

## MEMORANDUM REPORT

**To:** Members of the Board of Education  
Santa Monica-Malibu Unified School District

**From:** The Malibu Unification Negotiations Committee

**Date:** February 24, 2017

**Subject:** Negotiated Terms of Agreement on the Financial Implications of Reorganizing SMMUSD into Two Separate Unified School Districts

This Memorandum Report (the “Report”) is the Malibu Unification Negotiations Committee’s (the “Committee”) report to the Santa Monica-Malibu Unified School District (“SMMUSD” or the “District”) Board of Education (the “Board”) on financial issues involved in reorganizing the District into two separate Transitional Kindergarten (“TK”) through 12<sup>th</sup> grade public school districts: a Santa Monica Unified School District (“SMUSD”); and a Malibu Unified School District (“MUSD”). On December 17, 2015, the Board established the Committee and outlined a scope of work to be conducted by two teams of negotiators representing the Santa Monica and Malibu communities, with members appointed respectively by the Board and the Malibu City Manager.

An analysis prepared by the District’s Financial Oversight Committee (the “FOC”) and the District’s Chief Financial Officer had found that reorganization could have different impacts on the finances of the two new districts under the State of California’s system of TK-12 public school funding. Based on this analysis, the Board specified that a priority issue for the Committee should be to negotiate terms and conditions that would enable the reorganization to occur without a significant adverse impact on the financial condition of SMUSD.

After 11 months of work, the Committee’s two teams of negotiators have unanimously approved an integrated set of terms and conditions (the “Agreement”) for addressing all topics assigned to it by the Board, including an approach to eliminate any significant adverse financial effect of reorganization on a future SMUSD. This Report summarizes that Agreement and is organized into six parts (listed in the table below). It is supplemented by five Appendices that provide additional supporting information, including a detailed set of Term Sheets on each of four financial topics and a fifth topic dealing with implementation.

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The Committee thanks the Board for the opportunity to be of service to the District on this important matter and hopes that the Board and public find that the Committee's Agreement, as presented in this Report, satisfactorily responds to the Board's charge. The Committee looks forward to presenting this Report to the Board and other interested groups in Santa Monica and the Malibu community in the weeks ahead.

## Part I: Executive Summary

The District's approved General Fund budget for 2016-2017 is \$171.2 million, of which the Board approved \$150.5 million for expenditures with a projected fund balance of \$20.7 million. The District currently serves 11,003 TK through 12<sup>th</sup> grade students in the two non-contiguous coastal communities of Santa Monica and Malibu. On a daily basis, approximately 84 percent of the District's students attend 12 schools located in the City of Santa Monica and 16 percent attend four schools located in the Malibu community.

In December 2015, the Board approved an Action Item establishing the Committee to negotiate an agreement to resolve certain financial issues associated with a potential reorganization of the current District into two separate school districts (SMUSD and MUSD). The Board set the scope of financial issues to address and specified objectives for the negotiations.

The Committee consisted of six members, three appointed by the Board to represent the interests of a potential SMUSD, and three appointed by the Malibu City Manager to represent the interests of a potential MUSD. The Committee selected a professional facilitator, adopted organizational ground rules and guiding principles to frame negotiation particulars, and used Term Sheets to track its negotiations. The Committee also retained third-party legal and school finance experts.

After holding 38 meetings between March 2016 and February 2017, the Committee unanimously approved an Agreement. The Agreement meets the Board's objectives and aligns with the Committee's guiding principles that it must: (a) be financially viable for both MUSD and SMUSD; (b) ensure a degree of predictability for both SMUSD and MUSD; (c) enable each district to plan ahead with a reasonable degree of resource certainty; (d) avoid establishing potential negative incentives for either new district; and (e) be clear, understandable, legal, and enforceable.

**Overview of the Agreement.** The Agreement is a package of principles, terms, and related provisions organized into five topics that address: the impact of reorganization on SMUSD and MUSD revenues; the division of the District's assets between SMUSD and MUSD at the time of reorganization; bond-related items and other liabilities; a structure for managing environmental liabilities within the context of reorganization; and a process for implementing the Agreement.

**Topic #1: Impact of Reorganization on SMUSD and MUSD Revenues.** The Agreement meets the Board's objective to eliminate any significant adverse financial effect of reorganization on SMUSD by including a Revenue Neutrality Formula (the "Formula") that:

- Specifies how to calculate the financial effect of reorganization on SMUSD annually through fiscal year 2029-2030;
- Establishes a method for implementing a fair schedule of payments to SMUSD from MUSD that, in the aggregate, protects SMUSD's revenue from any significant adverse financial effect of reorganization;
- Calculates the payment owed in any single year in a way that takes into account MUSD's ability to pay, while also maintaining predictable and stable revenue growth for both districts in an amount at least equal to a Cost-of-Living Adjustment (COLA);

- Provides for amending the length of the payment arrangement if the annual measurements show that SMUSD can exist at an earlier time without significant adverse financial effect from the reorganization;
- Establishes methods and timetables for performing the calculations and making any required payments by MUSD; and
- Provides processes for reconsidering the formula, consistent with the Committee's guiding principles, in the event of significant changes in circumstances underlying the Agreement (e.g., major changes in the State's TK-12 funding system), or a one-year payment postponement by MUSD in the event of a severe natural or other disaster that prevents MUSD from making a required payment.

