SMUSD Rev/ADA	\$18,499	\$19,251	\$20,039	\$20,863	\$21,727	\$22,631	\$23,578	\$24,571		
5 Delta per ADA	\$1,051	\$1,092	\$1,135	\$1,178	\$1,223	\$1,270	\$1,318	\$1,367		
6 Delta \$	\$9,161,703	\$9,519,581	\$9,888,990	\$10,269,994	\$10,662,633	\$11,066,918	\$11,482,827	\$11,910,303		
7 Delta \$ Amt to be Paid	\$9,161,703	\$9,519,581	\$0	\$0	\$0	\$0	\$0	\$0		\$88,199,990
8 MUSD Payment	\$6,167,065	\$6,611,027	\$7,084,605	\$7,589,488	\$8,127,454	\$8,700,373	\$1,621,916	\$0		\$90,307,858
9 Delta \$ (Deferred) / Catch-up	(\$2,994,638)	(\$2,908,554)	\$7,084,605	\$7,589,488	\$8,127,454	\$8,700,373	\$1,621,916	\$0		
10 MUSD Owed to SMUSD	\$29,161,946	\$32,332,958	\$25,539,350	\$18,179,716	\$10,215,879	\$1,607,449	\$0	\$0		
11 Interest on MUSD Owed Balance	\$233,405	\$262,458	\$290,997	\$229,854	\$163,617	\$91,943	\$14,467	\$0		\$2,107,868
12 SMUSD Revenue After Payment	\$167,385,814	\$174,387,507	\$181,724,527	\$189,414,537	\$197,476,172	\$205,929,085	\$207,105,701	\$214,133,733		
13 SMUSD Revenue After Payment Growth Rate	4.2%	4.2%	4.2%	4.2%	4.3%	4.3%	0.6%	3.4%		
14 SMUSD Revenue After Payment / ADA	\$19,207	\$20,010	\$20,852	\$21,734	\$22,659	\$23,629	\$23,764	\$24,571		
15 Delta After Payment / ADA	\$344	\$334	\$322	\$308	\$291	\$272	\$1,131	\$1,367		
16 Delta After Payment as % of SMUSD Rev after Pmt	1.8%	1.7%	1.5%	1.4%	1.3%	1.1%	4.8%	5.6%		
17 MUSD Revenue	\$43,315,995	\$45,060,169	\$46,879,467	\$48,777,170	\$50,756,705	\$52,821,648	\$54,975,733	\$57,222,860		
18 MUSD Required Revenue (Budget)	\$37,098,747	\$38,397,204	\$39,741,106	\$41,132,044	\$42,571,666	\$44,061,674	\$45,603,833	\$47,199,967		
19 MUSD Required Revenue / ADA	\$21,236	\$21,979	\$22,748	\$23,544	\$24,368	\$25,221	\$26,104	\$27,018		
20 MUSD Revenue in Excess of Cap	\$6,217,247	\$6,662,965	\$7,138,361	\$7,645,126	\$8,185,039	\$8,759,973	\$9,371,900	\$10,022,893		
21 MUSD Minimum Fund Balance	\$1,483,950	\$1,535,888	\$1,589,644	\$1,645,282	\$1,702,867	\$1,762,467	\$1,824,153	\$1,887,999		
22 MUSD Fund Balance (Starting Bal: \$2,700,000)	\$1,483,950	\$1,535,888	\$1,589,644	\$1,645,282	\$1,702,867	\$1,762,467	\$5,472,460	\$5,663,996		
23 MUSD Fund Balance % of Budget	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	11.0%	9.9%		

ATTACHMENT #2

**Redlined Changes to the Term Sheet for Topic #1,
Impact of Reorganization on SMUSD and MUSD Revenues**

Term Sheet for Topic #1, Impact of Reorganization on SMUSD and MUSD Revenues¹

I. The Board's Objective

The Board's objective related to the impact of reorganization on SMUSD and MUSD revenues was to eliminate any significant adverse financial impact on SMUSD as a stand-alone district.

