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OFFICE OF EDUCATION

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October 8, 2019

Ms. Debbie Butler
Novato Unified School District

Dear Ms. Butler,

In accordance with Education Code Sections 42127, the Marin County Office of Education has reviewed the adopted budget of the Novato Unified School District for fiscal year 2019-2020. Education Code 52070 requires the County Superintendent to approve the Local Control and Accountability Plan (LCAP) including the Budget Overview for Parents prior to approving the District's adopted budget. A separate letter approving the District's LCAP accompanies this letter.

Education Code also requires the County Superintendent to approve, conditionally approve or disapprove the adopted final budget for each school district after examining and determining the following:

- Examine the adopted budget to determine whether it complies with the standards and criteria established pursuant to Section 33127 and identify any technical corrections needed to bring the budget into compliance with those standards and criteria.
- Determine whether the adopted budget will allow the district to meet its financial obligations during the current fiscal year and is consistent with a financial plan that will enable the district to satisfy its multi-year financial commitments.
- Determine whether the adopted budget includes the expenditures necessary to implement the LCAP or annual update to the LCAP.
- Determine whether the adopted budget includes a combined assigned and unassigned ending fund balance that exceeds the minimum recommended reserve for economic uncertainties and verify compliance with disclosure requirements if above the minimum reserves.

Based upon our review, the adopted budget of the Novato Unified School District has been approved, however, as detailed in the letter below, despite implementing material budget reductions in 2018-19 and again in the 2019-20 adopted budget, the District's projected decline in ending fund balance is cause for concern. We note the District has not yet settled with either of the bargaining units and the parcel tax measure expires in June 2022. We also note the district's enrollment is higher than estimated in the adopted budget.

STATE AND NATIONAL ECONOMIC INFLUENCES

Through our fiscal oversight role, we carefully monitor the economy, its impact on State and Federal revenues and how these might affect Marin County school districts and students. We also closely monitor changes associated with the accountability element of the Local Control Funding Formula (LCFF) as the State continues to refine the statewide accountability system, aligning federal and state compliance through the California School Dashboard and the Local Control Accountability Plan (LCAP). Also, on the watch list are current legislative efforts, especially those impacting property and parcel taxes, the continuing uncertainties associated with federal actions, the steady increase in pension costs despite recent State action to provide relief, and fiscal information unique to each district.

Current Economic Conditions

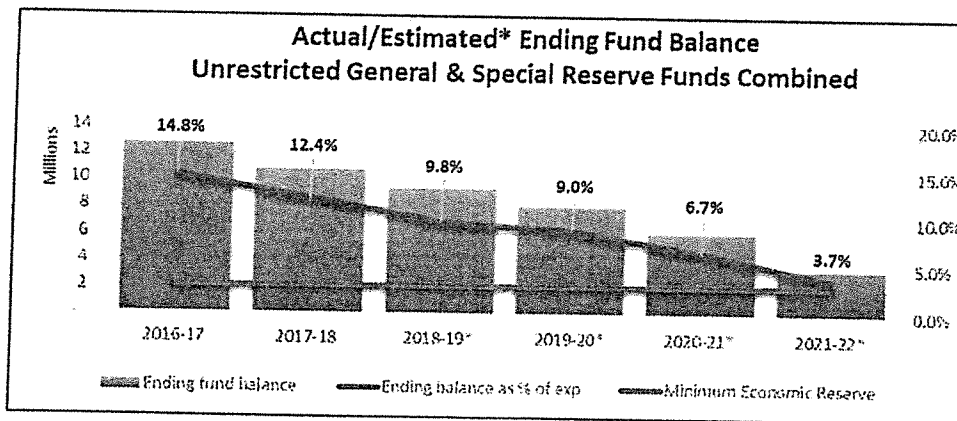
The 2019-20 California state budget provided a 3.26% cost of living adjustment (COLA) to the Local Control Funding Formula and selected categorical programs including the special education apportionment. The only other increases in the state budget are funded with non-Proposition 98 resources: The Special Education Early Intervention Preschool Grant will provide approximately \$2.6 million in one-time unrestricted funding to Marin’s school districts. Marin school district budgets will also benefit from the state’s \$3.15 billion one-time buy-down of the unfunded liabilities for pension benefits thereby reducing pension contribution rates.