**Topic #2: Division of the District's Assets (Fund Balances, Buildings, Land, and School Buses).**

The Agreement meets the Board's objective to allocate the District's assets in a way that is fair to both MUSD and SMUSD by:

- Outlining a method for dividing each SMMUSD Fund Balance at the time of reorganization, either based on the relative number of students attending classes in Santa Monica and the Malibu community (currently 84%/16%), or the source and use of the Fund's revenue;
- Allocating all school buildings and associated land to the district where they are located;
- Allocating school buses used to transport students in Santa Monica to SMUSD and school buses used to transport students in the Malibu community to MUSD;
- Allocating the District's other land and buildings located in Santa Monica to SMUSD, but with a provision that if SMUSD ever elects to sell the District Headquarters or a revenue producing property, then MUSD will receive its share of the net cash proceeds; and
- Allocating the District's land on Malibu Canyon Road to MUSD.

**Topic #3: Bond-Related Items and Other Liabilities.** The Agreement meets the Board's objective to develop a method(s) that is (are) fair to SMUSD and MUSD to: (a) allocate the District's existing bond debt; (b) address the refinancing of existing debt; and (c) allocate authorized but not-yet-issued Measure ES bonding authority. In sum, the Agreement provides that:

- Existing bond debt will be allocated based upon assessed property values in each new district, and each district will be authorized to refinance its share of the allocated debt without need to coordinate with the other; and
- The allocation of authorized but not-yet-issued Measure ES bonding authority should be determined at the time of reorganization, depending on the status of projects and plans of SMUSD and MUSD at that time.

**Topic #4: Environmental Liability.** A recent Court order directed the District to complete its current, ongoing remediation plan for PCBs (polychlorinated biphenyl) in certain schools in Malibu by the scheduled date of December 31, 2019. The Agreement recognizes that if reorganization becomes effective before that date, SMUSD is obligated to complete the remediation plan in compliance with the Court's order and that funds generated from ES bonds will be available to do so.

The Agreement meets the Board's stated objective on environmental liability by providing that remediation of contamination not covered by the Court's order will be the responsibility of the district that owns the property in question, and that the districts will indemnify one another against such liability.

***Topic #5: Implementation of the Committee's Recommendations.*** After considering: (a) the complexities and inter-relationships of the financial topics addressed in the Agreement; and (b) advice from the Committee's legal and education finance consultants that some aspects of dividing the District's finances could only be accomplished via State legislation, the Committee recommends State legislation as the best approach for implementing all aspects of the reorganization in order to ensure a comprehensive and legally enforceable result.

While implementation details were beyond the Board's assignment, the Committee recommends two groups be formed to address the financial items that cannot be finalized until the actual time of reorganization or during the months immediately following reorganization. Group One would be assigned to work on things that need to happen between the time the Board approves moving forward with reorganization and the time that reorganization becomes effective. After reorganization becomes effective, Group Two, under the guidance of each district's Board of Education, would work on all remaining issues that must be resolved to ensure a smooth transition to two separate school districts.

## Part II: Background

**General.** The District and Advocates for Malibu Public Schools (“AMPS”) have studied multiple issues related to a potential reorganization of SMMUSD into two separate, unified school districts: SMUSD and MUSD. (In California, a “unified” school district operates both primary schools, from kindergarten through middle school, and high schools. Paradoxically, State law refers to the process of separating one unified school district into two as “unification.” To avoid confusion, this Report uses the term “reorganization.”)

Among the many questions addressed, these previous studies paid particular attention to: (a) how to divide the finances of the current District between SMUSD and MUSD; and (b) the potential that reorganization could adversely affect the revenue per student in a stand-alone Santa Monica district as compared with the existing District. (See Appendix B.8 for SSC’s Review of Prior Reports and Analyses of District Reorganization.)

During 2014 and 2015, the FOC and consultants for AMPS analyzed many of the issues associated with dividing the District’s financial assets and liabilities between two potentially new districts. The FOC and District financial staff also performed a focused review on potential aggregate and per-student revenues in each new district as compared with the current District, which concluded that there was a distinct possibility that reorganization could, at least for a period of time, materially reduce revenue to SMUSD on a per Average Daily Attendance (“ADA”) basis when compared to revenue per ADA without reorganization. (See Appendices B.22 and B.23 for FOC’s reports to the Board.)

The reasons for a potential adverse financial effect on SMUSD are complex, and include the intricacies of how State funds are provided to local school districts in California. (See explanation below.) In addition, although a stand-alone SMUSD would keep certain revenues provided by the City of Santa Monica, which are currently shared with Malibu schools, SMUSD would no longer receive property tax revenue generated in the Malibu community.

The major mechanism for distributing State funds to TK-12 school districts in California is the Local Control Funding Formula (“LCFF”). Under LCFF:

- The State sets a target amount of revenue for each school district based upon ADA and certain other factors. Each district’s share of local property taxes is subtracted from this target and the State funds the difference;
- Any school district that receives enough local property tax revenue to come close to its LCFF target amount, as SMMUSD does today, is entitled to also receive an additional amount of State funding, which is known as “Minimum State Aid.” A district that receives a combination of local property tax revenue, some State LCFF funding and Minimum State Aid is known as a Minimum State Aid district;
- A school district whose property tax revenue meets or exceeds its LCFF target amount (i.e. a “Basic Aid” district), as would be the case for MUSD immediately upon reorganization, but which would not occur in SMMUSD in the absence of reorganization or in SMUSD for many years, also receives Minimum State Aid; and

- A Minimum State Aid or Basic Aid district can provide a higher level of funding for its schools than a district that does not qualify for Minimum State Aid (e.g., SMUSD, at least for several years following reorganization).

