Ryland | STRATEGIC BUSINESS CONSULTING

MEMORANDUM

Date: October 9, 2024

To: Patrick Sanchez, Superintendent

From: Terri Ryland, Financial Consultant

Subject: Budget Review

At your request, Ryland SBC together with staff is conducting a review of the Live Oak School District's 2024-25 Adopted Budget, historical information and multi-year projections. While there are still areas to review, we would like to update the board on the preliminary findings and recommendations to date. Further information and details of a Financial Stabilization plan will be available along with the First Interim financial report in December.

Current Budget and Background

Districts across California are facing the long-predicted "fiscal cliff" this year as enrollment and average daily attendance (ADA) yields continue to decline, one-time funds expire, and the State COLA is basically flat and below the level that costs increase year over year. A perfect trifecta. Many districts that haven't had fiscal challenges in the past are now facing them, and districts that have had challenges in the past are facing huge hurdles in balancing their budgets.

Enrollment and ADA

93% of the district's unrestricted revenue comes from the Local Control Funding Formula (LCFF). LCFF funding is determined by the district's ADA and the State's base grants by grade group, with several per-student add-ons. As the district's enrollment and related ADA continue to decline, funding declines. Especially in a year with a small 1.07% revenue Cost of Living Allowance (COLA).

The district has been declining in enrollment for years. The ADA to enrollment yield (portion of students who attend school daily on average) has been approximately 93.5% for the last several years and is projected to maintain that ratio in the near term. Enrollment is projected to continue to decline 1.5-2.0% through 2026-27. These are reasonable assumptions given the trend of

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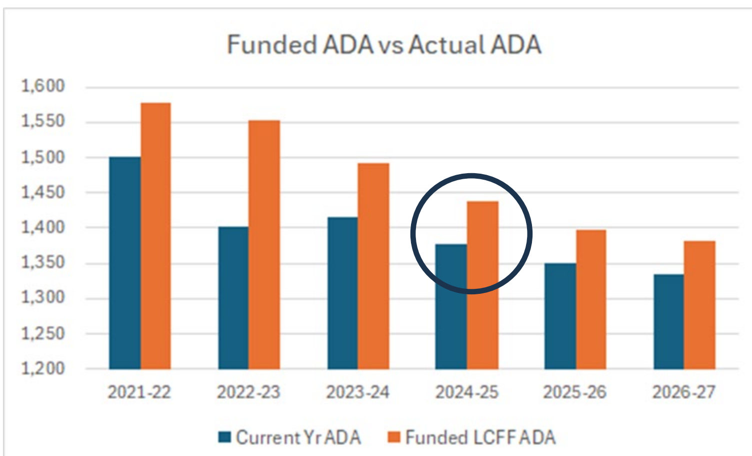
annual decline the district has experienced. We will prepare a 3-year weighted average cohort survival model to project enrollment to further refine projections in the First Interim report.

Under LCFF, districts are funded on the higher of current year ADA, prior year ADA, or a running average of the prior three years' actual ADA. Per the chart below, the district is currently in a stretch of funding based on the 3-prior year average:

	2021-22	**2022-23**	**2023-24**	**2024-25**	**2025-26**	**2026-27**
Current Yr ADA	1,500.26	1,400.99	1,415.98	1,376.48	1,351.22	1,335.55
Funded LCFF ADA	1,577.98	1,552.07	1,493.07	1,439.08	1,397.81	1,381.23
LCFF ADA Funding Method	*Prior Yr*	*3-PY Average*	*3-PY Average*	*3-PY Average*	*3-PY Average*	*3-PY Average*
Funded ADA less actual ADA	77.7	151.1	77.1	62.6	46.6	45.7
Equivalent enrolled students difference				67	50	49

For the current year, 2024-25, the funded ADA is approximately 62 ADA above the projected level of current year actual ADA. It would take an increase in enrollment of almost 67 to switch the district into funding based on current year attendance. As of the end of September, enrollment is above projections by a little over 20 students which is not enough to change funding for the current year.



The adopted budget assumes future ADA will also decline by a similar percentage as the recent past. The State Enacted Budget includes an attendance recovery program to begin in 2025-26 that, with appropriate planning and participation, could help increase ADA. We strongly recommend a review of current plans to implement an attendance recovery program, a robust monitoring system of both enrollment and ADA, and an understanding of the level of risk to the budget if the ADA does not materialize as currently projected.

The ongoing decline in enrollment is not accompanied by any plans to reduce staffing. As enrollment projections are fine-tuned this fall, the budget projections should reflect a related staffing adjustment.

One-Time Funds Expiring
As with all districts in the state, all COVID-related funds ended this year. The remaining state one-time programs will end in the current and following year. The district has been diligent in assuring the funds are spent timely and will continue to review any remaining expenditures in the current budget to be sure they are removed in the multi-year projections (MYP).

