



CSIS California School Information Services

May 12, 2011

Anne Campbell, Superintendent
San Mateo County Office of Education
101 Twin Dolphin Drive
Redwood City, CA 94065

Dear Superintendent Campbell,

In accordance with the study agreement between the San Mateo County Office of Education (San Mateo COE) and the Fiscal Crisis and Management Assistance Team (FCMAT), FCMAT has completed a review of property tax allocations related to Educational Revenue Augmentation funding (ERAF), and the practice of Auditor-Controller's Office of withholding 100% of the allocation from affected revenue limit school districts from the December property tax revenues.

The scope and objectives of this study are as follows:

The San Mateo County Office of Education is requesting FCMAT to provide one day of on-site assistance in developing cash flow strategies. Due to the current fluctuations in assessed valuation and reductions from the state budget, the county has multiple districts changing from basic aid status to revenue limit status within the current budget and/or two subsequent fiscal years.

FCMAT conducted fieldwork on April 5, 2011, and further research and analysis off-site.

Findings

San Mateo County has 23 school districts and one community college district. Seven districts are funded using the revenue limit formula. Two districts and the community college district may or may not be funded under the basic aid formula in any given year, depending on particular funding factors. The remaining 14 districts are basic aid.

Because of reduced revenue limit funding stemming from the state's economic crisis, a growing number of districts in the county have the potential to achieve basic aid status. Likewise, because of student population growth and level property taxes, a few districts could potentially cease to be basic aid districts. This change in school district funding status affects the operations of the remaining revenue limit (non-basic-aid) districts.

In 2005, the state of California redirected the local nonschool agency allocations of sales tax and vehicle license fees back to the state. In return, the state reallocated a matching portion of local property taxes to make up the local agencies' revenue losses. The state, as part of the revenue limit formula, provides school

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districts with their revenue limit entitlement minus the proceeds of local property taxes. Thus, any diversion of a district's property taxes is made up by the state.

Basic aid districts are funded with the proceeds of local taxes, whether or not those proceeds exceed their revenue limit entitlement. They receive no revenue limit funds except for the minimum guaranteed in the state's constitution (basic aid). By law, the county may only reallocate the property tax payments to fund the local agency ERAF obligation from the non-basic-aid school districts. When the San Mateo County Auditor/Controller's Office determines the ERAF payments due to the nonschool taxing entities, that obligation is borne by a smaller group of districts, consuming a larger portion of their local property tax revenues.

The districts are protected and held harmless from revenue loss, as the maximum amount that can be diverted is limited to a district's property tax allocation as determined by the AB 8 distribution factors. The diversion and its timing can significantly impact a district's cash balances. Thus, as local taxes are diverted from the non-basic-aid school districts to the other local agencies, the school district funding received from the state increases to offset the property tax diversion. However, this funding distribution no longer occurs in two large installments for use within the fiscal year; it is spread out over 15 months under the state apportionment schedule. As fewer districts are subject to the property tax diversion, the dollar amount is spread over fewer participants. This significantly affects the cash flow of those districts and requires them to issue additional short-term debt to meet their cash needs.

As the amounts of the ERAF offsets from individual districts increase, a non-basic-aid district could have 100% of its local revenues diverted, and receive 100% of its revenue limit entitlement from the state. As of the first interim report for 2010-11, it is anticipated that Bayshore Elementary will receive 96.19% and Ravenswood City Elementary will receive 92.47% of their respective revenue limit entitlement from the state. For 2009-10, the ERAF diversion from school districts and community colleges to the other taxing agencies of San Mateo County was \$103,473,398. The San Mateo Community College District's local property taxes provided \$49,738,019, nearly 50%. Because two districts fell out of basic aid status in the current year, the college's contribution toward the ERAF diversion was 32%. It is anticipated that the college district will become basic aid for 2011-12. Should the college district and one or two other districts achieve basic aid status, the remaining non-basic-aid districts could lose most or all of their local tax proceeds. Forecasting the ERAF diversion is difficult, as it is based on several factors that continually change and are subject to variances and changes in the economy.

In past years, the state's school districts received the property tax portion of their revenue limit entitlement in two installments, December and April, and the state aid portion was paid in ten installments throughout the fiscal year. In recent years the state, because of the economic crisis, has established a deferred payment schedule to schools. The state now defers 25.97% of the amounts owed to districts into the next fiscal year. Implicit in the deferral schedule is the assumption that all districts receive property tax payments in December and April.

The amount to be deferred in 2011-12 is forecasted to grow to 26.2%. This means that while districts will need to provide 100% of their services, they will receive only 74% of the state portion of funding during the fiscal year. The remainder will not be received until the following fiscal year. For most districts, local property taxes make up a good portion of their revenue limit entitlement. In San Mateo County, two districts currently find themselves receiving nominal amounts of local taxes and a large amount in state aid. With the community college district and possibly other districts becoming basic aid, the remaining non-basic-aid districts could be similarly affected in the future. The two current districts and possibly the remaining five non-basic-aid districts may be required to rely solely upon the state's deferred payment schedule for all of their operating revenues should the ERAF diversion consume all their local

taxes. These districts will need to determine whether it will be necessary obtain some form of short-term borrowing to meet their cash flow obligations for the upcoming fiscal year.

A secondary but related issue is the auditor/controller's policy and practice of withholding up to 100% of the ERAF diversion, based on the sum available from a school district's December property tax receipts. This substantially impacts a district's cash flow and requires the district to fulfill an obligation before it is due to the receiving agencies. Revenue and Tax Code Sections 97.68 & 97.70, which govern the ERAF diversion for the sales tax and vehicle license fee reimbursement to nonschool agencies, are specific as to when the participating agencies are to receive funds diverted from the non-basic-aid school districts in a county. The auditor is to allocate one-half of the annual amount to be received on or before January 31, and the other half on or before May 31. Each date is approximately 45 days after the respective property tax installments are due from taxpayers. The code is silent as to when the funds are to be redirected from the schools. Since the school districts receive their property tax payments in two installments and the ERAF obligation is paid to the receiving agencies in two installments, there is no requirement or overriding financial reason to redirect 100% of the ERAF obligation at the first installment of property tax receipts. The county benefits because it can invest the additional 50% payment for 120 days and retain the interest. However, the school districts experience the loss of investment earnings, the need to incur the cost of short-term borrowing for cash flow purposes, or a combination of both.

On May 2, FCMAT met with representatives of the San Mateo COE. The subject was reviewed in depth and additional data provided, and personnel with San Mateo County Treasurer and Auditor/Controller's offices were identified for contact by FCMAT. Subsequent to the meeting contacts were made and research was conducted.

Recommendations

The San Mateo COE should:

1. Advise its non-basic-aid districts to request waiver(s) of the state aid deferral schedule from the California Department of Education.
2. Advise its non-basic-aid school districts to prepare cash flow estimates assuming no or limited property tax receipts, with and without the deferrals, and take appropriate actions to meet their cash flow requirements for the current and future fiscal year.
3. Entertain discussions with the Auditor/Controller's office to bifurcate the ERAF diversions at the first and second tax installments to meet the payment requirements with the receiving agencies.

Thank for you allowing FCMAT to serve the San Mateo COE.

Sincerely,



Anthony Bridges, CFE
Deputy Executive Officer

C: Denise Porterfield, Deputy Superintendent, Fiscal/Operations