The relevance of the State’s funding formula to reorganization is that SMMUSD would likely maintain Minimum State Aid status and then achieve Basic Aid status sooner than would SMUSD alone due to the disproportionate amount of property tax revenue generated in MUSD on a per ADA basis that would no longer be available to SMUSD. MUSD is likely to become a Basic Aid district immediately. (See Appendix B.7 for a link to SSC’s presentation on school finance in California, which contains more explanation of these issues, including how LCFF affects the finances of reorganization.)

***The Board’s Establishment of the Malibu Unification Negotiations Committee.*** On December 17, 2015, the Board unanimously adopted an Action Item to establish the Committee to negotiate the financial implications of a reorganization of the current District into SMUSD and MUSD. The Board expressed its unanimous desire for the co-existence of SMUSD and MUSD as two excellent school districts serving their respective communities, so long as the reorganization could be accomplished in a way that eliminates any significant adverse financial effect on a stand-alone SMUSD. (See Appendix B.24 for a copy of the Board’s Action Item.)

The Committee consisted of two teams of negotiators. The District’s Superintendent would appoint three members to represent the interests of a potential stand-alone SMUSD (the “Santa Monica Team”); and the City Manager of the City of Malibu would appoint three members to represent the interests of a potential stand-alone MUSD (the “Malibu Team”).

The Board directed the negotiating teams to appoint an impartial facilitator to assist in the negotiations and instructed both teams to “work cooperatively with one another and with their counterparts, to develop and agree upon terms that promote the aspirations of the Board.” The Board set the scope and objectives for the negotiations, established a process to follow after the Committee submits a report, and outlined criteria for determining success of the negotiations. (See below.)

The Board’s Action Item acknowledged that the Committee would likely require access to outside consultants to advise on school budgeting and finance and legal issues. Based on past discussions, the Board Action Item noted an expectation that AMPS would pay for any consultants the Committee hired, and that the appropriate agreements between the District and AMPS to implement this arrangement would be executed before negotiations started. The Board Action Item directed the District and AMPs to evenly split the facilitator’s fees.

***The Board’s Stated Objectives for the Committee’s Negotiations.*** The Board’s stated objectives for the Committee’s negotiations are listed in the box on the next page.

The financial issues assigned to the Committee for negotiations address a subset of the statutory criteria for the State Board of Education to apply before approving the reorganization of a school district via the petition procedure contained in the State Education Code. (See Appendix B.27 for the *California Department of Education, District Organization Procedures.*)

The petition procedure outlined in the State Education Code is, however, not the sole option for school district reorganization in California. As discussed later in this Report, the Committee recommends an alternative approach in which all elements of the reorganization would be accomplished through State legislation.

### **The Board's Objectives for the Committee's Negotiations**

- Elimination of any significant adverse financial effects of reorganization on SMUSD.
- Allocation of cash in the General Fund Account and the Capital Facilities Fund in a manner which is fair to both MUSD and SMUSD considering the sources and uses of cash in the various funds.
- Allocation of bond debt and authority to issue authorized but unissued bonds in a manner which is fair to both MUSD and SMUSD and establishment of any legal mechanisms that might be required to achieve fairness.
- Establishment of a mechanism that would permit refinancing of outstanding bonds in order to reduce property tax assessments.
- Establish a procedure under which agreements on the preceding four items can be revisited on a reasonable schedule.
- Establishment of a structure under which MUSD assumes responsibility for any remaining remediation of any contamination in Malibu schools and indemnifies SMUSD for any future claims arising from such remediation work or failure to undertake appropriate work.
- Dismissal of the pending lawsuit against SMMUSD or an enforceable agreement from the plaintiffs that SMUSD will be dismissed from the lawsuit.
- Receipt by the Board of a legal opinion from a firm selected by the Board with respect to any potential continuing exposure of SMUSD following reorganization and a conclusion by the Board that any such exposure is reasonable.

Source: Board Action Item, 12/17/2015, Recommendation No. A.16

***What Happens Following Receipt of the Committee's Report.*** The Board's Action Item outlined the following steps to follow the submission of a report to the Board, should the Committee collectively determine that negotiations achieved the Board's objectives:

- The signed report will be made available for public inspection;
- Following a two-week period for public review, the Board will discuss the final written report on the negotiations as a Discussion Item during a regular Board Meeting;
- The Board may determine that changes to the negotiated agreement are required, based on comments from the public and its own discussion. If so, the Board will communicate the required changes to the Santa Monica negotiating team and ask them to reopen the negotiations with the goal of incorporating the required changes;



- After the changes are incorporated, the written report will be modified as needed; and
- Alternatively, if the Board determines that no changes in the negotiated agreement are required, then the final report will be presented to the Board as a Major Action item at the next regular Board meeting.

***The Board's Conditions for the Determination of Successful Negotiations.*** The Board's Action Item articulated the following four conditions for determining that the negotiations have been completed successfully:

- The negotiating teams collectively determine that negotiations have achieved the Board's objectives and present the evidence for their determination to the Board;
- Any technical and legal concerns regarding the negotiated agreements have been resolved satisfactorily;
- The Board determines that negotiations have achieved its objectives and formally approves the written report and the agreements therein as a Major Action Item during one of its regular public meetings; and
- The Malibu City Council formally approves the written report and agreements therein during one of its regular public meetings.

### Part III: Overview of the Committee’s Process

**Committee Members Appointed.** On January 21, 2016, the Board of Education approved the Superintendent’s nomination of the three members of the Santa Monica Team and formally acknowledged the three members appointed to the Malibu Team by the Malibu City Manager. The members of the Committee are listed below.