For those districts dependent on local economic conditions for revenue growth, the rise in the local property taxes is the primary source for revenue increases. While the property tax growth rate is estimated to outpace the state’s COLA in most areas of Marin, we are, nonetheless, seeing a slow-down in the property tax growth rate. We therefore advise caution to ensure reserves will be sufficient to withstand the inevitable slow-down in the economy.

We anticipate future increases in education funding will continue to be limited to the cost of living inflation factor at a maximum. For community-funded districts, there are potentially competing measures proposed for the upcoming ballot that, if passed, will impact property taxes. The risks of a record period of economic recovery and known cost pressures underscores the need to maintain budget reserves and fiscal flexibility. It is within this context that school districts should exercise caution when considering out-year spending commitments, to ensure they are well positioned for economic volatility over the next few years.

BUDGETARY POSITION FOR NOVATO UNIFIED SCHOOL DISTRICT

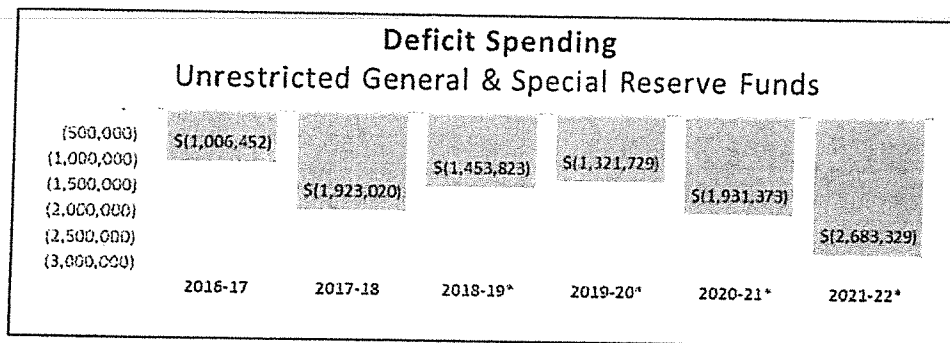
The following graph depicts the District’s estimated ending balance in the adopted budget and multi-year projection for the unrestricted general and special reserve funds combined, with both the state required minimum reserve and the District’s actual reserve as a percentage of total expenditures.



The District's ending balance as approved with the adopted budget meets the minimum required reserve requirement for the current and two (2) subsequent years, nonetheless, the projected rate of decline in the adopted budget is unsustainable. Since the District adopted the budget a number of changes have occurred to improve the District's financial position. A review of the District's recently submitted Unaudited Actuals for 2018-19 shows the District's ending balance in the unrestricted general fund is approximately \$1.6 million higher than anticipated at adoption. We also understand the District's student enrollment for 2019-20 is materially higher than projected, which will result in increased revenue estimates. In addition, the state budget adoption includes approximately \$0.8 million in one-time unrestricted funds to support pre-school students with disabilities. **Once the impact of these underlying assumptions has been determined, the District will need to reassess the structural deficit and associated deficit reduction plan, with its first interim budget.**

OPERATING DEFICITS

The District's adopted budget reflects six (6) consecutive years of actual and planned operating deficits in the unrestricted general fund as displayed in the chart below.



The cumulative impact of this projected deficit spending is a 63% decline in fund balance over the current plus two (2) subsequent years, leaving the District with reserves of \$3.4 million or 3.7% of general fund expenditures at June 30, 2022.

