



MARIN COUNTY

OFFICE OF EDUCATION

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September 15, 2017

Mr. Tom Cooper, President
Novato Unified School District
9 Monterey Court
Novato, CA 94945

Dear Mr. Cooper:

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 2017-2018. Education Code 52070 requires the County Superintendent to approve the Local Control and Accountability Plan (LCAP) 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.

STATE AND NATIONAL ECONOMIC INFLUENCES for NOVATO UNIFIED SCHOOL DISTRICT

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. This past year marked the fourth year of the

Local Control Funding Formula’s (LCFF) accountability element through the Local Control Accountability Plan and Annual Update (LCAP), and its accompanying impact on local budgeting and planning. Also on the watch list are the uncertainties associated with the Affordable Health Care Act, rising pension costs, as well as fiscal information unique to each district.

Current Economic Conditions

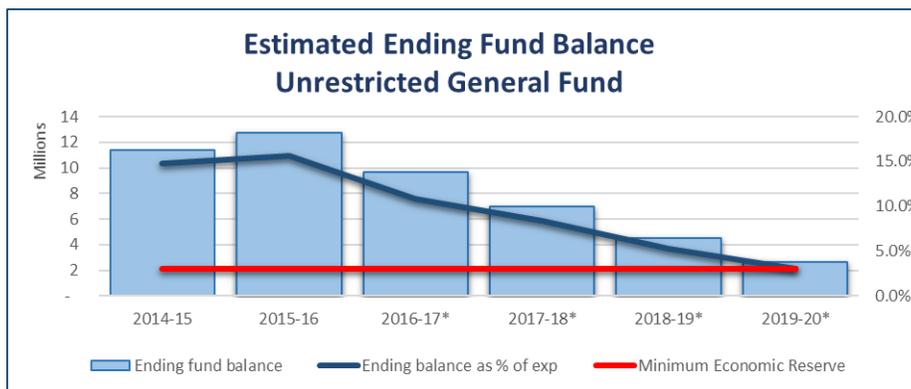
Although the 2017-18 California state budget increases education funding over the prior year, and local property tax bases continue to rise, school districts should be more cautious and conservative than ever in their financial planning. Projected increases in state general fund revenues and Proposition 98 entitlements are based on higher projections of volatile capital gains. The volatility of capital gain tax proceeds that leads to volatility in state revenues, coupled with the significant risks of an economic recovery that has extended for eight years and known cost pressures from increasing employer pension contributions, underscores the need to maintain budget reserves and fiscal flexibility. It is within this context that school districts should exercise extreme caution when considering out-year spending commitments, to assure they are well positioned for economic volatility over the next few years.

LOCAL CONTROL AND ACCOUNTABILITY PLAN and ANNUAL UPDATE (LCAP) for NOVATO UNIFIED SCHOOL DISTRICT

We commend the District’s efforts in preparing the 2017-20 LCAP and 2016-17 Annual Update using the new three year LCAP template. The Education Code requires the County Superintendent to first approve district LCAPs before approving district annual budgets. Information about the District’s LCAP approval has been provided through a separate letter. The California Department of Education will continue to increase the availability of the data sets forming the evaluation rubrics that help assess the District’s success in improving pupil outcomes. The Marin County Office of Education will be providing professional development again this year as part of our commitment to working with districts in support of their locally defined goals to make the LCAP process more meaningful while ensuring compliance with state statutes.

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 fund, with both the state required minimum reserve and the District’s actual reserve as a percentage of total expenditures.



The District’s ending balance is under increasing pressure from retirement system increases, obligations under the LCFF supplemental grant as well as natural inflation. The retirement system cost increases alone are projected to exceed the budgeted increase in LCFF revenues for 2017-2018 by \$0.27 million.

