Modesto City School District
2020-21 Proposed Budget Report and Multiyear Fiscal Projection
Public Hearing and Budget Adoption – June 22, 2020

We have become used to easy and well-funded budgets since the last recession. However, the 2020-21 State Budget will not be one of them. The legislative response to the Governor's May Revision has been to find alternatives to all of the Governor's proposed budget reductions, as outlined in our Proposed Budget Adoption. It is critical that we project and prepare for the Governor's worst case scenario, and should the final 2020-21 Budget contain fewer, or no program cuts to the May Revision, preparing for them now gives us far better options.

Local Educational Agencies are required to adopt a budget prior to July 1 of each year in order to authorize the expenditure of funds. The proposed budget is only an initial blueprint for revenues and expenditures since the preparation of the adopted budget occurs before the State has enacted its budget, and before actual expenditures and revenues are known for the current year. In the event that material revisions are necessary, a revised budget will be presented to the Board no less than 45 days after the enacted State budget.

Illustrated below is a summary of the proposed State budget and budget guidelines as provided by the Stanislaus County Office of Education, and School Services of California. The Proposed Budget Report also contains financial summaries, multi-year projections and detailed financial State reports relating to the estimated financial activity for 2019-20 through 2022-23 specific to the Modesto City School District.

<u>Governor's Revised State Budget Proposal "May Revision"</u>

The Governor released his revised 2020-21 budget proposal (May Revision), which contained a decrease of ($13.5 billion) in Proposition 98 revenues to K-14 from what was provided for in the January proposed budget. Unlike previous years, revenue projections have decreased for the May Revision as compared to the Governor's January Budget, due to the COVID-19 recession.

Illustrated below are the major components of the May Revision:

- The minimum guarantee for 2020-21 is projected to be $70.5 billion.
- Cost of Living Adjustment (COLA) is estimated to be 2.31%, slightly up from 2.29% as projected in January.
    - May revision suspends the 2.31% statutory COLA, and proposes additional LCFF cuts for a total of 10%
    - LCFF reductions provide a statewide average decrease of ($1,050) per pupil, beyond the 2019-20 levels.
- The May Revision does not provide any one-time Proposition 98 discretionary funding for school districts.
- Includes the Governor's January Budget Proposal in increase Special Education base rates to $645 per student.
    - Estimated to be $88 per student, for a 15.74% increase.

Local Control Funding Formula Structure:

Local Control Funding Formula – The Local Control Funding Formula (LCFF) is intended to provide a funding mechanism that is simple and transparent while allowing local educational agencies (LEAs) maximum flexibility in allocating resources to meet local needs.

The funding basis under the LCFF shifted from a primarily Average Daily Attendance (ADA) driven model to one that places emphasis on student population/demographics, as well as the District's ADA. It is calculated annually based on student population (ADA, enrollment, unduplicated pupil percentage (UPP); foster youth, socioeconomically disadvantaged, and English Learners).

The most distinct difference between revenue limit funding and the LCFF during the transition related to the role and impact of Cost-of-Living-Adjustments (COLAs). Under revenue limits, COLAs (and their deficits) played the central role in determining changes in year-over-year funding; under the LCFF, COLAs are but one step in the formula's calculation. Illustrated below are the basic components of the formula and transition into the LCFF:

- **Average Daily Attendance (ADA)**
  - Similar to revenue limits, funding is calculated on ADA
- **Annual COLA**
  - Determined by the implicit price deflator as set in May for the budget year and estimated by the Department of Finance (DOF) for the two subsequent years for use in projections
    - Applied to grade span base grants, which drives grade span adjustment and supplemental and concentration grant calculations
- **Unduplicated Percentages**
  - Certified through enrollment data each Fall (applied to supplemental and concentration grant calculations)

Supplemental and Concentration Grants – Education Code Section 42238.02 increases the LCFF base grant by a supplemental grant and a concentration grant. These are determined by LEAs' unduplicated count of pupils who are eligible for free and reduced price meals, and/or who are classified as English Learners, or as Foster Youth.

