

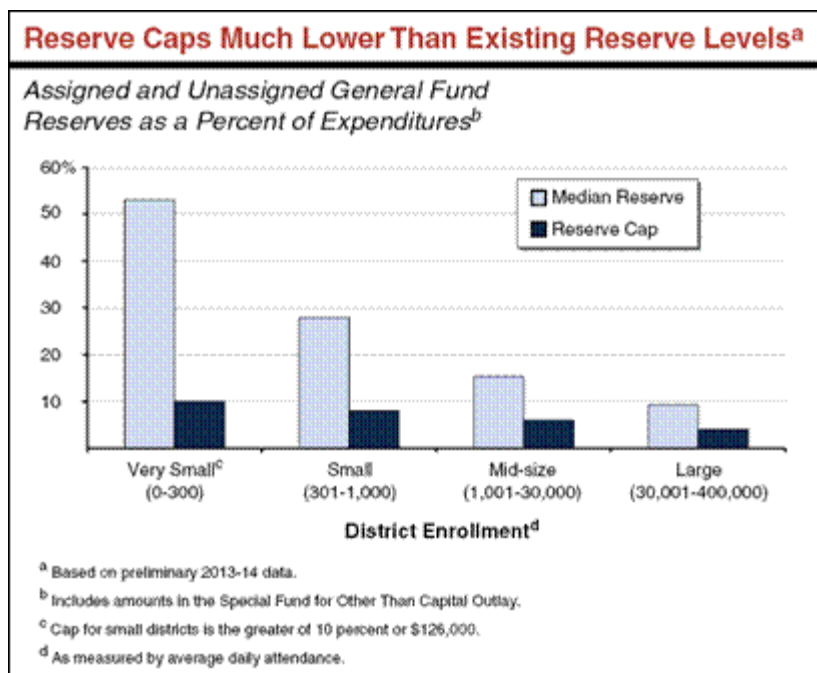
## EDUCATION: LEGISLATIVE ANALYST RECOMMENDS REPEAL OF NEW LAW THAT LIMITS SCHOOL DISTRICT RESERVES

The legislative analyst this week recommended that the Legislature and governor repeal a law they passed last year, as part of the rainy day fund that was approved by voters in November, that added statutory provisions placing a cap on school districts' local rainy day funds. The cap varies by district size, and is set at 6 percent of unassigned reserves for mid-size districts and 4 percent for large districts.

In a study released January 21, the legislative analyst found that "had caps been operative in 2013-14, all but 81 of the 944 districts in the state would have needed to apply for exemptions or adjust their budgets to comply with the law." The report continued: "For mid-size districts, the typical existing reserve is about three times higher than the cap. The cap also is far below the reserve level generally needed to receive a top credit rating."

To the extent that school districts start spending down reserves to comply with the cap, the report cites a number of risks:

- **Difficulty Maintaining Programs in Tight Fiscal Times.** The reserve caps allow most districts to maintain only a few weeks' worth of payroll in reserve.
- **Difficulty Addressing Unexpected Costs.** Emergency facility repairs and other unexpected costs would place districts with low reserves in a precarious position. Smaller districts' reserves can be overwhelmed easily by unexpected costs. According to the analyst: "For smaller districts, reserves that are relatively high as a percentage of expenditures can be small in absolute terms. A single major facility repair or other large cost might require a small district to deplete most of its reserves in a single year."
- **Greater Fiscal Distress.** Historically, districts with reserves below the caps have been about twice as likely to be flagged for fiscal intervention as their peers with higher reserves.
- **Higher Borrowing Costs.** Districts with lower reserves could have their credit ratings reduced, increasing the cost of borrowing money. Moody's has said that fund balance is an important metric that it considers when considering a school district's credit rating.



The table at the left, from the Legislative Analyst's Office, shows the extent that school reserves exceed the state's new cap.

There are several ironies in this cap on school district revenue. It is inconsistent with the purpose of the state rainy day fund – to save funds for an economic downturn, which history tells us happens in cycles. The net result could be less money in the aggregate in the state

and school rainy day funds.

Also, when schools receive one-time federal or state funding, the new law makes it harder for the schools to save some of the one-time funding and spread it over several years. Under previous law, schools did this, particularly with the \$6 billion that schools received from the federal stimulus act of 2008-09.

Only K-12 school districts were singled out by this rainy day fund statute, the analyst's report indicates. Community colleges' reserves are only slightly smaller than K-12 schools' reserves, and city governments generally have much larger rainy day funds. Neither was targeted by the state for a cap on reserves.

CalTax opposed last year's bill ([SB 858](#), Senate Budget and Fiscal Review Committee, of 2014) that put the cap on local school districts' reserves, and has supported efforts to repeal it ([AB 146](#), Olsen of 2014).