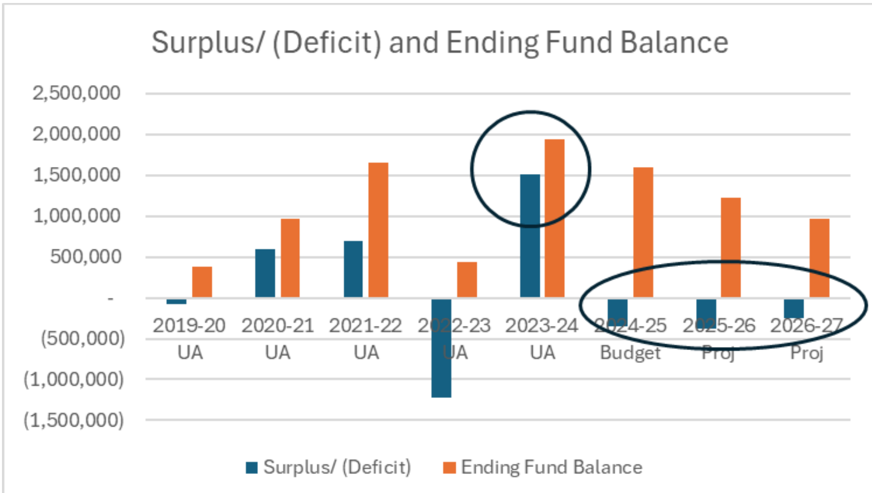
Flat State Funding
After two years of large COLA adjustments to LCFF funding (13% and 8+% in 2022-23 and 2023-24), the current year's 1.07% COLA is not sufficient to cover annual cost increases such as step movement on the salary schedule, utility and gasoline increases, food costs for the cafeteria program, and other inflation-related increases that we have not seen for years.

Recognition of Fiscal Distress
The good news is that the board and district recognized the upcoming fiscal challenges and began the process of addressing the deficits. The board adopted a Financial Stabilization Plan in March and brought in FCMAT (Fiscal Crisis Management Assistance Team) to perform a Fiscal Health Risk Analysis. In addition, staff has been working closely with the Santa Cruz COE who have been providing an extra set of eyes, as well as a COE-sponsored consultant to perform a deep analysis of personnel costs, tying the position control system to the budget. This work is greatly appreciated. SCCOE was also able to verify that the components of the Financial Stabilization Plan were reflected in the Adopted Budget with few exceptions. During our budget review, we discovered some budget issues that are going the wrong way, exacerbating the deficit spending. These changes are significant enough to require another phase of a Financial Stabilization Plan which we will discuss further below.

Signs of fiscal distress in a district include:
- Significantly declining reserves over the course of the MYP
- Long-term declining student enrollment (loss of revenue)
- Persistent structural deficits
- Sizable increases in personnel costs (salaries and benefits)
- Using one-time funding to pay for on-going expenditures
- Cash shortfalls during the year

Adopted Budget and Deficit Spending
The district's 2024-25 Adopted budget multi-year projection reflects unsustainable deficit spending in the unrestricted general fund resulting in a steep decline in ending fund balance. The budget meets the State's meager minimum reserve requirement of 3%, but just barely. It is recommended by the General Finance Officers Association (GFOA) that a small district should aim for a reserve in the 12-16% range to cover unexpected swings in expenditures. Note that a 16% reserve covers approximately 2 months of payroll and operating costs.

History of Unrestricted Balances						
Source: Prior Year SACS Unaudited Actuals reports and Adopted Budget MYP (Revised June 26)						
	2021-22 UA	**2022-23 UA**	**2023-24 UA**	**2024-25 Budget**	**2025-26 Proj**	**2026-27 Proj**
Surplus/ (Deficit)	688,274	(1,227,729)	1,512,796	(348,532)	(377,504)	(253,634)
Ending Fund Balance	1,659,412	431,683	1,944,479	1,595,947	1,218,443	964,809



The district just closed a year with a large surplus, with several components:

- The district had a small operating surplus but transferred $1.5M from the special reserve fund 17
- This is a one-time only fix as fund 17 is now depleted
- This transfer provided a workable general fund surplus for the next few years as the district works to eliminate deficit spending and rebuild a reasonable reserve (savings account).

Restricted General Fund

It appears the district has limited unexpended restricted resources that will soon expire and may potentially be used to support the district's fiscal solvency. We are continuing the review of remaining balances, the commitments that have been made against those funds, and an estimate of funds available to support the district's need to find budget solutions. We do not anticipate huge savings in this area but will maximize all opportunities for budget improvement.