The Superintendent of Public Instruction will annually compute the percentage of unduplicated count using the criteria above, utilizing data reported through the California Longitudinal Pupil Achievement Data System (CALPADS). A pupil who is identified in more than one category will only be counted once in determining the unduplicated pupil count. This data is subject to annual review and validation by the county office of education and is subject to audit under the State audit guidelines.

Local Control Accountability Plans:

Effective 2013-14, the LCFF relies on the use of accountability plans in shifting control of LEA budgets from the State to the local level. Therefore, school districts and county offices of education (COEs) are required to adopt a Local Control and Accountability Plan (LCAP) using a template adopted by the State Board of Education (SBE).

It is required that the LCAP be effective for three years (updated annually), and include annual goals for pupils (including each subgroup of pupils) to be achieved for State and local priorities, as well as, identify the specific actions the school district, or COE, will take during each year of the plan to achieve specified goals.

Prior to adopting or updating the LCAP, a district must provide the public and parent advisory committees (includes EL parent advisory committees) an opportunity to review and comment on the proposed LCAP. In addition, a district must hold at least one public hearing to solicit public comments regarding the LCAP, and must adopt the LCAP at a subsequent public meeting. Further, the LCAP must be adopted before the budget is adopted.

Due to the pandemic, Governor Newsom issued Executive Order (EO) N-56-20, which extended the deadline to adopt the LCAP, Annual Update and Budget Overview for Parents to December 15, 2020 on the condition that the governing board adopts a written report by July 1, 2020.

K-12 One-Time and Block Grant Mandate Funding:

The Governor's May Revision does not include any one-time discretionary funds for districts.

Reserves

District Reserve Requirements (Senate Bill 858):

The 2014 State Budget Act and the passage of Proposition 2 in November 2014 established a hard cap on district reserves, if all of the following conditions are met:

- The Proposition 98 maintenance factor must be fully repaid
- Proposition 98 must be funded based on Test 1
- Proposition 98 provides sufficient funds to support enrollment growth and the statutory COLA
- A deposit must be made into the Proposition 98 reserve when capital gains revenues exceed 8% of General Fund revenues
- Senate Bill (SB) 751 amended the triggering threshold to require the deposit into the Proposition 98 reserve to reach 3% of the Proposition 98 funding level, rather than a deposit of any size into the reserve.

Currently, the cap is not expected to be in effect for fiscal year 2020-21 since the proposed budget withdraws all funds over the next three years.

Senate Bill (SB) 858 also requires that school districts, starting with the 2015-16 adopted budgets, must add new procedures to the public hearing. The new required procedure consists of providing the following disclosures at the public hearing beginning with the 2015-16 budget adoption:

- The minimum reserve level required in each year
- The amount of assigned and unassigned ending fund balance that exceeds the minimum in each year
- Reasons for the reserve being greater than the minimum

On January 21, 2015, the Legislative Analyst's Office (LAO) released a report regarding Senate Bill 858, which illustrated the rationale behind school district reserve levels, the benefits of prudent reserves, and the risks of reduced reserves. The report details five main reasons that school districts maintain adequate reserves:

- Managing cash flow
- Mitigating volatility in funding or expenditures
- Saving for larger purchases
- Addressing unexpected costs
- Reducing costs of borrowing

Further, the LAO described specific risks to school districts that lower their reserves in accordance with the SB 858 cap, including:

- The cap would allow most districts to maintain only a few weeks of payroll
- Emergency facility repairs and other unexpected costs would place districts with low reserves in a precarious position
- Districts with reserves below the caps have been about twice as likely to be flagged for fiscal intervention
- Districts with lower reserves could have their credit ratings reduced, increasing the cost of borrowing money

The experience of recent recessions have clearly demonstrated the minimum levels are insufficient to protect educational programs from severe disruption in an economic downturn. The typical 3% reserve minimum represents less than two weeks of payroll for many districts.

Effective 2019/20, the Board designated reserve level for Modesto City Schools to be maintained at a level of 6%. Based on current factors and assumptions, the District is able to maintain a 6% reserve level for the 2020/21 fiscal year. However, based on those same assumptions, the District is only able to maintain the required 3% reserve level in subsequent years.

