Review of Revenue Options for District Reorganization

October 30, 2017

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Santa Monica-Malibu Unified School District
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School Services of California INC.
An Employee-Owned Company

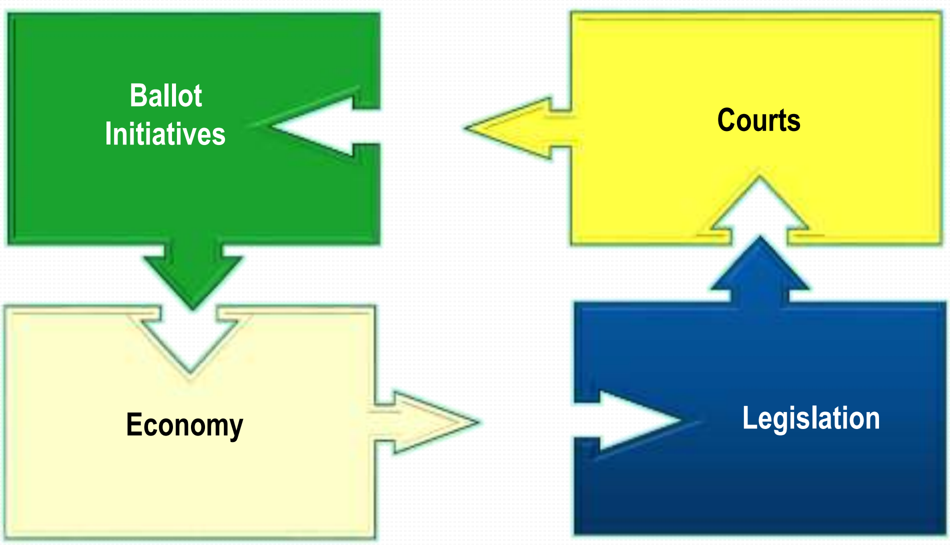
What We Did

- School Services of California, Inc., (SSC) was asked to do three things:
  - Update our long term forecast of revenues for Santa Monica-Malibu Unified School District (SMMUSD), Santa Monica Unified School District (SMUSD), and Malibu Unified School District (MUSD)
  - Review and validate the application of the Malibu Unification Negotiations Committee's (MUNC) 2.0 Revenue Neutrality Formula, and its effects
  - Develop an alternative formula to (1) mitigate the immediate loss of revenue that a reorganization of SSMUSD into two separate district would cause for SMUSD, and (2) transition SMUSD and MUSD to full financial independence
- This presentation is divided into four parts:
  - Overview of school finance in California
  - Summary of our revised long term revenue forecast
  - Results of our review of the MUNC 2.0 Revenue Neutrality Formula
  - Explanation of the alternative SSC formula developed for this report

School Finance in California

A Brief Overview

Factors Shaping School Finance



4

The Serrano Court Decision

- Prior to the *Serrano v. Priest* case, the state's system of funding its public schools relied primarily on the local property tax
- In the 1971 landmark case, the California State Supreme Court ruled that:
  - The existing school finance system violated the "Equal Protection" clause of the State Constitution
  - Students in low property wealth districts were being denied an equal educational opportunity
  - The state must mitigate wealth-related disparities in per-pupil funding across districts to $100 or less
- In response to the court decision, the Legislature adopted Senate Bill 90 (Chapter 1406/1972), which established revenue limits and a system of differential cost-of-living adjustments (COLAs) to equalize general purpose revenues over time

5

The Local Control Funding Formula

- We are now in the fifth year of the historic Local Control Funding Formula (LCFF), the most significant change to California's school finance system since the creation of revenue limits 45 years ago
- It took Governor Jerry Brown two years to enact this reform, but its impact will be felt for decades to come
- Invoking themes reminiscent of the historic *Serrano* court case, the Governor championed his LCFF proposal as a matter of civil rights
  - "Treating unequals equally is not justice," explained Governor Brown in his January 2013 press conference unveiling the LCFF