The Board anticipated the possibility of a significant adverse financial effect after receiving, in the fall of 2015, a second report on the potential financial implications of reorganization from the District's Financial Oversight Committee and the District's Chief Financial Officer. Based on updated financial data, the report concluded there was a distinct possibility that reorganization could, at least for a period of time, materially reduce revenue to SMUSD on a per ADA basis when compared to revenue per ADA without reorganization.

This concern was confirmed by the Committee's school budget and finance consultant, School Services of California, Inc. (SSC), which prepared a 12-year revenue forecast for the existing District, and a future SMUSD and MUSD. SSC concluded that SMUSD could, indeed, experience a significant reduction in per-ADA revenues, as compared with the existing District over the same period, particularly in the latter years of the projection.

The reasons for a potential adverse financial effect on SMUSD are complex, and include the intricacies of how State funds are provided to local school districts in California. (See explanation below.) In addition, although a stand-alone SMUSD would keep certain revenues provided by the City of Santa Monica, which are currently shared with the Malibu schools, SMUSD would no longer receive property tax revenue generated ~~in~~by the Malibu community.

The major mechanism for distributing State funds to TK-12 school districts in California is the Local Control Funding Formula (LCFF). Under LCFF:

- The State sets a target amount of revenue for each school district based upon ADA and certain other factors. Each district's share of local property taxes is subtracted from this target and the State funds the difference;
- Any school district that receives enough local property tax revenue to come close to its LCFF target amount, as SMMUSD does today, is entitled to also receive an additional amount of State funding, which is known as "Minimum State Aid." A district that receives a combination of local property tax revenue, some State LCFF funding and Minimum State Aid is known as a Minimum State Aid district;

A school district whose property tax revenue meets or exceeds its LCFF target amount is known as a "Basic Aid" district.~~), as would be the case for MUSD immediately upon reorganization, but which would not occur in SMMUSD in the absence of reorganization or in SMUSD for many years, also receives Minimum State Aid; and~~ A Minimum State

¹ [This document indicates, in editing format, the recommended changes to the Term Sheet for Topic #1, Impact of Reorganization on SMUSD and MUSD Revenues \(contained in the Committee's Original Report\), to align with the Committee's Supplemental Memorandum Report.](#)

Aid or Basic Aid district can provide a higher level of funding for its schools than a district that does not qualify for Minimum State Aid.

• (e.g., SMUSD, at least for several years).

The relevance of the State’s funding formula to reorganization is that SMMUSD would likely maintain Minimum State Aid status and then achieve Basic Aid status sooner than would SMUSD alone due to the disproportionate amount of property tax revenue generated in MUSD on a per ADA basis that would no longer be available to SMUSD. MUSD is likely to become a Basic Aid district immediately. (See Appendix B.7 for a link to SSC’s presentation on school finance in California, which contains more explanation of these issues, including how LCFF affects the finances of reorganization.)

For further explanation of these issues, see Appendix B.7 for a link to a video of SSC’s presentation on school finance in California, and Appendix B.9 for a report that contains SSC’s long-range revenue forecasts, including a sensitivity analysis on key variables.

II. The Committee’s Approach

The Committee approached Topic #1 in multiple steps by first adopting common definitions and guiding principles, then studying the fiscal assumptions and projections provided by SSC, and finally, developing and evaluating a formula and calculation approach for resolving the anticipated per-ADA revenue reduction in SMUSD, consistent with the guiding principles.

Through this process, the Committee adopted an approach to calculate the revenue impacts of reorganization on SMUSD, and established a method for determining a schedule of payments to SMUSD from MUSD that will maintain predictable and stable revenue growth for both districts and, in the aggregate, would eliminate any significant adverse per-ADA revenue impacts from reorganization on SMUSD.

III. Definitions Adopted for Key Words and Phrases

The Committee adopted the following terms and definitions to guide its work:

Definitions Adopted for Topic #1 Negotiations	
Average Daily Attendance (“ADA”)	ADA is the average number of pupils actually attending class each school day and generally equals 95-98 percent of enrollment. The State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). All ADA references in this Report are to the P2 ADA.
Financial Effect	The difference in Unrestricted General Fund revenue per ADA in SMUSD vs. what that revenue per ADA would have been if reorganization had not occurred and SMMUSD continued to exist.