<b>Santa Monica Team</b>	<b>Malibu Team</b>
Tom Larmore	Laura Rosenthal
Debbie Mulvaney	Manel Sweetmore
Paul Silvern	Makan Delrahim*

\* In April 2016, Mr. Delrahim replaced Kevin Shenkman, an original Malibu Team member. Mr. Delrahim served on the Committee until January 20, 2017, when he resigned due to an employment change.

Between March 2016 and February 2017, the Committee held 38 meetings. All Committee meetings were open to the public and the Committee operated under the rules of the State of California’s Brown Act. The meetings rotated between the District offices in Santa Monica and Malibu City Hall. Support with taking minutes was provided by the District for meetings held in Santa Monica and by City of Malibu staff for meetings held in Malibu. (See Appendix B.6 for the Committee’s meeting agendas and minutes.)

**Committee’s First Order of Business.** The Committee convened several pre-negotiation meetings in March 2016 to select a professional facilitator, develop the agreement between the District and AMPS regarding the payment of consultant fees, and begin the process of selecting consultants to provide legal support and expertise on school financing in California.

During its initial meetings, the Committee selected Karen Orlansky to serve as its professional facilitator and adopted Ground Rules that addressed expectations for Committee member conduct that makes for effective groups, meeting logistics, compliance with the Brown Act, public comments at Committee meetings, and the method adopted by the Committee for making decisions by consensus. The Ground Rules included a written agreement on the role of the Committee’s facilitator. (See Appendix B.1 for the Committee’s Ground Rules.)

The Committee selected Procopio, Cory, Hargreaves & Savitch LLP, a full-service law firm located in San Diego (“Procopio”), to provide legal support, and School Services of California, Inc. (SSC) to provide consultant services related to school budgeting and finance. Following consultant selection, the appropriate retention agreements were executed by Procopio, SSC, AMPS, and the District.

Early on, the Committee recognized that its discussions and subsequent public reporting would benefit from adopting a glossary that defined key words and phrases as well as acronyms for use during the negotiations. Appendix E contains the Committee’s glossary, which was updated throughout the course of the Committee’s work.

**Plan of Work.** To guide its work, the Committee adopted a Plan of Work that reflected the Board’s charge to the Committee. The Committee organized its negotiations into four key financial topic areas:

- The impact of reorganization on SMUSD and MUSD revenues;
- The division of the District’s assets (Fund Balances, land, buildings, and school buses);
- Bond-related items and other financial liabilities; and
- Environmental liability.

The Committee added a fifth topic for addressing issues related to implementation of its recommendations. (See Appendix B.3 for the Committee’s Plan of Work.)

**Principles Adopted to Guide the Negotiations.** The Committee adopted general principles to serve as guidelines for its negotiations. The Committee agreed that all terms of an Agreement related to the financial reorganization of the District into two separate districts must:

- Be financially viable for both SMUSD and MUSD;
- Ensure a degree of predictability for SMUSD and MUSD, to enable each school district to be able to plan ahead with a reasonable degree of resource certainty;
- Avoid establishing potential negative incentives for either SMUSD or MUSD. For example, creating a disincentive to pursue increased revenue or otherwise improve education in their schools; and
- Be clear and understandable, legal, and enforceable.

As the Committee worked its way through each of the four financial topics, where it proved useful to the negotiation process, the Committee developed topic-specific guiding principles.

**Term Sheets.** To track the progress of the Committee’s negotiations, the Committee employed a set of “Term Sheets,” one for each of the five topics in its Work Plan. The Term Sheets were updated after each meeting to reflect the Committee’s discussion and tentative decisions, and as a package, served as the basis for documenting the principles, terms, conditions and related provisions that constitute the unanimously approved Agreement. (See Appendix C for the Committee’s final set of Term Sheets.)

**Resource Materials Used by the Committee.** Many resources informed the Committee’s fact-finding, deliberations and decision-making. Appendix B to this Report contains a categorized listing of these resources, with instructions on how to access them electronically on the District’s website.

**Part IV: Summary of the Negotiated Agreement**

As noted above, the Committee organized its negotiations into four major financial topics and a fifth topic to address implementation of the Committee’s Agreement. The Board’s objectives and a summary of the major terms in the unanimously approved Agreement are summarized below.

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**Topic #1: Impact of Reorganization on SMUSD and MUSD Revenues**

**Board’s Objective.** The Board’s primary objective for the negotiations was to eliminate any significant adverse financial effect on a Santa Monica-only district as a result of reorganization.

<b>Definitions Adopted for Topic #1 Negotiations</b>	
Average Daily Attendance (“ADA”)	ADA is the average number of pupils actually attending class each school day and generally equals 95-98 percent of enrollment. The State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). All ADA references in this Report are to the P2 ADA.
Financial Effect	The difference in Unrestricted General Fund revenue per ADA in SMUSD vs. what that revenue per ADA would have been if reorganization had not occurred and SMMUSD continued to exist.
Revenue Neutrality	The Board’s objective to eliminate any significant adverse Financial Effect on SMUSD from the reorganization of the District into two separate districts (SMUSD and MUSD).
Revenue Neutrality Formula (the “Formula”)	The Committee’s agreed-upon method for calculating the Financial Effect of reorganization and related payment schedule that, in the aggregate, results in Revenue Neutrality in SMUSD.
Delta	The annual measurement of the Financial Effect multiplied by SMUSD’s ADA. A <i>negative</i> value (i.e., the revenue per ADA for SMUSD is less than that which would have been realized by a theoretical SMMUSD) creates an obligation on the part of MUSD to make a payment in that amount to SMUSD. A <i>positive</i> value (the revenue per ADA for SMUSD exceeds that which would have been realized by a theoretical SMMUSD) will result in a credit to MUSD offsetting future payment obligations.
Cumulative Delta	The sum of the Delta for any fiscal year added to any amount of the Delta, plus interest where applicable, remaining unpaid from prior years. A positive Cumulative Delta balance represents a credit to MUSD that will be applied against future negative Deltas. A negative Cumulative Delta balance represents the amount of money owed to SMUSD by MUSD.