6

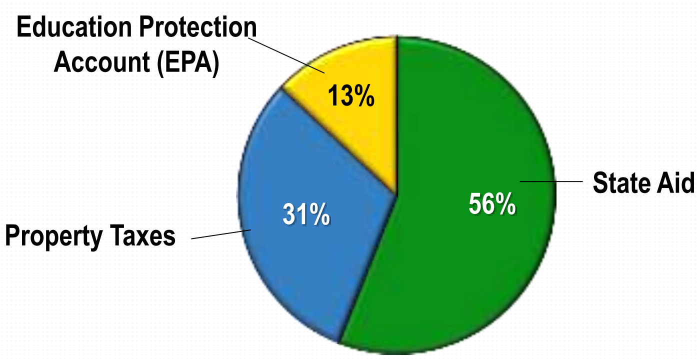
LCFF Attempts to Balance Needs and Resources

- "Unequals" receive more funding to address higher needs and costs
- Need is defined by the characteristics of the students
- Concentration of needs is also addressed

7

LCFF Revenue Sources – Statewide Average

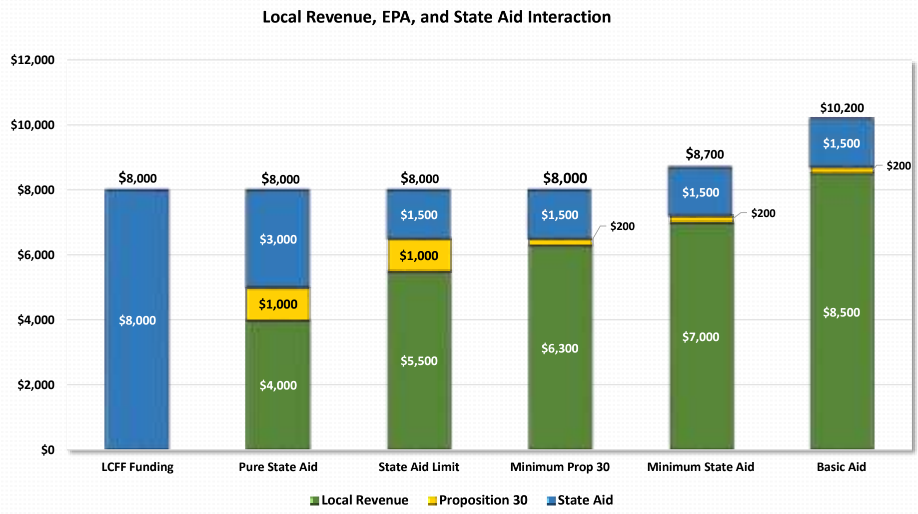
- Each local educational agency's (LEAs) LCFF entitlement is supported from three component revenue sources:



- Individual school district proportions vary considerably and are unique to each LEA

8

Impact of LCFF Minimum State Aid – The Path to Local Funding



9

Basic Aid School Districts

- Basic aid school districts are primarily supported by property taxes and do not receive LCFF incremental funding increases from the state
  - Basic aid is the minimum state funding required by the State Constitution to be allocated to each school district – $120 per average daily attendance (ADA)
- Under the LCFF, school districts receive no less in state aid than received in 2012-13, a protection referred to as Minimum State Aid
- Proposition 30 established the Education Protection Account, which provides a minimum allocation of $200 per ADA to all school districts, including basic aid districts
- Basic aid districts retain property tax revenues and growth
- The Local Control and Accountability Plan is required for all school districts – the same provisions apply to basic aid school districts

SSC Revenue Forecast

SMMUSD Reorganization Into
Two Unified School Districts – SMUSD and MUSD

SSC Revenue Forecast Factors

- We updated our previous long-term forecast of LCFF revenues and Other Local Revenues for the SMMUSD and for the two districts following reorganization – SMUSD and MUSD
  - Reflects most recent SMMUSD financial information and data on assessed valuation
- We extended our forecast to 2032-33
- We use a modified growth factor applied to prior-year revenues where we expand our forecast beyond 2032-33
- Our baseline analysis holds ADA constant at the level used by the MUNC
  - 10,462 ADA in SMMUSD; 8,715 ADA (83.3%) in SMUSD; 1,747 ADA (16.7%) in MUSD