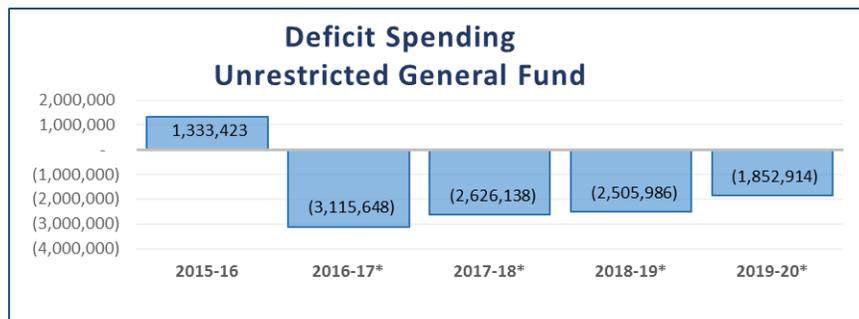
As detailed in this letter below, the District's projected decline in ending fund balance is cause for concern, especially considering the transfer of the entire \$2 million balance of the special reserve fund to the general fund in 2019-20 to reach the minimum reserve requirement. The District's student enrollment continues to decline reducing revenues while the District's obligation under the LCFF spending requirements continues to increase. We also note that bargaining unit negotiations have not settled for the budget year. All of these factors indicate the District's structural deficit will likely worsen with time. Without action to reduce deficit spending, the District's budget will be qualified in 2018-19.

We understand the District has already convened a budget advisory committee to begin developing a deficit reduction and recovery plan. In light of the severity of the projected decline in the District's fiscal solvency, we expect the District will submit a progress report relative to the advisory committee's work identifying those elements under consideration.

We expect the District will then submit a Board-approved deficit reduction and recovery plan with the second interim budget report. As a follow-up to the above, if the deficit reduction and recovery plan includes a reduction in staff, a board resolution authorizing these reductions must accompany the second interim budget report.

OPERATING DEFICITS

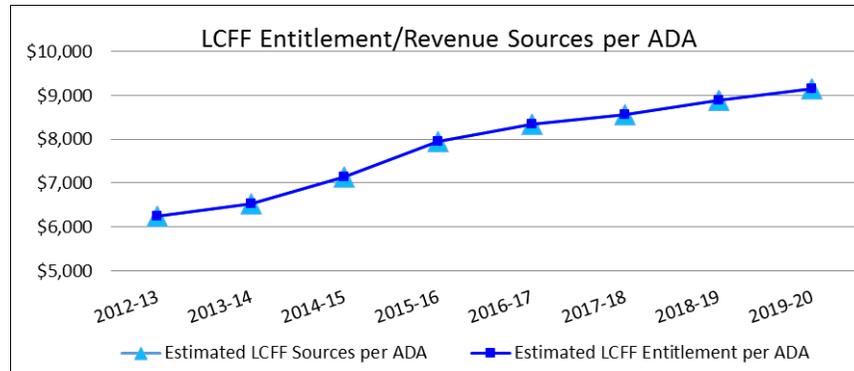
The District's adopted budget and multi-year projection reflects operating deficits in the unrestricted general fund as displayed in the chart below.



The cumulative impact of this projected deficit spending is a 72% decline in fund balance over the current plus two subsequent years, leaving the District with reserves of \$2.6 million or the minimum 3% of total expenditures at June 30, 2020. While some deficit spending may be a result of one-time costs from prior year funding sources, ongoing structural deficits threaten a school district's future educational programs. The District has a number of factors that threaten to increase the District's structural deficit: the use of one time reserves to reduce deficit spending in 2019-20 by \$2 million, bargaining unit negotiations have not been settled for the budget year, and the District's student enrollment continues to decline. 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.

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

The 2017-18 state budget includes an increase in Proposition 98 funding for schools primarily directed towards fully implementing the LCFF. Notwithstanding the restoration to education funding, the new funding formula has markedly different results for the individual districts in Marin County. The graph on the following page shows the District’s LCFF entitlement per unit of attendance (ADA) from the inception of the LCFF in 2012-13 to 2016-17 with projections for the adopted budget and multi-year projection.