## ***Major Negotiated Terms***

The Committee approached Topic #1 in multiple steps by adopting common definitions and guiding principles, studying the fiscal assumptions and projections provided by the Committee's educational finance consultants (SSC), and developing and evaluating options for consistency with the guiding principles.

Through this process, the Committee reached unanimous agreement on a Revenue Neutrality Formula, which calculates the Financial Effect of reorganization on SMUSD and establishes a schedule of payments to SMUSD from MUSD that will maintain predictable and stable revenue growth for both districts and, in the aggregate, eliminate any significant adverse financial effect of reorganization on SMUSD.

***Key Elements of the Revenue Neutrality Formula.*** The following points summarize the key elements of the Formula:

- A neutral and expert third party will perform the Revenue Neutrality Formula's annual calculations. The Boards of Education of SMUSD and MUSD will jointly select a neutral third party, with expertise in TK-12 public school financing in California to perform the annual calculations provided for in the Formula. SMUSD and MUSD will agree on appropriate and reasonable fees for performing the annual calculations and evenly split the cost.
- Delta calculations will use data from the audited financial statements of SMUSD and MUSD, not from projections. In addition, calculations of per-ADA Unrestricted General Fund revenue for a theoretical SMMUSD will be derived from the audited financial statements and the State budget. Student counts will be based on ADA data reported to the State.
- The Formula specifies the revenue sources to include in the Delta calculation. All revenue sources to be counted are components of the Unrestricted General Fund, meaning that the funds are not earmarked for a particular program. A handful of Unrestricted General Fund revenue sources are excluded because they either would make no mathematical difference or could create a disincentive for pursuing increased revenue to support education.
- The sum of payments to SMUSD from MUSD over time will equate to the sum of all of the annual Deltas through fiscal year 2029-2030, while the schedule of payments will take into account MUSD's ability to pay and financial needs as a new district. The Delta will be calculated and tracked each year beginning with the first year that reorganization becomes effective through fiscal year 2029-2030. In the aggregate, MUSD will pay SMUSD an amount equal to the sum of the annual Deltas over that period plus interest (if applicable).

The actual payment owed in any one year will be calculated to maintain predictable and stable revenue growth for both districts in an amount at least equal to a Cost-of-Living Adjustment. The Formula also provides for MUSD's need to ensure financial viability as a new district in the early years after reorganization becomes effective.

- Any difference between the amount actually paid by MUSD and the amount of the Delta (less any remaining credits) will be carried forward into the next year with interest. The Committee agreed that the interest rate would be the rate earned by both SMUSD and

MUSD on funds deposited with the County of Los Angeles Treasurer’s pooled investments account composed of short-term securities (currently 1.00%).

- If the Delta calculation demonstrates that (before fiscal year 2029-2030), the two districts can operate independently without any significant adverse Financial Effect on SMUSD, then the Agreement provides for amending the original term of the Delta calculations. Beginning three years after reorganization becomes effective or fiscal year 2022-2023 (whichever is later), if there are three consecutive fiscal years in which the Delta is less than 0.5% of the applicable components of SMUSD’s Unrestricted General Fund revenues, then the Revenue Neutrality arrangement ends, except that any outstanding payments due to SMUSD from MUSD must still be paid.
- Criteria for renegotiating the Formula. The Committee’s illustrative Revenue Neutrality Formula Projection (the “Illustrative Projection” in Appendix D) assumes that reorganization becomes effective in fiscal year 2018-2019. The Agreement provides that the Formula stands so long as reorganization becomes effective by fiscal year 2020-2021, but requires that if reorganization is delayed beyond fiscal year 2020-2021, then the Formula and terms of payment will be revisited and open for renegotiation, based on the same principles adopted for the original negotiation. The Agreement also spells out other post-reorganization events (e.g., a major change in how the State provides funds to TK-12 school districts) that would trigger a renegotiation of the Formula, or a permitted delay in payment.

Appendix C (beginning on page C-2) contains further details about the Agreement on Topic #1.

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## **Topic #2: Division of the District’s Assets**

**Board’s Objective.** Allocate the Fund Balance in SMMUSD’s General Fund Accounts and the Capital Facilities Fund in a manner that is fair to both MUSD and SMUSD and that considers the sources and uses of the revenue in the various funds.

### **Major Negotiated Terms.**

The Committee approached Topic #2 by separating the assignment into negotiations on the District’s Fund Balances and negotiations on the District’s buildings, land, bus yards, and school buses. The Committee added three supplemental guiding principles regarding asset allocation:

- The allocation of the Fund Balances will be decided by Fund, and will be guided by a method representing a mutually agreed-upon fair and equitable division between SMUSD and MUSD that considers the sources and uses of revenue in each Fund;
- The negotiated methods of asset division are intended for a one-time use because, unless otherwise noted, the division will occur at the time reorganization becomes effective; and
- For items where the necessary data are not available at this time, the fair and equitable division between SMUSD and MUSD will be assigned to a group appointed closer to the time that reorganization actually occurs. (See Topic #5, Implementation.)