12

SSC Revenue Forecast Factors

- Our baseline forecast assumes a 6% average annual growth in property tax revenues in each year beginning with 2018-19, applied to each of the school district configurations
  - We also modeled the impact of different property tax growth rates among the two new districts for our analysis of the SSC alternative revenue allocation formula
  - The outcomes are sensitive to changes in assumptions about property tax growth and the division of property tax revenues between SMUSD and MUSD
  - Our baseline forecast divides base property tax revenues with 66.5% to SMUSD and 33.5% to MUSD
- Revenues accruing to SMMUSD from the dissolution of the Santa Monica redevelopment agency are credited to SMUSD
- Most other local revenue sources included in our forecast grew at a more modest 2% annual increase, unless other annual adjustments were specified by law or agreement

13

SSC Revenue Forecast

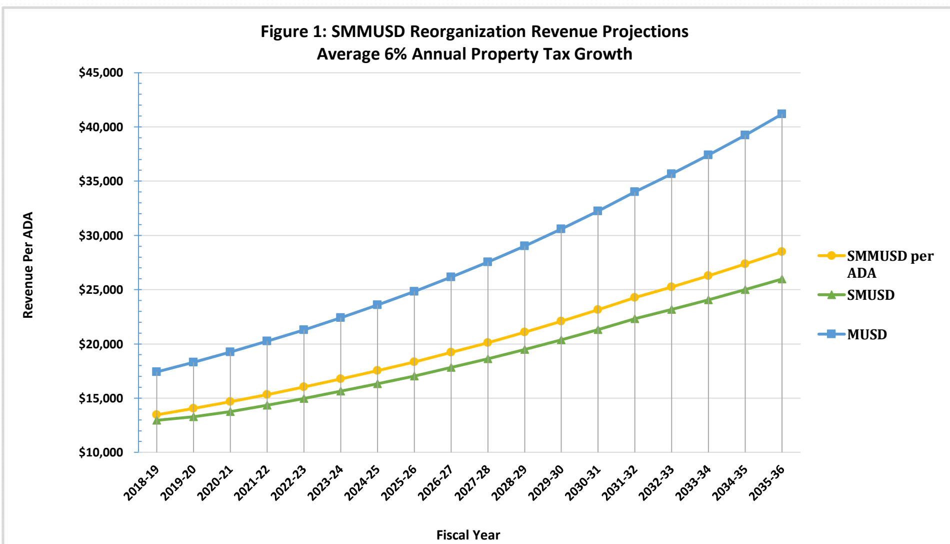


Figure 1: SSC Revenue Forecast Outcomes

- Figure 1 displays the results of the proposed reorganization absent any revenue sharing arrangement
  - SMMUSD is a minimum state aid district in 2017-18 and becomes a basic aid district in 2018-19
  - MUSD begins as a basic aid district in 2018-19
  - SMUSD would become a minimum state aid district in 2020-21and a fully basic aid district in 2023-24
- Absent any other financial adjustments . . .
  - MUSD revenues per-pupil increase by 36.45% in the first year of reorganization (2018-19) and then increase annually at a rate largely based on the growth in property tax revenues
  - SMUSD revenues per pupil, as a state aid school district, increase at approximately the rate of the K-12 statutory COLA in 2018-19 and 2019-20 – 1.54% and 2.43%, respectively
  - SMUSD revenues, beginning in 2021-22, increase at a rate roughly equivalent to the growth in property tax revenues