Revenue Neutrality	The Board’s objective to eliminate any significant adverse Financial Effect on SMUSD from the reorganization of the District into two separate districts (SMUSD and MUSD).
Revenue Neutrality Formula (the “Formula”)	The Committee’s agreed-upon method for calculating the Financial Effect of reorganization and related payment schedule that, in the aggregate, results in Revenue Neutrality in SMUSD.
Delta	The annual measurement of the Financial Effect multiplied by SMUSD’s ADA. A <i>negative</i> value (i.e., the revenue per ADA for SMUSD is less than that which would have been realized by a theoretical SMMUSD) creates an obligation on the part of MUSD to make a payment in that amount to SMUSD. A <i>positive</i> value (the revenue per ADA for SMUSD exceeds that which would have been realized by a theoretical SMMUSD) will result in a credit to MUSD offsetting future payment obligations. ²
Cumulative Delta	The sum of the Delta for any fiscal year added to any amount of the Delta, plus interest where applicable, remaining unpaid from prior years. A positive Cumulative Delta balance represents a credit to MUSD that will be applied against future negative Deltas. A negative Cumulative Delta balance represents the amount of money owed to SMUSD by MUSD.

IV. Guiding Principles

The Committee designed the Formula based on the general principles the Committee adopted for all portions of an Agreement, plus a number of supplemental guiding principles developed specifically for achieving Revenue Neutrality.

The general principles applicable to all terms in the Agreement are that they must: (a) be financially viable for both SMUSD and MUSD; (b) ensure a degree of predictability for both SMUSD and MUSD; (c) enable each district to plan ahead with a reasonable degree of resource certainty; (d) avoid establishing potential negative incentives for either SMUSD or MUSD to pursue increased revenue or otherwise improve education in their schools; and (e) be clear and understandable, legal, and enforceable. (See Memorandum Report, page 11.)

The supplemental guiding principles developed specifically for achieving Revenue Neutrality are summarized below. Appendix D contains an illustrative Revenue Neutrality Formula Projection (the “Projection.”), which the Committee developed based on the best information available at the time of this writing.³

² We do not foresee a positive Delta or any associated credits during the period covered by the Projection referred to below. However, this does not mean it cannot occur.

³ [An updated version of Appendix D is included as Attachment #1 to the Committee’s Supplemental Memorandum Report, dated July 11, 2017.](#)

- The Formula must provide for annual Delta calculations beginning with the first fiscal year that reorganization becomes effective through fiscal year 2029-2030, a 12-year period commencing with 2018-2019, the presumed first year of separation. The Committee agreed on a 12-year calculation of the Delta as the last year for calculating the Delta because:
 - ✓ It represents the length of time that was negotiated by the Committee within the context of the Agreement across all five topics. In its entirety, the Agreement was structured to maximize mutual interests as well as fairly balance the priority interests of both communities.
 - ✓ It represented the time period provided by SSC in its model of revenue projections that the Committee used during the negotiations and which SSC deemed to be as long as was reasonable to make revenue projections for both districts. The uncertainty of revenue projections over a long period of time was demonstrated by the recent change in the RDA revenue (discussed earlier), which led to a substantial difference in the Delta calculation and a significant reduction in the time before SMUSD would become a Basic Aid district.
 - ✓ It approximates the length of time a student attends primary and secondary schools in California.
 - ✓ ~~SSC's revenue projections indicate that SMUSD would likely reach Basic Aid status in fiscal year 2030-2031;~~
 - ✓ ~~The Projection indicates that payments to SMUSD from MUSD would continue for an estimated seven years beyond fiscal year 2029-2030 due to the MUSD "ability to pay" principle (explained below); and~~
 - ✓ ~~The time period was negotiated considering all other elements of the Agreement.~~
- The Formula must provide predictable and stable operating revenue growth for both SMUSD and MUSD. The Formula assumes that a MUSD parcel tax is passed that is equal to at least 90% of the parcel tax currently paid by the Malibu community to SMMUSD.
- If the Delta in any year would require a payment by MUSD that would cause MUSD's operating revenue growth to be less than a specified annual cost-of-living adjustment, then: (1) the payment amount for that year will be reduced to equal the adjusted revenue; and (2) the unpaid amount will be deferred for payment in future years, plus interest on the deferred amount. During the years that the Delta is calculated, the annual cost-of-living adjustment for MUSD will be 3.5%. (This is the Malibu "ability to pay" principle.)
- In the aggregate, the payments to SMUSD from MUSD must equal the sum of the annual Deltas, plus any interest that has accrued.
- The Formula must provide criteria for modifying the number of years that the Formula remains in place based on evidence that SMUSD can stand alone financially without any

