
SENATE COMMITTEE ON EDUCATION

Senator Carol Liu, Chair
2015 - 2016 Regular

Bill No: SB 774
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Urgency: No
Consultant: Lenin Del Castillo
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Fiscal: No

Subject: School finance: school districts: annual budgets: reserve balance

NOTE: This bill has been referred to the Committees on Education and Rules. A "do pass" motion should include referral to the Committee on Rules.

SUMMARY

This bill repeals the existing statutory cap on the amount of fiscal reserves that a school district is allowed to maintain.

BACKGROUND

As part of the 2014-15 Budget Act, the state enacted a new law to cap school district reserves in years following a deposit in the state school reserve recently established by Proposition 2. Additionally, the legislation created a separate requirement for districts to disclose certain information about their reserves each year. Specifically, existing law requires that in a fiscal year immediately after a fiscal year in which a transfer is made into the Public School System Stabilization Account, a school district budget that is adopted or revised shall not contain a combined assigned or unassigned ending fund balance that is in excess of the following:

1. For school districts with fewer than 400,000 units of average daily attendance (ADA), the sum of the school district's applicable minimum recommended reserve for economic uncertainties adopted by the State Board of Education, as specified, multiplied by two.
2. For school districts with more than 400,000 units of ADA, the sum of the school district's applicable minimum recommended reserve for economic uncertainties adopted by the State Board of Education, as specified, multiplied by three.

Existing law authorizes a county superintendent of schools to grant a school district under its jurisdiction an exemption from the cap for up to two consecutive fiscal years within a three-year period if the school district provides documentation indicating that extraordinary fiscal circumstances, including, but not limited to, multi-year infrastructure or technology projects, substantiate the need for a combined assigned or unassigned ending fund balance that is in excess of the minimum recommended reserve for economic uncertainties. As a condition of receiving an exemption, a school district shall do all of the following:

1. Provide a statement that substantiates the need for an assigned and unassigned ending fund balance that is in excess of the minimum recommended reserve for economic uncertainties.
2. Identify the funding amounts in the budget adopted by the school district that are associated with the extraordinary fiscal circumstances.
3. Provide documentation that no other fiscal resources are available to fund the extraordinary fiscal circumstances. (Education Code § 42127.01)

ANALYSIS

This bill repeals the statutory cap on the amount of fiscal reserves that a school district would be allowed to maintain under specified conditions and also repeals the authority for a county superintendent of school to grant a school district within its jurisdiction an exemption from this requirement.

STAFF COMMENTS

1. ***Need for the bill.*** According to the author's office, "the 2014 statutory requirement that sets a maximum amount of fiscal reserves school districts are allowed to maintain is counter-intuitive to sound budget principles. Districts of all sizes, levels of wealth, student and community make up have incredibly different needs that cannot be addressed by an arbitrary one-size-fits-all cap that is tied to a contribution of any size, even \$1, to the state's Proposition 98 rainy day fund. The current cap is fraught with problems for school districts. Those include:
 - A. The reserve cap applies to assigned and unassigned ending balances, which includes funds being saved by school districts for such things as school construction, school repair, self-insurance, post-employment benefits for employees, investments in education programs including textbooks and technology, and larger purchases such as school buses.
 - B. Limiting assigned and unassigned ending balances to two or three times the minimum reserve for economic uncertainty leaves districts exposed to the next recession and eventual downturn in Proposition 98 funding. During the Great Recession, school districts used their reserves to weather mid-year cuts, zero cost of living adjustments, growing deferrals of state payments, and to avert greater employee layoffs than actually occurred.
 - C. Having the cap on the books, whether or not the cap is ever triggered, is having an immediate impact on credit ratings by the nation's most notable rating agencies. Standard and Poor's and Fitch and Moody's have reported the cap as credit negative. It makes no sense for taxpayers to have to pay higher interest on school district debt, which is perhaps one of the most secure debt instruments, because of the presence of the reserve cap.

- D. Small school districts and those districts that are funded with high percentages of property taxes will be even more exposed to the uncertainties of the day-today surprises that they deal with constantly, such as: managing cash flow based on receiving property tax payments only twice a year, adjusting to the ebb and flow of student enrollments, or enrollment of one or more high cost special education students. These are just a few examples of issues that stress district finances and the ability to stay solvent.
- E. Triggering the reserve cap would leave school districts with only a few days' worth of cash flow to be able to manage payroll and other ongoing expenses."

