June 13, 2014

FLOOR ALERT
LANGUAGE IMPOSING RESTRICTIONS ON LOCAL SCHOOL DISTRICT RESERVES

ASSEMBLY BILL 1463 (Sec. 26 and 27)
SENATE BILL 858 (Sec. 26 and 27)

POSITION: OPPOSE

The Education Management Group – representing statewide management education groups including school boards (CSBA), school administrators (ACSA, CCSESA), school business officials (CASBO), urban school districts, suburban school districts, and small school districts (Small School Districts Association) as well as individual school districts and county offices of education – remains **strongly opposed to trailer bill language that would impede the ability of school districts to manage their resources in a fiscally prudent manner by placing restrictions on the level of budget reserves.** This proposal is contained in Assembly Bill 1463 (Sec. 26 and 27) and Senate Bill 858 (Sec. 26 and 27).

Supporters of the proposal have used a number of statistics to try to demonstrate reserve levels they believe to be excessive**. These statistics have been presented without context, fail to take into consideration the conditions that led to the need for reserves, and erroneously imply that the purpose of reserves is to keep funds in "bank accounts" and not spend them in the classroom.**

We ask members of the Legislature to consider the following:

<u>District reserves do not equate to spendable cash</u>. School districts operate under strict financial rules for governmental accounting. Reserves include cash *and* non-cash items for both assets and liabilities. To provide one example, a school district in the greater Sacramento region held an unrestricted reserve at year end of 14.7% - however, only 4.9% of that represented a cash reserve. Districts do <u>not</u> pay staff and vendors with reserves – they pay them with cash – and cash flow is not even across the year. Many districts must borrow short-term cash (through TRANs) to cover mid-year shortfalls, and a 3% reserve minimum represents <u>less than two weeks of payroll for most districts</u>. **Maintaining a reserve at or near the required minimum limits the ability to borrow and places cash flow at risk, in turn risking the ability to meet payroll and the fiscal solvency of the district.**

<u>Reserve levels during the recession</u>. Some have questioned the level of reserves that school districts maintained during the recession. In fact, prudent reserves were a key factor in the ability of school districts to avoid even deeper cuts than those they suffered during the 2008-11 recession. In 2009-10, districts were forced to make midyear cuts ($2.85 billion) and midyear deferrals ($5 billion added between 2008-11) after they had already begun the school year. After that, the threat of an additional $5.34 billion in midyear cuts for schools lasted with local education agencies until November 2012 with the passage of Proposition 30. From 2009-12, school district governance teams were always faced with the threat of midyear reductions. **School districts increased reserves to prepare for external actions they had no control over that would significantly impact their ability to maintain day-to-day operations.**

Proposal is counter to sound fiscal management. Had districts been prohibited from maintaining healthy reserves during the last economic recession, they would have been forced to spend available funding at the beginning of the recession and drastically cut at the end – instead of spreading the impact over time. Having healthy reserves has positively impacted credit discussions with financial investors and rating agencies, as they place significant weight in their criteria on the ending funding balances. This has helped districts save money via higher credit ratings.

Reserve levels of small school districts. It is true that many small school districts hold high percentage reserves. Some of these districts are basic aid districts, and have property tax cash flow issues. Others are subject to variable funding, such as rural schools that are dependent on federal funds such as the Secure Rural Schools and Community Self Determination Act. In addition, because of issues of scale small districts have difficulty replacing lost revenue from declining enrollment. Reserves carry those districts through until they have the ability to consolidate classes at a reasonable size. **Because of their small budgets, small districts are also particularly vulnerable to the loss of ADA, which can result from many factors including state funding lapses, mill closures, drought, etc.**

One size fits all approach makes no sense. A one size fits all approach in the form of a hard cap fails to recognize local factors such as percentage of federal funds, property tax and other variable cash flow funding sources, and proper planning needs at the local level. These concerns are magnified in small school districts with smaller budgets.

Reserve levels of Basic Aid districts. Basic aid school districts have prudently held higher reserves to guard against the unique uncertainties they face. They receive the bulk of their revenues from property taxes, and have several risk factors that are addressed through the maintenance of reserves above the minimum requirement. Unlike state-funded districts, nearly all of basic aid district revenues come only twice a year, not every month; an adequate reserve is needed to cover cash flow during months that there are no property tax disbursements.

For a basic aid school district, unexpected increases in average daily attendance result in fewer resources per student and therefore reserves are able to cover the gap. In addition, a decline in property taxes, as occurred for a number of years during the Great Recession, can impose a precipitous and very difficult budget squeeze on basic aid school districts. Since the state does not provide a fiscal safety net, districts must prepare accordingly to maintain fiscal solvency. And while a state-funded district will be backfilled with state funds if local property taxes come in below projections during the year, community-funded school districts are simply left with a shortfall to be covered through the use of one-time funds available from their reserve.

The EMG continues to believe that this proposal is fiscally irresponsible, is inconsistent with the principle of subsidiarity that serves as the foundation of the Local Control Funding Formula, and discounts the role that prudent fiscal reserves play in the ability of school districts to maintain fiscal solvency. The single greatest predictor of an interim qualified or negative budget report status is the failure to maintain an adequate level of reserves. To place restrictions on the ability of school districts to manage their resources in a fiscally prudent manner simply makes no logical sense.

The Education Management Group respectfully requests that you OPPOSE this proposal.