The District's budget reflects deficit reductions of \$2.2 million in 2018-19 and an additional \$1.8 million in 2019-20. We commend the District for the planning necessary to incorporate these and future deficit reduction plans. Districts that wait too long to address and correct structural deficits are forced to make dramatic corrections all at once. In contrast, carefully planned and phased-in structural corrections lessen the impact on children. **As noted above, the District needs to develop a deficit reduction and recovery plan for inclusion with the first interim budget.**

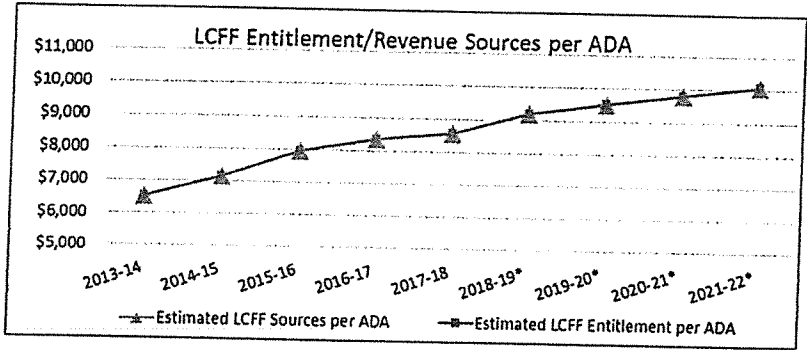
CASH FLOW

The District's historical cash flow statements indicate the District has insufficient cash in certain months of the year to meet operating expenditures necessitating cash borrowing from the County of Marin through an approved Tax Anticipation Note (TAN). We note the District's TAN for the 2019-20 fiscal year has been approved by the Board of Supervisors. The District is well advised to maintain reserve levels at far higher levels than the state required minimums to ensure sufficient cash for operating purposes.

LOCAL CONTROL FUNDING FORMULA (LCFF) FOR NOVATO UNIFIED SCHOOL DISTRICT

The increase in Proposition 98 funding for schools in the 2019-20 state budget is just enough to fund the statutory cost of living adjustment (COLA) of 3.26%. Going forward, based on state projections, Proposition 98

funding will continue to be enough to fund the LCFF entitlement with adjustments for changes in the pupil population and the annual cost of living factor. The following graph is based on the State's Adopted Budget and shows the District's LCFF entitlement per unit of attendance (ADA) from the inception of the LCFF in 2013-14 with projections for the adopted budget and multi-year projection.



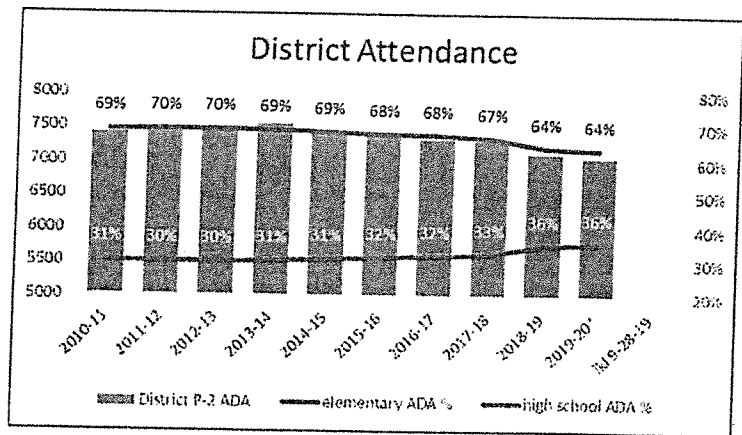
The District's estimated LCFF entitlement is expected to increase by approximately \$1 million over the 2018-19 entitlement despite projected declining enrollment. As previously noted, the District's opening day enrollment counts indicate the District may experience an increase in student attendance rather than a decline. Should this increase in ADA materialize, the District will be able to reassess the structural deficit.

As depicted in the graph above, the growth in per pupil funding is unlikely to keep up with annual cost increases now that LCFF funding increases are driven solely by COLA.

The District has an obligation under the new funding formula to direct the supplemental grant included in the District's LCFF entitlement towards increasing or improving services to pupils of higher need. This requirement applies to all districts, including community funded districts. The District's estimated 2019-20 supplemental LCFF grant is approximately \$5 million.