significant adverse Financial Effect from reorganization. (The Agreement refers to these criteria as the “Delta Tracking Process.”) If the number of years that the Formula remains in place is shortened, then any outstanding payments due to SMUSD from MUSD must still be paid.

The timing of reorganization could affect the above guidelines. The [Committee’s Agreement and associated projection](#) assume that reorganization becomes effective in fiscal year 2018-2019. If reorganization becomes effective ~~after in 2019-2020 or 2020-2021~~ ~~fiscal year 2018-2019, but before or during fiscal year 2020-2021~~, the Agreement provides that the Formula would continue as presented, [including the 12-year Delta calculation](#). However, if reorganization is delayed beyond fiscal year 2020-2021, the Agreement provides that the Formula will be revisited and open for renegotiation in case the revenue forecasting assumptions or other related TK-12 school finance factors underlying the Formula change. The Committee recommends that any renegotiation be conducted within the context of the basic principles outlined in this Agreement. (See page C-10 for other criteria that would trigger a renegotiation.)

IV. Details of the Formula and Related Implementation Provisions

The balance of this Term Sheet outlines the details of how the Formula calculations translate into a schedule of payments or payment credits, and outlines several additional provisions related to Formula implementation. It is organized into the following explanatory sections:

- The method for annually calculating the Financial Effect of reorganization on SMUSD (i.e., the “Delta”).
- The method for annually calculating the payment to be made to SMUSD by MUSD based on the size of the Delta and MUSD’s “ability to pay.”
- The mechanics of a “Delta Tracking Provision” that could result in a reduction in the number of years during which the Delta is calculated.
- The designation of a neutral third-party to perform the above calculations and provisions for SMUSD and MUSD to share equally in the associated costs.
- Criteria for renegotiating the Formula or terms of payment, in the case of a significant change in a key underlying assumption or unexpected future event.

A. The Method for Annually Calculating the Financial Effect of Reorganization on SMUSD

As defined above, the Delta is the annual measurement of the Financial Effect multiplied by SMUSD’s ADA.

1. Sources of Data for the Formula

Average Daily Attendance Data: The student count used in the Formula will be ADA data, which is the average number of pupils actually attending classes each school day, and generally falls

within a range of 95-98% of enrollment. As noted earlier, the State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). The ADA Data used in the Formula will be the P2 ADA.

Audited Financial Statement Data: The calculations in the Formula will use revenue data from audited financial statements for SMUSD and MUSD, which are generally available in December of each year following the fiscal year ending in June. Calculations related to future revenue per ADA for a theoretical SMMUSD (i.e., meaning an assumption that reorganization had not occurred) will be derived from these financial data.

As explained below, the Formula uses data for certain components of Unrestricted General Fund revenue. To ensure that the needed data are available, the Committee recommends that SMUSD and MUSD require their respective auditors to provide a supplemental schedule in the audited financial statements that separately shows the revenues noted below. This format of reporting is already the District’s practice for preparation of the unaudited financial statements.

2. Revenue Sources to Include and Exclude in the Delta Calculation

This section outlines the sources of Unrestricted General Fund revenue to include and exclude in the Delta calculation. The table below lists the Unrestricted Revenue Sources to include in Delta calculations. Below the table is an explanation of the Unrestricted Revenue Sources to exclude in Delta calculations.