2020-21 Modesto City School District Primary Budget Components

- ❖ Average Daily Attendance (ADA) is estimated at 27,962 (excludes COE ADA of 521).

- ❖ The District's estimated unduplicated pupil percentage for supplemental and concentration funding is estimated to be 87.67% for the ESD and 67.93% for the HSD. The percentage will be revised based on actual data.

- ❖ Lottery revenue is estimated to be $148 per ADA for unrestricted purposes and $52 per ADA for restricted purposes.

- ❖ Mandated Cost Block Grant is $32 for K-8 ADA and $61 for 9-12 ADA.

- ❖ Except for Special Education and RRMA, all Federal and State restricted categorical programs are self-funded.

General Fund Unrestricted Revenue Components:

The District receives funding for its general operations from various sources. A summary of the major funding sources is illustrated below:

Description	Amount
General Purpose Revenue	$301,890,473
Federal Revenues	$0
Other State Revenues	$5,590,501
Other Local Revenues	$1,983,738
TOTAL	**$309,464,712**

Education Protection Account:

As approved by the voters on November 6, 2012, The Schools and Local Public Safety Protection Act of 2012 (Proposition 30) temporarily increased the State's sales tax rate and the personal income tax rates for taxpayers in high tax brackets.

The creation of the EPA by Proposition 30 provides that a portion of K-14 general purpose funds must be utilized for instructional purposes. Revenues generated from Proposition 30 are deposited into a State account called the Education Protection Account (EPA). The District will receive funds from the EPA based on its proportionate share of statewide general purpose funds. A corresponding reduction is made to its State aid funds.

K-14 local agencies have the sole authority to determine how the funds received from the EPA are spent, but with these provisions:

- The spending plan must be approved by the governing board during a public meeting.
- EPA funds cannot be used for the salaries or benefits of administrators or any other administrative costs (as determined through the account code structure).
- Each year, the local agency must publish on its website an accounting of how much money was received from the EPA and how the funds were expended.

Further, the annual financial audit includes verification that the EPA funds were used as specified by Proposition 30. If EPA funds are not expended in accordance with the requirements of Proposition 30, civil or criminal penalties could be incurred.

Illustrated below is how the District's EPA funds are appropriated for 2019-20. The amounts will be revised throughout the year based on information received from the State.

Education Protection Account (EPA) Budget ***2020-21 Fiscal Year***	
Description	Amount
BEGINNING BALANCE	$0
BUDGETED EPA REVENUES:	
Estimated EPA Funds	$38,429,207
BUDGETED EPA EXPENDITURES:	
Certificated Instructional Salaries	$30,502,160
Certificated Instructional Benefits	$7,927,047
TOTAL	$38,429,207
ENDING BALANCE	$0