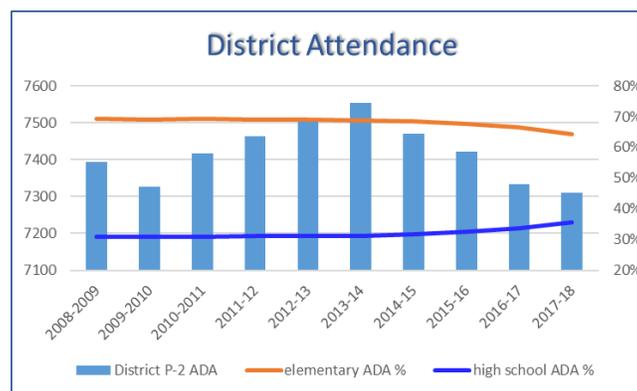


For most state-funded districts, including Novato Unified School District, increases in the LCFF translate directly into increased funding. For the Novato Unified School District, the resulting LCFF entitlement is 97% of full LCFF funding. Once the District’s LCFF is fully funded, annual entitlement increases will be limited to cost of living adjustments (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. The District’s estimated 2017-18 LCFF supplemental grant entitlement is \$4,119,404.

STUDENT ATTENDANCE

The District’s average daily attendance (ADA) peaked at 7,554 ADA in 2013-14 and has since declined by approximately 240 ADA. We also note that after many years of high school and elementary ADA maintaining a ratio of 31%/69%, the last few years have seen high school ADA climbing to 36% of overall ADA.



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 underserved populations of students such as students living in poverty, students of color, and English learners. As part of California's transition to the ESSA, California must submit an ESSA State Plan to the U.S. Department of Education (ED). The State Plan describes the state's implementation of standards, assessment, accountability, and assistance programs, moving us toward California's goal of having a single, coherent local, state, and federal education system. The California Department of Education (CDE) plans to present the ESSA State Plan to the State Board of Education (SBE) for final approval at its September 2017 meeting before submitting to the ED. In the meantime, regulations requiring districts to report expenditures at the school level have been delayed until 2018-19.

Most districts are anticipating a reduction in federal revenues in 2017-18 due to new requirements for the state to develop a set-aside outside of the formula grants to assist those districts in greatest need. We continue to monitor events in Washington to see if the deeper cuts to the education budget for K-12 public schools in the preliminary federal budget proposal for 2018-19 will materialize.

OTHER STATE FUNDING

The State's adopted budget includes 'one-time' funding of approximately \$147 per ADA or \$1.1 million for Novato Unified School District. We note the District's adopted budget did not include this funding, as advised, because the Governor's May Revision budget for 2017-18 proposed one-time funding deferred to the 2018-19 year.

Also of note, the timeline for submitting new or amended applications for Proposition 39 Clean Energy and Jobs Creation funding has been extended until February 2018. All funds must be encumbered by June 2019. We note the District is carrying a balance of \$0.5 million in unexpended Proposition 39 funds.

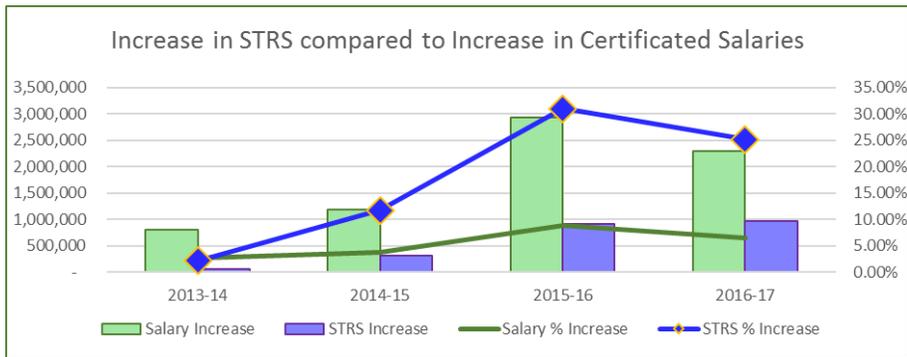
PARCEL TAXES

Your community has shown support for its schools through a parcel tax. The District's multi-year projection includes parcel taxes in all three 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 the District has not settled negotiations with any of the 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 10 working days prior to Board approval. Budget revisions associated with salary settlements should be approved within 45 days of Board approval.