STUDENT ATTENDANCE

The District is estimating average daily attendance (ADA) will continue to decline as reflected in the chart below. The District's decline is particularly difficult to manage, as high school attendance has increased while elementary school attendance continues to decline, to the extent that high school now accounts for 36% of total attendance.



FEDERAL BUDGET

The Every Student Succeeds Act (ESSA) is the 2015 reauthorization of the Federal Elementary and Secondary Education Act, which provides states, districts and schools with supplemental funding to ensure equitable education for disadvantaged students such as students living in poverty, minorities, students who receive special education and English learners. The accountability provisions of ESSA identifies districts for 'Comprehensive Support and Improvement' to help improve pupil outcomes.

Beginning with the 2018-19 unaudited actuals, provisions of ESSA become effective, requiring all districts to report per pupil expenditures at the school level. The California Department of Education anticipates collecting this data from districts in early 2020. Additionally, beginning with the 2019-20 application for federal funding known as the 'Consolidated Application', ESSA required districts to certify board approval of the federal addendum to the LCAP.

The federal budget for fiscal year 2020 is likely to provide small increases in Title I funding. A concerted effort to secure an increase in the federal budget for Special Education has emerged, however, the budget has not yet been approved. Federal funding for California school districts is forward funded meaning that the 2020 budget will determine federal revenues in the District's 2020-21 budget. Federal actions especially as related to immigration and trade are heightening economic uncertainties both nationally and in California, and, as such, we will continue to monitor events in Washington closely.

PARCEL TAXES

Your community has shown support for its schools through a parcel tax. The District's multi-year projection includes parcel taxes in all three (3) years starting with a base of \$4.1 million in the adopted budget representing 5% of the District's total general fund revenue sources. The District's current parcel tax expires on June 30, 2022.

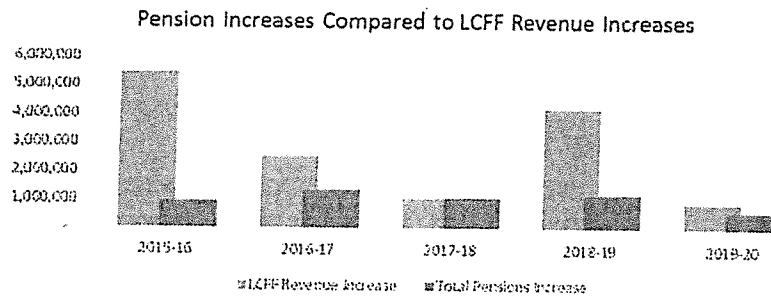
SALARY SETTLEMENTS

School districts are in the "people business." We note that the District has not settled negotiations with bargaining units for the budget year. Due to the ongoing nature of these costs, any permanent increases to salary require permanent and ongoing funding sources. When the District and bargaining unit are ready to settle negotiations, Government Code 3547.5 requires the District to publicly disclose costs, as certified by the superintendent and chief fiscal officer. Please provide a Public Disclosure of Collective Bargaining Agreement including the tentative agreement(s) and multi-year projection to our office ten (10) working days prior to Board approval. Budget revisions associated with salary settlements should be approved within 45 days of Board approval.

PENSION CONTRIBUTIONS

As noted above, the state budget included an infusion of \$3.15 billion to slow the pension contribution rate increases for the budget and subsequent years. The final state budget includes relief for both CalSTRS (teachers retirement system) and CalPERS (classified employees retirement system). The District's adopted budget includes pension relief savings of approximately \$550 thousand.

While the state's actions have provided some welcome relief to the budget, pension contributions will continue to increase for at least the foreseeable future. The following chart reflects the historical and budgeted change in LCFF funding, including local property taxes, compared to the change in retirement system costs.



RETIREE BENEFITS

The District provides other post-employment health benefits (OPEB) to retired employees that have met certain eligibility requirements. The District’s estimated unfunded liability is \$1.4 million. This measurement is based on the District’s actuarial study dated June 2018.