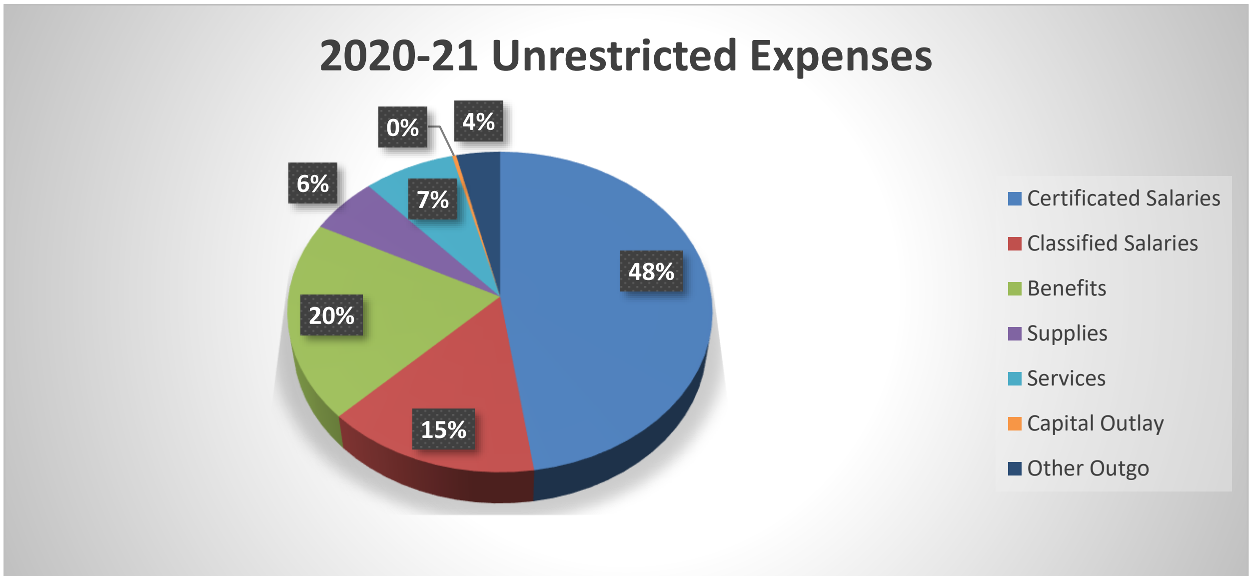
Subsequently, on November 8, 2016, the voters approved the California Children's Education and Health Care Protection Act (Proposition 55) that maintains increased personal income tax rates for taxpayers in high tax brackets through 2030. Proposition 55 did not extend the sales tax increase; therefore, the temporary sales tax increase expired at the end of calendar year 2016.

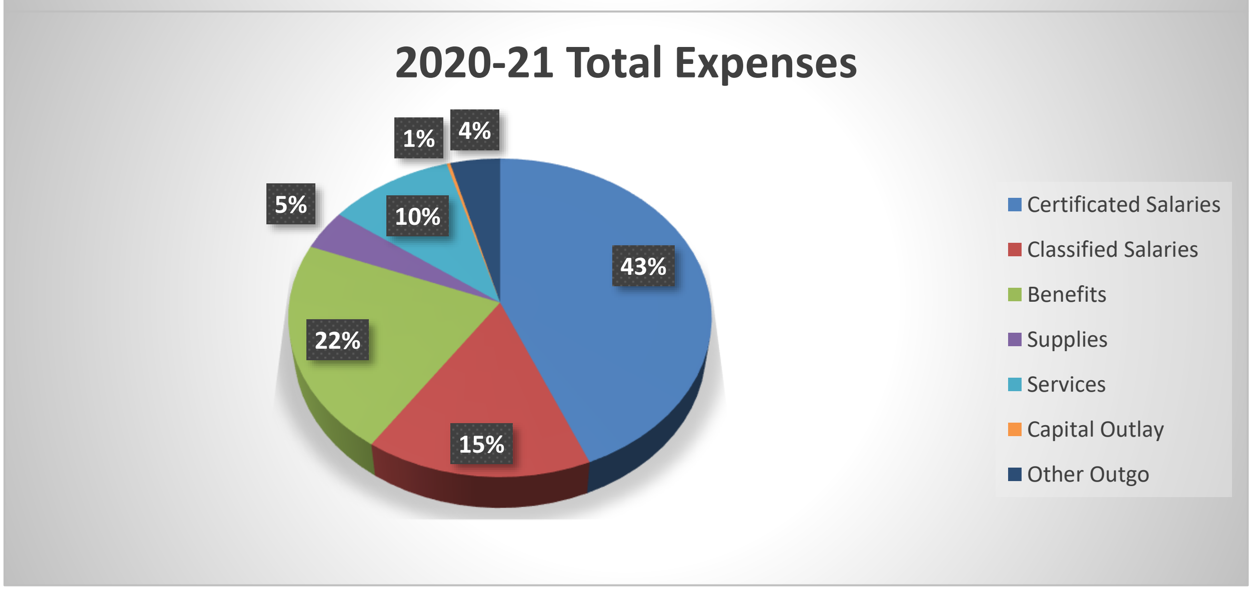
Operating Expenditure Components:

The General Fund is used for the majority of the functions within the District. As illustrated below, salaries and benefits comprise of approximately 83% of the District's unrestricted budget, and approximately 80% of the total General Fund budget.

