June 11, 2014

The Honorable Nancy Skinner
Chair, Budget Conference Committee
State Capitol, Room 6026
Sacramento, CA 95814

The Honorable Mark Leno
Vice Chair, Budget Conference Committee
State Capitol, Room 5100
Sacramento, CA 95814

RE: Proposed Trailer Bill language – Reserve for Economic Uncertainties

Position: OPPOSE

Dear Assembly Member Skinner and Senator Leno:

On behalf of the Education Management Group, which represents all statewide management education groups including school boards (CSBA), school administrators (ACSA, CCSESA), school business officials (CASBO), urban, suburban, and small school district associations and individual school districts and county offices of education, we are writing to express our vehement opposition to proposed trailer bill language pertaining to the level of budget reserves that are maintained by school districts.

As drafted, the trailer bill language would impose a number of requirements, beginning in the 2015-16 fiscal year, on school districts that adopt a budget with a level of reserves higher than the minimum required reserve for economic uncertainties. Further, should ACA 1 (second extraordinary session) be approved by voters in November, the proposal would impose an absolute cap on the amount of fiscal reserves for economic uncertainty a school district and county office of education would be allowed to maintain. Those restrictions would be in place in the first fiscal year after which a transfer is made into the Public School System Stabilization Account.

In our judgment, 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 critical role that prudent budget reserves play in the ability of school districts to maintain fiscal solvency. In addition, it fails to recognize the numerous factors that go into school district decisions on reserve levels and ignores recent history with regard to how school districts used budget reserves during the great recession to avoid even greater cuts to educational programs and certificated and classified staff reductions.

The proposal is fiscally irresponsible. For most of the last two decades, California has focused on preventing school district bankruptcies by enacting laws that require multiyear projections, enforcement of strict fiscal standards by county offices of education, early intervention, and even the authority to override the spending decisions of local governing boards. It is therefore ironic that, at the very time an initiative has been placed on the statewide ballot to strengthen the state's rainy day fund, that the Legislature and Governor would consider statutory changes that eviscerate provisions at the local school district level that are based on the same premise of fiscal prudence and responsibility. To enact these provisions would be fiscally irresponsible and fundamentally in conflict with the principles articulated by the Governor and Legislature in placing the Rainy Day Reserve initiative (ACA 1) on the November ballot.

The proposal is counter to the concept of subsidiarity and a core principle of the LCFF. In his 2013 State of the State Address, Governor Brown called upon the Legislature to embrace the concept of subsidiarity, stating "it is the idea that a central authority should only perform those tasks which cannot be performed at the more immediate or local level." This concept was at the heart of the governor's Local Control Funding Formula, which was described in the governor's 2013 Budget Summary as a proposal that would "increase local control, reduce state bureaucracy, and ensure that student needs drive the allocation of resources." The reserve proposal is counter to both the concept of subsidiarity and the premise of LCFF in that it fails to allow locally elected governing boards to make fiscal decisions that best serve the needs of their students, staff and communities.

The proposal fails to recognize the critical role that prudent budget reserves play in the ability of school districts to maintain fiscal solvency. It is important to recognize that a 3% reserve requirement represents, for most districts, six to eight days of payroll. Second, although the minimum reserve level is usually 3%, well managed districts have historically felt safe only when they carry more than that amount in reserve. The recent (2008-11) experience of being required to manage $6 billion in ongoing revenue reductions, including $2.85 billion in mid-year ongoing cuts, only serves to underscore the critical importance of maintaining healthy budget reserves above the statutory minimums. Districts at the minimum level of reserves are vulnerable to any unanticipated financial developments. This is now particularly relevant in the light of some of the significant and major obligations that are currently facing school districts, including but not limited to increased contribution rates for CalSTRS and CalPERS, and increased costs for health care as a result of the Affordable Care Act.

To further this point, a recent quantitative study measured the presence of the 15 common conditions of fiscal distress that have been identified by the Fiscal Crisis & Management Assistance Team, and their impact on the budget status of school districts. In this study, *the single greatest predictor of an interim qualified or negative budget report status was the failure to maintain reserves*. The study concluded that California policymakers should consider <u>increasing</u> the minimum reserve level maintained for economic uncertainty.

The proposal fails to recognize the factors that go into school district decisions on reserve levels. School districts consider many factors when determining what constitutes a prudent level of reserves. Those include size of the district, source of revenues, revenue trends, ADA projections and charter schools, future needs, unfunded debt, and salary settlements. These decisions are not made lightly, and are based on the best efforts of the governance team to identify the key priorities for the district, its students and staff.

The proposal ignores recent history. Simply put, many school districts were able to survive the great recession only through a prudent management of budget reserves. As noted above, prudent reserves allowed districts to avoid having to make even greater cuts to educational programs and reductions to certificated and classified staff than those painful cuts that became necessary, due to budget reductions and deferrals.

The Governor and the leaders of the Senate and Assembly have all spoken eloquently this year regarding the need for California to strengthen the state's rainy day fund. As they have all noted, California revenues are volatile, and in many years, uncertain. Those uncertainties inevitably trickle down to school districts, and it is unclear why the state would propose a reserve policy for school districts that is entirely counter to the one being considered for the state. Further, to suggest that there is a nexus between contributions to the Proposition 98 portion of the rainy day fund and the level of district reserves simply flies in the face of logic.

Lastly, we object to the process by which this language is being proposed and considered. This language was not proposed in the Governor's January budget or the May Revision and has not been discussed in any public hearing in either legislative house; likewise it is not in print for the public to comment. The proposed language represents a permanent, significant fiscal and policy shift with regard to how school districts and county offices of education conduct the annual budget process. As a result, public discussion should be afforded to interested parties before the language is voted on by the Legislature.

For the reasons outlined above, we strongly urge the Legislature to reject this proposal. As always, thank you for your consideration of our views.

Sincerely,

Jeffrey a Vaca

Erika Hoffman
Co-Chair
Education Management Group

Jeffrey A. Vaca
Co-Chair
Education Management Group

cc: Members, Budget Conference Committee
Members, Assembly Budget Committee
Members, Senate Budget and Fiscal Review Committee
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