Revenue Neutrality Formula

Review of the Application and Effect of the
MUNC 2.0 Revenue Neutrality Formula

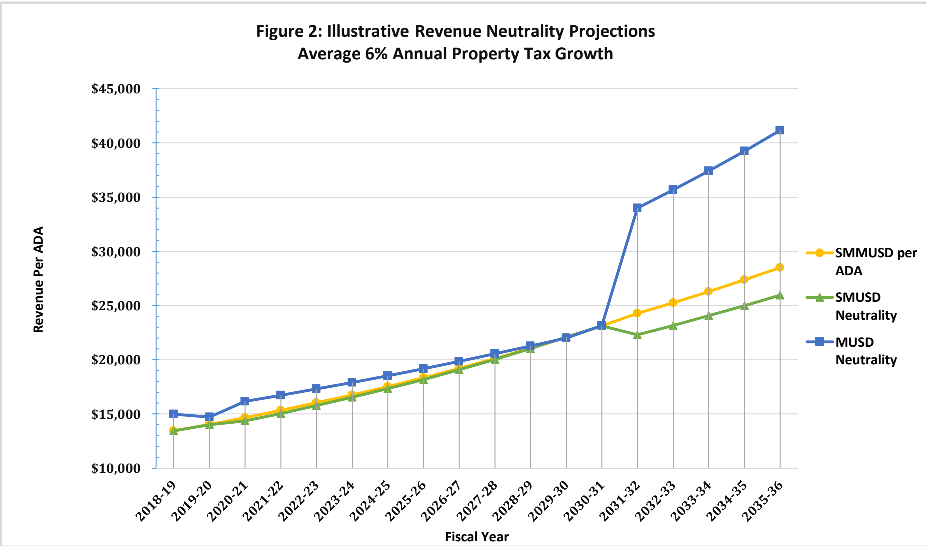
16

MUNC Revenue Formula Characteristics

- Calculates the financial effect of reorganization on SMUSD – the Delta
- Establishes annual payments from MUSD to SMUSD equal to the Delta, with some limitations
  - Delta calculation ends in 2029-30, a period of 12 years assuming a reorganization is effective in beginning with 2018-19
  - Limits Delta payment to the lesser of the Delta or an amount based on the MUSD ability to pay
    - Provides for shortfalls to be accumulated and paid, with interest, in the years following 2029-30
- Assures a minimum level of "startup" funding for MUSD
  - Recognizes documented higher average cost per student of operation among MUSD schools
  - Approximately $15,000 per pupil in 2018-19, 16% above the prior-year SMMUSD per-pupil estimate
- Thereafter, sets MUSD's annual revenue growth at 3.5%, with a minimum 4% ending balance
  - Growth target is met first
  - Funds remaining beyond 3.5% growth go toward Delta payment

17

MUNC 2.0 Revenue Allocation Formula



18

Figure 2: MUNC 2.0 Formula Review Findings

- Our review validates the accuracy of the Revenue Neutrality Formula included in the MUNC Supplemental Memorandum Report of July 11, 2017 (MUNC 2.0)
- Due to the loss of the Malibu property tax base following reorganization, SMUSD revenues per ADA will necessarily fall below per-ADA funding of the SMMUSD absent reorganization, once SMUSD is financially independent
- The Delta payments proposed under the MUNC 2.0 formula generally sustain SMUSD funding at pre-reorganization levels, and would conversely depress per pupil revenues for MUSD, during the 12-year period of Delta determination
- After Delta payments end, both districts would be financially independent of one another, with SMUSD experiencing a year-over-year decline in revenues, while MUSD benefits from a sharp increase in revenues as both districts revert to their respective property tax revenue trendlines
- By 2032-33 all three district configurations would be basic aid districts, with projected per-ADA funding in MUSD $10,404 (41%) above the SMMUSD projected funding level of $25,256 per ADA, while per-ADA funding in SMUSD would be $2,086 (8%) below the SMMUSD level