Description	Unrestricted	Combined
Certificated Salaries	$137,908,632	$170,835,266
Classified Salaries	$43,109,351	$62,057,564
Benefits (Payroll Taxes and Health & Welfare Contributions)	$57,989,923	$88,512,480
Books and Supplies	$16,731,477	$21,237,514
Other Operating Expenditures	$22,002,573	$39,383,106
Capital Outlay	$993,000	$3,133,461
Other Outgo	$4,316,277	$9,076,034
TOTAL	**$283,051,233**	**$394,235,425**

Following is a graphical representation of expenditures by percentage:





Unrestricted General Fund Summary:

The District's 2020-21 Unrestricted General Fund projects a total operating deficit of $28 million resulting in an estimated ending fund balance of $59.9 million. The components of the District's fund balance are as follows: revolving cash & other non-spendable - $1.5 million; economic uncertainty - $24.1 million; Onetime Expenditures - $0.25 million; LCAP Supplemental & Concentration $16.2 million.

Fund Summaries:

Illustrated below is a summary of each Fund's fund balance and corresponding change.

FUND	2019-20	Est. Net Change	2020-21
GENERAL (UNRESTRICTED & RESTRICTED)	$96,113,583	($26,765,452)	$69,348,131
ADULT EDUCATION	$3,796	$0	$3,796
CHILD DEVELOPMENT FUND	$160,266	$0	$160,266
CAFETERIA FUND	$4,119,629	($1,674,465)	$2,445,164
DEFERRED MAINTENANCE	$1,468,898	($959,807)	$509,091
SPECIAL RESERVE NON-CAPITAL PROJ	$5,467,700	($2,754,800)	$2,712,900
BUILDING FUND	$5,692,232	($4,573,127)	$1,119,105
CAPITAL FACILITIES	$1,140,246	$412,005	$1,552,251
SPECIAL RESERVE CAPITAL PROJECTS	$24,913,051	($3,668,513)	$21,244,538
BOND INTEREST & REDEMPTION	$14,866,389	$733,400	$15,599,789
DEBT SERVICE FUND	$7,991,154	$1,075,941	$9,067,095
SELF INSURANCE FUND	$7,967,857	($208,165)	$7,759,692
TOTAL	**$169,904,801**	($38,382,983)	**$131,521,818**

Multiyear Projection

General Planning Factors:

Illustrated below are the latest factors released by the Department of Finance (DOF) that districts are expected to utilize as planning factors:

	Fiscal Year			
Planning Factor	**2019-20**	**2020-21**	**2021-22**	**2022-23**
COLA (DOF)	3.26%	-7.92%	0.00%	0.00%
LCFF Gap Funding Percentage (DOF)	100.00%	-	-	-
STRS Employer Rates	17.10%	16.15%	16.02%	18.10%
PERS Employer Rates (PERS Board / Actuary)	19.721%	20.70%	22.84%	25.50%
Lottery – unrestricted per ADA	$148	$148	$148	$148
Lottery – Prop. 20 per ADA	$52	$52	$52	$52
Mandated Cost per ADA / One Time Allocations (DOF)	-	-	-	-
Mandate Block Grant for Districts: K-8 per ADA	$32	$32	$32	$32
Mandate Block Grant for Districts: 9-12 per ADA	$62	$62	$62	$62

Various aspects of the planning factors illustrated above will be further discussed below with the District's specific revenue and expenditure assumptions.

Revenue Assumptions:

Per enrollment trends, the District continues to anticipate a decline in its enrollment. The Local Control Funding Formula is based on the Department of Finance's estimates of COLA and funding percentages towards the District's LCFF Target as noted above. Unrestricted local revenue is estimated to remain relatively constant for the subsequent years. Restricted Federal and local revenue increases are associated with increased costs relating to self-funded programs. State revenue is expected to decrease due to the reduction of various program revenues.

Federal Special Education revenue has been adjusted by the 15% required set-aside for Coordinated Early Intervening Services (CEIS), resulting from the significant disproportionality finding in the elementary district.