The last several years have been flush with one-time funding. Of these, the only remaining one-time funds include:

- ESSER Summer Learning Programs ($17,853)
- Special Education Supporting Inclusive Practices ($18,663)
- ARP Homeless ($20,949)
- Antibias Education Grant ($62,645)
- Kitchen Infrastructure ($211,205)

Review Process
Ryland SBC and staff have engaged in a review of the budget assumptions and implementation of the Adopted Budget and Financial Stabilization Plan.

Areas analyzed to date include:

- A detailed assessment of the adopted budget to updated position control was conducted by a representative of the COE
  - Budget appropriately reflects details in position control
- Compared budget to prior spending and revenue, making adjustments and recommendations as indicated
  - Reviewing a history of contributions to restricted programs indicated that projected contributions are insufficient and additional contributions are required in the MYP
  - A review of contracts and purchase orders for the current year indicated overspending of approximately $200,000. We will continue to look for possible budget savings in other areas of the budget to cover these overages; however, the budget may need to be increased to pay for these commitments.
  - A review of special education contracts indicated that the budget must be increased to cover new non-public school contracts.
  - Reviewed current budget and restricted fund balances carried over from the prior year and identified limited available restricted sources
- Administration continues to look at opportunities for efficiencies and restructuring

Identified deterioration

- Special Education contributions need to be increased in MYP (~$250,000 annually in MYP)
- Additional Special Education contracts this fall (~$215,000)
- Contracts and professional services exceed the budget as of September 30 (~$200,000)

Desired budget additions

- Site support personnel
- Reinstate raises put on hold
- The current budget and MYP do not include any provisions for future compensation improvements

Potential budget improvements

- Utilize restricted funding first
- Districtwide restructuring and position changes
- Eliminate certain contracts
- Shift certain site positions to Cafeteria Fund
- Remove support services for students as they age out of programs
- Examine MOU with and fees charged to charter school

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As a result of the identified deteriorations to the Adopted Budget, the current estimated amount of budget solutions looks to be in the $700K - $800K range. To provide compensation increases and to restore fund balance to a more appropriate reserve level would require *additional* solutions.

Other Funds

The district operates a number of funds outside the General Fund to account for resources that are legally required to be accounted for separately.

Cafeteria Fund

The district receives more funding than it has expended and has, therefore, been building a reserve in this fund. Current regulations limit reserves to an amount that does not exceed six months of average operating expenditures. The district already has an approved plan in place with the California Department of Education (CDE) to reduce the reserves. However, the associated plan should be monitored to ensure the district makes adequate progress and does not continue to grow fund balance. The successful Cafeteria program allows the district to recover certain direct and indirect costs from the fund which is a benefit to the unrestricted general fund.

Facilities Funds

The district has various facilities funding sources available to it. These dollars are outside the general fund but are instrumental in the district's facilities program.

Significant facilities dollars include:

- Community Facilities District (CFD or Mello Roos) dollars are available for pay-as-you-go projects in the district.
- Redevelopment Agency (RDA) dollars are significant for Live Oak. Several million dollars are passed through as property taxes and are part of the LCFF funding for the district (reducing State Aid). However, another several million dollars are available outside the LCFF calculation and are available for facilities projects. The district uses these funds to make its Certificate of Participation (COP) payments and contributes to the general fund to cover the 3% contribution to the Routine Restricted Maintenance Account, a true luxury. We need to spend more time reviewing these dollars as they do not continue into perpetuity, expiring and becoming secured property taxes (all in the LCFF) once all Successor Agency RDA debt is paid off. We will bring more information on this funding source to the board in the future.
- The district recently issued $43M of bond debt for major facilities modernization.

Next steps

While this review is a work in process, a number of suggestions are being made now to keep the momentum of budget review flowing. The budget will continue to be reviewed in depth through the First Interim reporting process with adjustments reflected in the report.

Recommendations
Due to the overspending on contracts compared to the current budget, we will investigate the processes and procedures that can be changed to implement controls in the purchasing process that would prevent this type of budget override in the future.

In our experience the preparation of budget solutions is best accomplished through the establishment of a budget advisory committee that is given sufficient time to fully vet ideas and come to consensus on the recommendations they will provide to the superintendent. Walking backwards from the point decisions must be made, the board should be prepared to take action in March 2025 regarding any potential reductions to 2025-26 staffing. This generally means the budget advisory committee should finalize their recommendations in December of 2024 with the superintendent's recommendations going to the board in January 2025. The Budget Advisory Committee is being convened to review the status of the budget and brainstorm ideas for the next steps of the financial Stabilization plan. The first meeting is scheduled for November 6.

Finally, we would also recognize and encourage continued communication with the Santa Cruz County Office of Education, with the superintendent and SCCOE staff working collaboratively to develop the next steps in the district's fiscal recovery plans.

We are thoroughly enjoying working with you and the district staff and look forward to further analysis and recommendations throughout the fall.