19

SSC Recommendations for MUNC 2.0 Formula

- If the MUNC formula is adopted as part of a district reorganization, we recommend two modifications:
  - Establish a series of payments to be made by MUSD to SMUSD after the Delta calculation period ends to smooth the transition of SMUSD revenues to a lower, financially independent level
    - The transition payment could be tied to a minimum level of annual revenue growth, such as the K-12 statutory COLA
    - The transition payment would need to be responsive to unanticipated financial shocks at MUSD
  - Provide estimated payments in the year that a Delta is incurred, followed by a “true-up” payment or credit, as needed, once final financial data is available
    - The estimated payments mitigate the cashflow impacts of a delayed final Delta calculation based on audited district financial data

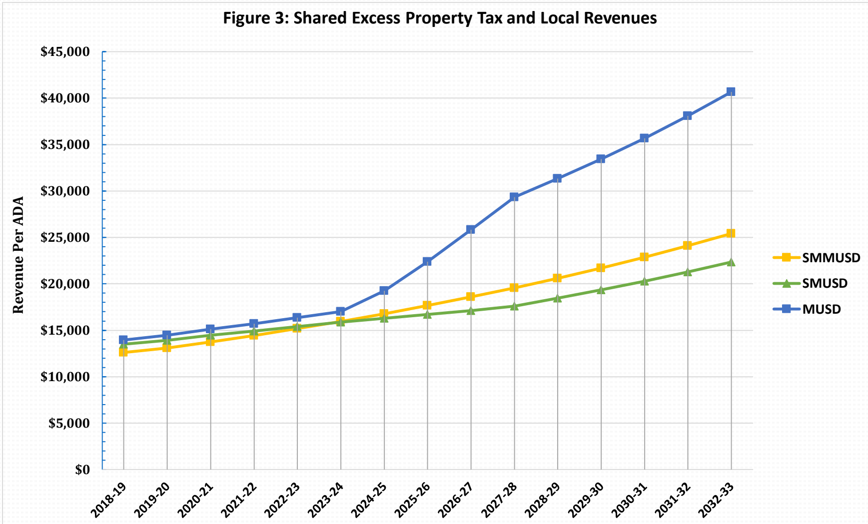
SSC Alternative Revenue Allocation Formula

SMMUSD Reorganization Into
Two Unified School Districts – SMUSD and MUSD

Figure 3: SSC Alternative Revenue Allocation Formula

- **SSC developed an alternative revenue allocation formula which requires that the two districts share both excess property tax revenues generated in MUSD and other local revenues, which accrue primarily to SMUSD**
- **The sharing of both these revenue sources yields per-ADA funding for both SMUSD and MUSD slightly greater than what would have been provided if the reorganization did not take place**
- **The growth rates in total funding available to the two districts would be roughly the same until SMUSD becomes a basic aid district in 2023-24**
- **From 2023-24 forward, MUSD's funding accelerates significantly until it receives 100% of its excess property tax commencing in 2027-28**
- **SMUSD's funding would increase in line with expected COLAs for three years from 2024-25 through 2026-27, resulting from the supplemental transition payment from MUSD to SMUSD to maintain total revenues, adjusted for cost of living**

SSC's Alternative Revenue Allocation Formula



Summary and Conclusions

Summary

- In the near term, the existing SMMUSD and both of the new district configurations under consideration will become basic aid school districts, funded largely through local property taxes
- Absent any other arrangements, reorganization of SMMUSD into two districts, one serving Santa Monica and one serving Malibu and surrounding areas, will result in a Santa Monica district with less revenue per pupil than the existing district, and Malibu with significantly more
  - Santa Monica serves approximately 85% of the students and garners two-thirds of the property tax revenues
  - Malibu serves approximately 15% of the students and retains one-third of the property tax revenues
- If there were a reorganization, both the MUNC and SSC revenue sharing options achieve similar objectives, although in somewhat different ways
  - Mitigate the immediate financial impact of reorganization on Santa Monica
  - Provide a pathway for an orderly transition for both school districts to new, financially independent revenue levels

Thank You!

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