As noted above, the District's budget is under increasing pressure from increases in employer contributions to the retirement systems. The following graph shows the increase in certificated salaries subject to retirement contributions and the increase in retirement contributions to the California State Teacher's Retirement System (STRS) both in absolute amounts as well as by proportionate increase. The trends in this graph are mirrored for classified salaries and associated retirement contributions to the California Public Employees Retirement System (PERS). As can be seen, a 6.5% increase in reportable certificated salaries resulted in a 25% increase in STRS in 2016-17.



CASH FLOW

The District’s historical cash flow statements indicate the District has sufficient cash throughout the year to meet operating expenditures without external cash borrowing. We note the District has, nonetheless, taken the extra precaution of submitting a Tax Anticipation Note (TAN) request that was recently 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.

BOND FINANCED CAPITAL PROJECTS

The District’s voters passed Measure G on the November 2016 ballot authorizing \$222 million in general obligation bonds to finance the District’s capital improvement plan. The District recently issued the first series of bonds in the amount of \$51 million under this authority. The maturity schedule indicates the bonds issued under Series A will be retired in 2041 and the \$4 million term bond issued under Series A-1 will be retired in 2020.

The District previously issued general obligation bonds under the authority of Measure A approved by the voters in November 2001. As of June 30, 2016 the District reported outstanding general obligation bond debt of \$74.7 million exclusive of the remaining unamortized bond premium. The debt service schedule indicates all previously issued general obligation bond debt will be retired by June 30, 2029.

School district bond financing has come under increasing scrutiny in the past few years and is subject to new regulations relative to disclosure, issuance structure and debt-service ratios. The passage of Senate Bill 1029 in 2016 also requires all districts issuing debt to have adopted a debt policy. We are encouraging 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 related to financing published by the Government Finance Officers Association (GFOA) to assist in the management of risks associated with bond financing.

RETIREE BENEFITS

The District provides health benefits to retired employees (OPEB) that have met certain eligibility requirements funding these benefits with the annual budget appropriation paying as the expenditures come due. The District’s projected OPEB cost for 2017-18 is approximately \$100,000 and the entire liability is \$1.5 million. This measurement is based on the District’s actuarial study dated July 2014.

New accounting standards relative to OPEB benefits come into effect in 2017-18. The new standards require full accrual of the outstanding actuarially accrued liability, expanded note disclosures and require that actuarial studies are updated every two years. If the District has not already done so, we recommend engaging an actuary to update the District’s study prior to 2017-18 year-end financial reporting.

CHARTER SCHOOLS

The District first authorized the Novato Charter School (Charter) in 1995. The Charter's operations remain very stable serving approximately 250 students. We thank District staff for providing copies of the financial and budget reviews conducted in the course of the District's oversight role. 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 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.

Cap on Reserves

A cap on reserves of twice the minimum requirement is only triggered under a series of infrequent conditions. Additionally, if triggered, districts may request an exemption from the cap from the County Superintendent of Schools. In all circumstances, we continue to encourage districts to maintain higher than minimum reserves.

CONCLUSION

We thank Yancy Hawkins and Nancy Walker for their timely submission of the adopted budget using the statutorily required forms. If you have any questions, please do not hesitate to contact me at 415-491-6607. We appreciate your dedication and service to the children of Marin County. Due to your good fiscal stewardship, the children of Marin County will continue to experience quality education now and in the future.

Sincerely,

MARY JANE BURKE
Marin County Superintendent of Schools



JAMES R. CERRETA
Assistant Superintendent

cc: Jim Hogeboom, Superintendent
Yancy Hawkins, Assistant Superintendent
Nancy Walker, Director of Fiscal Services