The Committee studied information about the sources and uses of revenue in each Fund, and an inventory of SMMUSD's land and buildings. The Committee then developed and evaluated options for consistency with the guiding principles and the Board's objectives. The terms of the Committee's unanimously approved Agreement on these issues are summarized below.

**Agreement on Dividing the District's Fund Balances.** The following methods were agreed to for dividing the District's Fund Balances between SMUSD and MUSD at the time reorganization becomes effective:

The ADA Method. For the District's Funds where the source of revenue (in relative terms) has essentially mirrored the number of students in Santa Monica and the Malibu community, the Agreement provides that the division of Fund Balances at the time reorganization becomes effective will be based on a calculation of each district's percentage share of total ADA in both districts. The current Santa Monica/Malibu community ADA ratio is 84%/16%.

To account for changes in ADA counts between now and the time of reorganization, the Committee designed a calculation titled the "ADA Method," which is the three-year average of ADA in each district. The three years will be the three fiscal years immediately preceding the fiscal year when reorganization becomes effective.

The Agreement identifies the following Funds as meeting the criteria for the ADA Method: the Unrestricted General Fund (excluding amounts raised by the Santa Monica-Malibu Education Foundation and remaining on deposit in the Unrestricted General Fund at the end of the fiscal year), the Restricted General Fund, and the Cafeteria Special Revenue Fund.

Alternative Methods. For the ending balance in the District's Funds where the relative source of revenue (Santa Monica vs. Malibu community) has not mirrored the ADA ratio, or if based on the source of funds, there is a more appropriate way to divide a Fund Balance, the Committee designed an alternative method. The Agreement defines such alternative methods for the Adult Education Fund, Child Development Fund, Deferred Maintenance Fund, Capital Facilities Fund, and Special Reserve for Capital Projects Fund.

The Committee agreed that a decision on a fair and equitable allocation of the Fund Balance in the Building Fund (i.e., bond proceeds) should be deferred until a time closer to reorganization when the needed data are available. With respect to the Retiree Benefit Fund, the Committee believes that an actuary will need to be engaged to make the determination of a fair and equitable split of the ending balance in this Fund.

**Agreement on Dividing SMMUSD's Buildings, Land, and School Buses.** The Committee's Agreement for dividing the District's schools, school buses, bus yards, and other land/buildings provides that:

- School buildings and associated land area will be allocated to the respective district where they are located;
- If MUSD decides not to provide for a continuation high school program in its own facilities, then SMUSD will provide assurance to MUSD that its students will be able to

participate in SMUSD's continuation high school (currently located at Olympic High School) and MUSD will pay any transportation costs for its own students;

- At the time of reorganization, school buses used to transport students in Santa Monica will be allocated to SMUSD and school buses used to transport students in the Malibu community will be allocated to MUSD. Each district will make its own decisions about how to store and maintain its bus fleet;
- The Washington West property will be treated as if it were a school, and therefore will be allocated to SMUSD, where it is located;
- The District's land on Malibu Canyon Road will be allocated to MUSD;
- The District Headquarters building will be allocated to SMUSD, and SMUSD will assume sole responsibility for paying the outstanding debt owed on the Certificates of Participation (COPs) used to fund the purchase of this property. If SMUSD ever elects to sell the District Headquarters, the net cash proceeds from the sale (minus the outstanding COP balance at the time of reorganization) will be split between SMUSD and MUSD according to the ADA Method calculated at the time reorganization becomes effective; and
- The buildings/land that are a source of revenue to the District are all located in Santa Monica and will be allocated to SMUSD. If SMUSD ever elects to sell any of these revenue-producing assets, then the net cash proceeds from the sale will be split between SMUSD and MUSD according to the ADA Method calculated at the time reorganization becomes effective. SMUSD will retain sole control and discretion over the leasing, financing, disposition and use of all of these assets, including the District Headquarters building.

Appendix C (beginning on page C-12) contains further details about the Agreement on Topic #2.

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### **Topic #3: Bond-Related Items and Other Liabilities**

**Board's Objective.** Develop a method(s) that is (are) fair to SMUSD and MUSD to: (a) allocate the District's existing bond debt; (b) address the refinancing of existing debt; (c) allocate authorized but not-yet-issued Measure ES bonding authority; and (d) allocate other District liabilities between SMUSD and MUSD existing at the time of reorganization.

**Major Negotiated Terms.** The Committee developed the following supplemental guiding principles for its Topic #3 negotiations:

- Post-reorganization, each district (SMUSD and MUSD) should, to the maximum extent possible, have sole discretion to make its own decisions regarding the issuance of new bonds and the refinancing of existing bond debt.
- Post-reorganization, any decisions regarding the allocation of authorized but-not-yet-issued bonding authority should be consistent with decisions and commitments regarding projects and division of bonding authority made before reorganization becomes effective, and place priority and mutual respect on the needs and preferences delineated by SMUSD and MUSD at the time the allocation decisions are made.



The Committee studied information available in District resource materials about the status of Measure BB and Measure ES bond funds, posed legal questions on bond-related issues to Procopio (see Appendix B.10), and discussed and evaluated different methods and approaches. The terms of the Committee's unanimously approved Agreement are summarized below.