Additionally, the author's office indicates that reserve levels are determined by governing boards to meet local priorities and allow school districts to save for potential future expected and unexpected expenditures. These include economic downturns. Funds for crucial services such as classroom materials, technology, major textbook/instructional materials, school construction projects, deferred maintenance, etc. require successful and ongoing cash flow management and disciplined planning.

2. **2014-15 Budget Act.** The provisions that the bill proposes to repeal were introduced during negotiations with the Administration shortly before the adoption of the 2014-15 budget and that left a relatively short amount of time for the Legislature to review them. Proponents of the bill have expressed concern that the deliberations were insufficient and left many issues that need to be addressed, such as the need for district reserves, how reserves have fluctuated over time, how they vary from district to district, and how the cap will affect district finances. Notwithstanding concerns over the process, proponents of the bill also indicate that healthy reserves will protect students and teachers from budget cuts during future economic downturns.
3. **Is the bill necessary?** To the extent that school districts are concerned about the potential impact the cap would have on their ability to maintain adequate reserve levels and save for future expenditures as well as unanticipated expenditures, existing law provides a mechanism for school districts to be exempted from this requirement. A county superintendent of schools is authorized to grant a school district under its jurisdiction an exemption if a school district is able to provide documentation that demonstrates extraordinary fiscal circumstances.
4. **Premature?** The 2015-16 Governor's Budget Summary indicated that "the Administration does not anticipate fiscal conditions requiring a Proposition 98 Rainy Day Fund deposit and the related potential for caps on local reserves at any point in the budget forecast period (through 2018-19). Nonetheless, the Administration appreciates the concerns expressed by stakeholders regarding potential caps on school district reserves and will engage in a dialogue with these groups in the coming months to protect the financial security and health of local school districts." While there have been several meetings with stakeholders and conversations continue, the Administration has yet to issue any related proposal

and its next opportunity to take budgetary action will be on May 14th as part of the May Revision for 2015-16 Governor's Budget. As such, would be prudent to wait until after the May Revision is released to see if the Administration includes a proposal to address this issue?

Additionally, the state must make deposits into the Rainy Day Fund when certain conditions are met to trigger the cap for districts. Among these conditions, Test 1 must be the applicable Proposition 98 test level and the state must have paid off all maintenance factor created before 2014-15. The Legislative Analyst Office (LAO) indicated in its 2015-16 Proposition 98 Education Analysis in February 2015 that the interaction between these two requirements makes deposits unlikely in the near term.

5. ***LAO's assessment and recommendations.*** The LAO released a report, "Analysis of School District Reserves" in January 2015. In the report, the LAO provided its assessment and recommendations on the reserve caps. Specifically, the LAO indicated, "to the extent districts begin shifting monies to avoid the caps, we are concerned that local budgeting practices could become more confusing. To the extent districts begin spending down their reserves, we are concerned that they would incur a number of risks." The risks include difficulty for school districts to maintain programs in tight fiscal times, difficulty addressing unexpected costs, greater fiscal distress, and higher borrowing costs. The LAO also indicated concern that the caps become operative following any deposit into the state school reserve, even if the size of that deposit is smaller than the triggered reduction in local reserves. To avoid all of these risks, the LAO has recommended the Legislature repeal the reserve caps.

6. ***Related and prior legislation.***

AB 1048 (Baker), similar to this bill, proposes to repeal the statutory cap on the amount of fiscal reserves that a school district would be allowed to maintain under specified conditions. This bill is pending before the Assembly Education Committee.

AB 1318 (Gray) proposes to modify the calculation of the statutory cap on fiscal reserves. This bill is pending before the Assembly Education Committee.

AB 531 (O'Donnell), similar to AB 1318, proposes to modify the statutory cap on fiscal reserves and is pending before the Assembly Education Committee.

SUPPORT

Association of California School Administrators
 California Association of School Business Officials
 California School Boards Association
 California Taxpayers Association
 EdVoice
 Fresno Unified School District
 Kern County Superintendent of Schools
 San Francisco Unified School District

School Employers Association of California
Letters from individuals

OPPOSITION

American Federation of State, County and Municipal Employees (AFSCME)
California Labor Federation
California School Employees Association
California Teachers Association
Labor Coalition
Service Employees International Union

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