BOND FINANCED CAPITAL PROJECTS

The District is managing a major capital projects program funded with proceeds from general obligation bonds authorized by the voters on Measure G in November 2016. Including the most recent issuance of Series B bonds in the amount of \$55 million, the District has issued \$106 million of the \$222 million bond authority. The adopted budget does not include the recent issuance.

The current environment for construction activity continues to prove to be challenging with a shortage of available contractors and an escalation in costs that far outpaces inflation. The District will need to closely monitor estimated project costs and the impact of cost escalation on the approved project list as cost over-runs become an obligation of the general fund once bond resources are exhausted and, given the relative size of construction budgets to the general fund budget, often result in the need for financing through additional long-term debt. In addition, capital projects funded in any part under the Schools Facility Program are subject to performance audit procedures.

We advise all districts to monitor the activity in other funds, especially those related to capital projects including debt financing. Activities related to capital projects, including procurement and financing in particular, have come under increasing scrutiny in the past few years and are subject to increasing regulation. We encourage all Marin County school districts to become familiar with the resources available through the California Debt and Investment Advisory Commission (CDIAC) and the best practices guides published by the Government Finance Officers Association (GFOA) to assist in the management of risks associated with capital projects and debt financing.

CHARTER SCHOOLS

The District first authorized the Novato Charter School (Charter) for operations beginning in September 1995. The Charter has maintained stable enrollment over the 24 years and primarily serves students residing within the District’s boundaries. We note the Charter has made the appropriate notification to become their own Local Educational Agency LEA for special education services beginning in 2020-21 and will be withdrawing from the Marin County SELPA. We encourage the District to continue perform financial and budget reviews and all other oversight responsibilities as iterated in Education Code section 47604.2. Documented evidence of the District’s due diligence serves to protect the District from any liabilities incurred by the not-for-profit corporation governing the Charter school.

RESERVES

The District maintains the state-required minimum reserve for economic uncertainty of 3% in the current and two (2) subsequent years. All school districts, whether state aid or community funded, are well advised to establish higher than minimum reserves in order to provide for the financial flexibility to absorb unanticipated expenditures without significant disruption to educational programs, cash flow deferrals, and general economic uncertainties. Higher than minimum reserves allows the District to better ensure a consistent and stable program offering for students.

Transparency Requirement

The District met the requirement of disclosing reserve levels, including justification for carrying higher than minimum reserves, at the adopted budget public hearing.

Cap on Reserves

Should the Public School System Stabilization Account (PSSSA) equal or exceed 3% of state general fund revenues, a cap on district reserves is effective in the following fiscal year. Although conditions have triggered the requirement for the State to deposit \$389 million to the PSSSA, this amount falls far short of 3% of state general fund revenues. The reserve cap does not apply to community-funded districts or districts with less than 2,500 ADA. Additionally, if triggered, districts may request an exemption from the reserve cap from the county superintendent of schools. In all circumstances, we continue to encourage districts to maintain higher than minimum reserves.

LOCAL CONTROL AND ACCOUNTABILITY PLAN (LCAP) AND 2019-20 UPDATE TO THE 2017-2020 LCAP

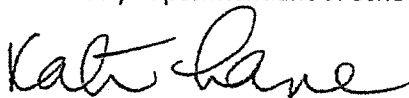
We commend the District’s efforts in preparing the final update to the 2017-2020 LCAP including the 2018-19 Annual Update and the Budget Overview for Parents. Information about the District’s LCAP approval has been provided through a separate letter.

CONCLUSION

We thank Yancy Hawkins and Nancy Walker for their timely submission of the adopted budget using the statutorily required forms and responsiveness to the requests for information made in the course of our technical review. We appreciate your dedication and service to the children of Marin County. Your attention to good fiscal stewardship ensures the children of Marin County will continue to experience quality education now and in the future. If you have any questions, please do not hesitate to contact me at 415-499-5822.

Sincerely,

MARY JANE BURKE
Marin County Superintendent of Schools



KATE LANE
Assistant Superintendent

cc: Kris Cosca, Superintendent
Yancy Hawkins, Assistant Superintendent
Nancy Walker, Director of Fiscal Service