***Agreement on Bonds Issued by SMMUSD Before Reorganization.*** With respect to the Measure BB and Measure ES bonds issued by the District before reorganization, the Agreement provides:

- SMMUSD's bond debt should be apportioned between SMUSD and MUSD based upon the respective assessed values of real property in Santa Monica and Malibu on the most recent assessment rolls when reorganization becomes effective. This means that Santa Monica property will be assessed for SMUSD's proportionate share of the bond liability and property within MUSD will be assessed for its share; and
- With respect to refinancing this debt post-reorganization, State legislation and the related reorganization documents, to the extent that the rights of bond holders are not prejudiced, should provide that SMUSD or MUSD can, without need to coordinate with the other, make decisions regarding refinancing of its portion of the bond debt.

To accomplish the above, Procopio advises that language in the State legislation regarding reorganization specify that each successor district is treated as the issuing district for purposes of Government Code section 53580 and related statutes, and that each new district be separately responsible for Internal Revenue Service tax compliance and continuing disclosures under Securities and Exchange Commission regulations.

***Agreement on the Allocation of Authorized But-Not-Yet-Issued Measure ES Bonds.*** Because this allocation decision will depend on the status of projects and plans of SMUSD and MUSD at the time reorganization becomes effective, the Committee recommends delegating the allocation of outstanding Measure ES bonding authority to Group 1 (See Topic #5, Implementation) consistent with the following guidelines:

- Allocate the bonding authority consistent with decisions and commitments regarding projects and division of bonding authority made prior to reorganization, including that Malibu receives \$77.0 million (at minimum) out of Measure ES's total of \$385.01 million, and mutual respect for the needs and preferences delineated by SMUSD and MUSD at the time reorganization becomes effective.
- To be specific, the allocation decision should take into account: (a) the status of current projects in Malibu schools; (b) previous decisions regarding authorized but-not-yet-issued bonds; and (c) the Measure ES bond fund balance.

Finally, since SMUSD will retain the obligation to pay for the completion of Court-ordered remediation of contamination in Malibu schools, the projected costs for any remaining remediation at the time of reorganization must be included in SMUSD's allocation when calculating the split of bond fund proceeds and authorized but-not-yet-issued bonding authority.

Appendix C (beginning on page C-19) contains further details about the Agreement on Topic #3.

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#### **Topic #4: Environmental Liability**

**Board's Objectives.** The Board's objectives on the issue of environmental liability, as stated in the Board's Action Item of December 17, 2015, were:

- Establish a structure under which MUSD assumes responsibility for any remaining remediation of any contamination in MUSD schools and indemnifies SMUSD for any future claims arising from such remediation work;
- Dismissal of the pending lawsuit against SMMUSD or an enforceable agreement from the plaintiffs that SMUSD will be dismissed from the lawsuit; and
- Receipt by the Board of a legal opinion from a firm selected by the Board with respect to any potential continuing exposure of SMUSD following reorganization and a conclusion by the Board that any such exposure is reasonable.

The Committee believes that the September 1, 2016 ruling by Judge Anderson relating to the lawsuit instituted by America Unites for Kids (the "Court Order") essentially eliminated the Committee's need to address the Board's objective on this subject. (See Appendix B.28 for a copy of the Court Order.)

Although the Court Order is on appeal, the Committee understands that the issues on appeal are limited to: (a) whether attorneys' fees should be awarded to the plaintiff; and (b) whether the injunction imposed by the Court on certain private parties should be reversed. The Court's decision regarding the obligations of SMMUSD to complete remediation work has not been appealed.

The Committee made no recommendation regarding the receipt of a legal opinion the Board may wish to obtain in accordance with the final objective.

**Major Negotiated Terms.** The Committee approached the Board's first objective by dividing the assignment into two categories: (a) remediation of contamination required under the Court Order; and (b) any other environmental contamination, whether or not known about at the time reorganization becomes effective.

The Committee studied District information and other resource materials that addressed issues of environmental liability specific to a possible reorganization of the District. The Committee posed legal questions to Procopio (See Appendix B.11) and spent time discussing and evaluating different methods and approaches to addressing the Board's objectives. The Committee's Agreement on environmental liability is summarized below.

***Agreement on Liability for Remediation Obligations of SMMUSD Under the Court Order.***

SMMUSD's obligations to complete remediation of PCBs (polychlorinated biphenyl) in Malibu school buildings, to the extent required by the Court Order, is included in SMMUSD's building replacement and renovation program and is scheduled to be completed by December 31, 2019. The Committee agreed that this ongoing remediation program, including the use of Measure ES bond funds to pay for it, would not be affected by reorganization.

The Agreement provides that if any part of this remediation program has not been completed by the effective date of reorganization, SMUSD would be obligated to complete it under the terms of the Court Order, with the terms of project management and completion being subject to negotiation by Group 2.

***Agreement on Liability for Contamination Beyond that Covered by the Court Order.*** The Agreement provides that for contamination in this category, each district will be responsible for any remediation obligation relating to its own properties and in charge of developing, approving, funding, and implementing a remediation plan.

The Agreement also provides that MUSD will indemnify and defend SMUSD for any liability associated with any contamination falling within this category in MUSD property (other than personal injury arising from contamination where the first exposure preceded the effective date of reorganization), and SMUSD will indemnify and defend MUSD for any liability associated with any contamination falling within this category in Santa Monica property (other than personal injury arising from contamination where the first exposure preceded the effective date of reorganization). With respect to personal injury arising from contamination where the first exposure preceded the effective date of reorganization, each district will reserve its rights against the other.

Appendix C (beginning on page C-23) contains further details about the Agreement on Topic #4.