Revenue Categories	Unrestricted General Fund Revenue Sources to Include in Delta Calculations
LCFF Revenue	<ul style="list-style-type: none"> ● All categories of LCFF revenue (including property tax, State and Minimum State Aid revenue). <p>In fiscal year 2016-2017, LCFF revenue accounts for 62% of SMMUSD’s total Unrestricted General Fund revenue.</p>
Locally-Generated Revenue	<ul style="list-style-type: none"> ● Parcel tax revenue (SMUSD and MUSD) ● Revenue from leases and rentals (SMUSD and MUSD) ● City of Santa Monica contract revenue ● City of Malibu contract revenue ● Santa Monica Measure Y and Measure GSH revenue
New Sources of Local Revenue Generated Post-reorganization	<ul style="list-style-type: none"> ● Revenue from any new revenue sources established and generated post-reorganization by SMUSD. (See the next paragraph for information on new revenue sources generated post-reorganization by MUSD.)

Other new sources of revenue that MUSD generates post-reorganization will not be be incorporated into the annual assessment calculation of MUSD’s “ability to pay” (explained in Section B below), but or used in will not be used in the annual Delta calculation. This is based on the general principle to avoid any disincentive for either new district to pursue increased

revenue or otherwise improve education in their schools. New sources of locally generated SMUSD revenue are included in the Delta calculation because the relatively small amount (i.e., 16% ADA share) that would benefit MUSD is not considered a disincentive.

The other Unrestricted General Fund revenue sources to exclude in the Delta calculation are listed below with an explanation of the rationale behind exclusion.

- Education Foundation Revenue (currently SMMEF) or any similar parent, PTA, and local business generated revenue program. The rationale for excluding revenue from these sources is that these monies would be raised by local organizations in each district respectively, and exclusion aligns with the guiding principle not to create any disincentives for local fundraising efforts.
- Lottery Funding Revenue and Mandated Cost Block Grant Revenue (MBG). These two sources of State funds are allocated (as Unrestricted General Fund revenue) to each school district based on the same dollar amount per unit of annual ADA. As a result, revenue from these sources would have no effect on the calculation of the Delta.

As discussed later in this Term Sheet, if the State changes the method under which it funds TK-12 public schools from the current LCFF approach, representatives from SMUSD and MUSD will meet and confer in order to make reasonable changes, if necessary, to the Formula, consistent with the Guiding Principles adopted for this Agreement. If any of the locally-generated sources of revenue in Santa Monica is terminated, it will be removed as an item of revenue in calculating the Delta.

B. The Method for Annually Calculating the MUSD Payment (or Credit) Based on the Delta and MUSD’s “Ability to Pay”

The Delta calculation will be performed each year beginning with the first year that reorganization becomes effective through fiscal year 2029-2030. (See page C-4 and C-5 for why this year was selected and how the year of reorganization could affect the Formula.) In the aggregate, MUSD will pay SMUSD an amount equal to the sum of the annual Deltas, plus interest (as applicable). The actual payment owed to SMUSD by MUSD in any single year will be calculated to maintain predictable and stable revenue growth for both districts in an amount at least equal to an annual cost-of-living adjustment. This is further explained below.

The Formula incorporates MUSD’s “ability to pay” in several ways. Specifically, the Formula:

- Takes into account the fact that the MUSD revenue will need growth in the early years to ensure the financial viability of the new district, including the ability to fund one-time start-up costs and initiate a reserve fund.
- Ensures that MUSD revenue will not experience net reduction in its year over year revenue due solely to a required payment to SMUSD. MUSD’s “ability to pay” during the years of the Delta calculation is based on an annual

- ~~To ensure that~~Ensures that ~~Provides that~~ MUSD revenue will not experience a net reduction in its year over year revenue due solely to a required payment to SMUSD. This is because MUSD’s “ability to pay” during the years of the Delta calculation is based on ~~will be based on~~ an annual Cost-of-Living Adjustment (COLA) equal to 3.5%. ~~The COLA will be the published State Revenue COLA, but if necessary, will be adjusted so that it will be no less than 50% and no more than 80% of the annual percentage change in the total assessed value of real property within MUSD.~~

As explained above, any sources of local MUSD revenue adopted after reorganization will not be included in either the calculation of assessing MUSD’s annual ability to pay ~~but or will not be included in the Delta revenue for calculation.~~ ng the Delta.