Expenditure Assumptions:

Proposed new LCAP items for 2020-21 have been placed on hold as a result of Executive Order (EO) N-56-20. Any Supplemental and Concentration dollars that are not reflected in the proposed budget have been placed on an assigned line, and will be allocated based on the LCAP adoption in December 2020.

On December 21, 2016, the California Public Employees' Retirement System (CalPERS) Board took action to approve lowering what is known as the "discount rate" from 7.5% to 7.0% over three years beginning in 2018-19. This action effectively lowers what CalPERS projects will be the annual rate of return on its entire investment portfolio (i.e. investment return percentage). By reducing the current discount rate from 7.5% to 7.375% in 2018-19, 7.25% in 2019-20, and then 7.0% in 2020-21, the CalPERS Board will be scheduling higher employer contribution rates that will significantly exceed previous projected increases. Illustrated below are the actual rates through 2017-18 and projected rates through 2023-24.

CalPERS Rate Comparison								
Description	2016-17 Actual	2017-18 Actual	2018-19 Actual	2019-20 Projected	2020-21 Projected	2021-22 Projected	2022-23 Projected	2023-24 Projected
2018-19	13.888%	15.531%	18.062%	19.721%	20.70%	22.84%	25.50%	26.20%

Assembly Bill (AB) 1469 (CalSTRS Full-Funding Plan) increased the contribution rates that employers, employees and the State pay to support the California State Teachers' Retirement System (CalSTRS). Similar to CalPERS, the CalSTRS Board lowered its assumed rate of return on its investment portfolio from 7.5% to 7.0% and adopted new demographic assumptions on February 10^{th}. Under AB 1469, both State and employer contribution rates may be increased by the CalSTRS Board in order to maintain the goal of reaching full funding of the retirement system by 2046.

Current law increases contribution rates to 19.1% beginning July 1, 2020. Further, under Education Code Section 22950.5, CalSTRS will have the authority to increase or decrease the employer and State contribution rates. However, the rates may not be increased by more than one percent in a year and cannot exceed 12% overall until the remaining unfunded actuarial obligation is eliminated. In addition, new CalSTRS members (hired after January 1, 2013) are required to pay at least half of the normal cost of the new program; thus, these members' contributions will increase by 0.5% effective July 1, 2017.

Illustrated below are the statutory rates through 2020-21 and maximum rates from 2021-22 through 2023-24:

CalSTRS Rates per Education Code Sections 22901.7 and 22950.5								
Description	2016-17 Actual	2017-18 Actual	2018-19 Actual	2019-20 Projected	2020-21 Projected	2021-22 Projected	2022-23 Projected	2023-24 Projected
Statutory Rates	12.58%	14.43%	16.28%	17.10%	16.15%	16.02%	18.10% (Max.)	18.10% (Max.)

Therefore, adjustments to benefits reflect the expected change to employer pension costs.

As a result of the projected deficit in the Governor's May Revision, reductions are necessary in subsequent years to remain fiscally solvent. The expenditure assumptions reflect a reduction of $10 in 2021-22 and an additional reduction of $4M in 2022-23 in the area of supplies, operating costs and capital outlay. Transfers out to reserve funds have also been projected to be cut by $5.3M starting in 2021/22. Contributions to restricted programs are expected to increase for 2021-22 and 2022-23 due to step and column increases, and additional pension costs for restricted programs that receive support from the unrestricted General Fund.

<u>Estimated Ending Fund Balances:</u>

During 2021-22, the District estimates that the unrestricted General Fund is projected to deficit spend by $12.97 million resulting in an unrestricted ending General Fund balance of approximately $46.9 million.

During 2022-23, the District estimates that the unrestricted General Fund is projected to deficit spend by $16.36 million resulting in an unrestricted ending General Fund balance of $30.58 million.

In accordance with the disclosure requirements of Senate Bill 858, amounts over the State mandated reserve of three percent of total General Fund outgo are reserved as outlined on subsequent schedule.

<u>Conclusion</u>

The projected budget and multi-year projections support that the District is projecting to be able to meet its financial obligations for the current and subsequent year.