The mechanics of how the Formula determines the annual payment amount to SMUSD are outlined below:

- If, in any year through the first 12 years, fiscal year 2029-2030, the Delta is *negative*, MUSD will owe a payment in that amount to SMUSD, except to the extent that any credits remain available from prior years to offset the amount of that payment.
- The amount of the payment to be made by MUSD for any year will be the lesser of:
 - ✓ The amount of the negative Delta for that year (less any remaining credits) plus any unpaid amounts, plus interest, remaining from prior years; or
 - ✓ The amount by which MUSD’s Unrestricted General Fund revenues for the year exceed its operating revenues for the prior year adjusted by the MUSD ability to pay COLA of 3.5%.
- Any difference between the amount actually paid by MUSD and the amount of the Delta (less any remaining credits) will be carried forward into the next year with interest at the rate earned by both SMUSD and MUSD on funds deposited with the County of Los Angeles Treasurer’s pooled investments account composed of short-term securities (currently 1.00%).
- No further calculation of the Delta will be made for any year ~~beyond after 12 years~~fiscal year 2029-2030, but annual payments will continue to be due to SMUSD from MUSD in an amount equal to the lesser of:
 - ✓ Any Cumulative Delta from prior years, plus interest, or
 - ✓ The amount by which MUSD’s Unrestricted General Fund revenues for the year exceeds its operating revenue for the prior year adjusted by the MUSD ability to pay COLA of 3.5%.
- This procedure will continue for each year until all amounts owed to SMUSD by MUSD, including interest, have been paid in full.

C. The Mechanics of the “Delta Tracking Provision”

The Agreement includes a provision that would end the annual calculation of the Delta before ~~fiscal year 2029-2030~~12 years if only relatively small amounts are owed by MUSD for a specified

period of time, because that would demonstrate that the two districts are operating independently with no significant adverse Financial Effect on SMUSD. This Delta Tracking Provision is outlined below.

- The tracking phase will begin either three years after reorganization becomes effective or fiscal year 2022-2023, whichever is later.
- During the tracking phase, if there are three consecutive years in which the Delta is less than 0.5% of the applicable components of SMUSD's Unrestricted General Fund revenues, then the Revenue Neutrality arrangement ends, except that any outstanding payments, plus interest if applicable, due to SMUSD from MUSD must still be paid.
- If there remains a credit at that time arising from previous calculations of the Delta, SMUSD will not be required to make any payment to MUSD.

D. The Designation of a Third-Party to Perform the Delta Calculations and Annual Timing of Calculations and Payments

1. Designation of a Third-Party

After reorganization becomes effective, the Boards of Education of SMUSD and MUSD will jointly select a neutral third party, with expertise in TK-12 public school financing in California, to perform the annual calculations provided for in the Formula. The two districts will agree on a fair and reasonable fee associated with the performance of this work, and share equally in the costs. The Committee agreed that the procedure for selecting the neutral third party be determined by Group 2, the second of two transition and implementation groups that the Committee recommends be appointed. (See Topic 5, Implementation.)

2. Calendar of Calculations and Payments

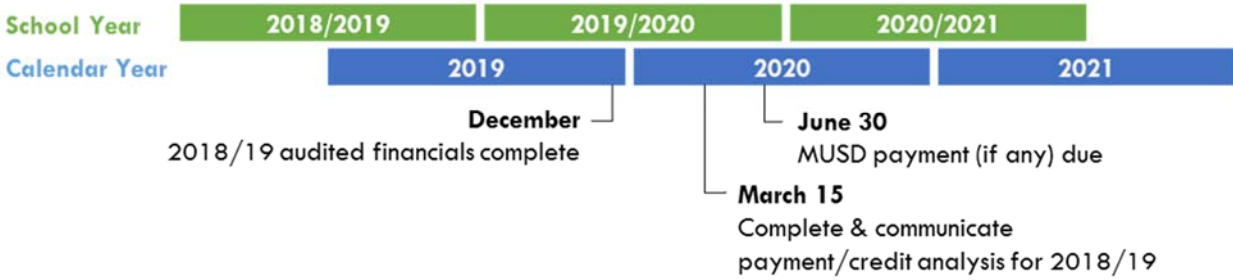
As noted above, the neutral third party's calculations will use data from the audited financial statements for SMUSD and MUSD, which are assumed to be available in December of each year following the fiscal year ending in June. It is expected that the initial annual calculations of the Delta and associated payment (or booking of credit) will proceed as follows:

- The audited financials for the first fiscal year of reorganization will be available in December of the second fiscal year of reorganization.
- The neutral third-party will perform the calculations of the Delta and associated payment or credit using these audited financials by no later than March 15th of the second fiscal year of reorganization.
- These calculations will be communicated by the neutral third-party to SMUSD and MUSD no later than March 15th of the second fiscal year of reorganization.
- Annual calculations by the neutral third party shall be conclusive and binding on both districts except for arithmetical errors identified by either district within 30 days of the communication to the districts.

- The payment from MUSD to SMUSD, if any is due under the terms of this Agreement, will be paid no later than June 30th of the second fiscal year of reorganization.

The graphic below depicts the cycle of calculations and payments for the first year of reorganization, based on an assumption that reorganization becomes effective in fiscal year 2018-2019.

Calculation and Payment Timeline



This pattern of calculating the Delta and the amount of any payment or credit for each fiscal year will continue for the length of time as specified elsewhere in the Agreement. It is understood that ~~that~~, due to the annual schedule for preparing and reporting the results of school district audits, the decision to use audited financials as the source of data for the Formula means that there will be no payment (or credit) at the beginning of the first or second fiscal year of reorganization. As a result, the payment (or booking of a credit) before the end of the second fiscal year of reorganization will correspond to the Delta for the first fiscal year of reorganization.

2. Criteria for Renegotiating the Formula or Terms of Payment

1. Before Reorganization Becomes Effective

As noted above, the mechanics of the Formula as well as the Projection assume that reorganization becomes effective in fiscal year 2018-2019. If, however, implementation is delayed beyond fiscal year 2020-2021, then the Formula and terms of payment will be revisited and open for renegotiation. The Committee recommends that any renegotiation be conducted within the context of the basic principles outlined in this Agreement.

2. After Reorganization Becomes Effective

- **Provision for significant change in key underlying assumption.** If at any time when the Delta is to be calculated or MUSD is required to make a payment to SMUSD there has been a significant change in any of the key underlying assumptions in the Formula or SSC’s projections, such as the manner in which the State provides funds for TK-12 public schools or the manner in which property is taxed, either district may notify the other

district that it wishes to meet and confer regarding the Formula and the terms of payment. If either district gives such a notice, the districts will meet to discuss appropriate changes in the Formula by applying the basic principles utilized by the Committee and any other principles agreed upon by the districts.

- **Provision for unexpected and costly event.** It is possible that a “force majeure” event may occur, such as an earthquake or major fire, that could adversely impact either or both districts and MUSD’s ability to make payments, due to a divergence of funds for emergency repairs, cleanup, obtaining alternate classroom or administrative facilities, or providing for other needs in order to maintain district operations and stable revenue growth.

If such an event occurs and the Board of MUSD concludes that the financial effect of that event may prevent MUSD from making all or any portion of the next payment to SMUSD required under the Formula, then the following process applies:

- ✓ MUSD shall give written notice of that conclusion to SMUSD within 30 days of the event stating the basis for that conclusion (a “Force Majeure Notice”).
- ✓ If MUSD gives a Force Majeure Notice, it shall, within 45 days thereafter provide SMUSD with written notice (the “Payment Notice”) of the amount of such payment, if any, that it will be able to make given the need to divert revenue to address emergency needs, including calculations supporting that conclusion.
- ✓ MUSD will, to the extent consistent with good accounting practice, first use reserve funds, amounts in other Funds and amounts available in a timely fashion from governmental, insurance and other sources, to cover the emergency costs before applying funds classified as Unrestricted General Fund revenue.
- ✓ To the extent set forth in the Payment Notice, MUSD’s obligation to make the next payment to SMUSD will be deferred for up to one year with the amount deferred being added to the Cumulative Delta. No further deferrals of that payment amount will be permitted.