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## **Topic #5: Implementation**

In its action creating the Committee, the Board outlined the process that will occur directly after the Committee submits its report to the Board. (See page 8.) With respect to the implementation of a school district reorganization, there are several different avenues available. In sum, these avenues are a petition procedure outlined in the State Education Code, State legislation, or through some combination of the two.

The Committee recommends that the Board consider supporting processing the reorganization matter entirely through State legislation, rather than the petition procedure outlined in the State Education Code or some combination of State legislation and the Education Code procedure. The Committee believes that State legislation would be the best approach for ensuring a comprehensive and legally enforceable result.

The Committee arrived at this recommendation after considering (a) the complexities and inter-relationships of the financial topics addressed by the Committee, and (b) advice of the Committee's legal and education finance consultants that some aspects of dividing the District's finances could only be accomplished via State legislation.

Negotiations on the details of the implementation process were beyond the scope of the Board's objectives for the Committee. However, the Committee agreed it was important to offer a recommendation on how to resolve the financial items identified in the report that, due to various reasons, cannot be finalized until either the effective date of reorganization or in the time period post-reorganization. For this purpose, the Committee recommends the appointment of two groups.

**Group One:** The SMMUSD Board should appoint Group One to work on the things that need to happen between the time the Board approves moving forward with reorganization and the time that reorganization becomes effective. The Committee recommends that Group One consist of senior officials and domain experts from both Santa Monica and Malibu who can collaborate to meet the interests of the future SMUSD and MUSD, consistent with the Guiding Principles adopted by the Committee for the initial negotiations.

Candidate tasks for Group One are:

- Monitoring of any State legislation being drafted after the Board resolves to support and implement reorganization consistent with the Committee's Agreement.
- Making final recommendations about the division of the Fund Balances in the District's Funds where the allocation method depends on the status of capital projects and expenditures at the time reorganization is scheduled to become effective. (This must be done in conjunction with the next task.)
- Making final recommendations about the apportionment of bonding authority for authorized but-not-yet-issued Measure ES Bonds based on the allocation of Fund Balances as described in the bullet above, as well as the funding necessary for SMUSD to complete the required remediation of Malibu schools.
- With the assistance of a professional actuary, making final recommendations regarding the allocation of the Fund Balance in the Retiree Benefit Fund, and liabilities associated with Compensated Absences and Other Post-Employment Benefits.

**Group Two:** After reorganization becomes effective, the respective Boards of Education of SMUSD and MUSD should appoint Group Two to work on the logistics and any outstanding issues that need to be resolved to ensure a smooth transition. The Committee recommends that Group Two include the Superintendents and Chief Financial Officers from SMUSD and MUSD, as well as Board Member representation from each district.

Candidate tasks for Group Two are:

- Determining the process for SMUSD and MUSD to jointly select a neutral third-party to perform the annual Delta calculations, negotiate reasonable and appropriate fees for this work, and evenly split the costs.
- Monitoring negotiations between SMUSD and MUSD for project management and completion of the Court-ordered remediation of environmental contamination in MUSD schools.

## **V. Acknowledgements**

The Committee thanks the following individuals and organizations for their time and contributions to the Committee's work. Final responsibility for the content of this Report and the Agreement, however, rests with the Committee.

SMMUSD Board of Education  
City of Malibu  
Advocates for Malibu Public Schools

### District Superintendents

Dr. Ben Drati, SMMUSD Superintendent  
Dr. Chris King, former SMMUSD Interim Superintendent  
Dr. Sylvia Rousseau, former SMMUSD Interim Superintendent  
Dr. Sandra Lyon, former SMMUSD Superintendent

### SMMUSD Staff

Janece Maez, Associate Superintendent Business and Fiscal Services, Chief Financial Officer  
Sarah Wahrenbrock, Assistant to the Superintendent  
Diana Kamibayashi, Senior Office Assistant, Office of the Superintendent  
Dr. Mark Kelly, Assistant Superintendent of Human Resources  
Maryanne Solomon, Webmaster  
Gail Pinsker, Community and Public Relations Officer  
Kim Nguyen, Senior Administrative Assistant, Fiscal Services  
Gary Bradbury, Risk Management

### SMMUSD Consultants/Contractors

Anthony Hsieh, Keygent Advisors LLC  
Alliance of Schools for Cooperative Insurance Programs (ASCIP)  
Theodore Scott Smith, SMMUSD contractor (assisted with taking minutes)

### City of Malibu Staff

Reva Feldman, City Manager  
Jim Thorsen, former City Manager  
Christi Hogin, City Attorney  
Mary Linden, Executive Assistant, City Manager's Office  
Kathleen Stecko, Senior Office Assistant, Planning Department

### Procopio, Cory, Hargreaves & Savitch LLP

John Lemmo, Partner

### School Services of California, Inc.

Robert Miyashiro, Vice President  
Mike Ricketts, Associate Vice President  
Kelly Saterfield, Governmental Relations Assistant

### Committee Facilitator

Karen Orlansky

## VI. Signatures of Agreement

The members of the Malibu Unification Negotiations Committee certify that they have read, understood, and agreed to the terms of this Agreement as set forth in this Report and its Appendices

Tom Larmore Tom Larmore Date 2-24-17

Debbie Mulvaney Debbie Mulvaney Date 2-24-17

Laura Zahn Rosenthal Laura Zahn Rosenthal Date 2-24-17

Paul J. Silvern Paul J. Silvern Date 2-24-17

Manel Sweetmore Manel Sweetmore Date 2-24-17

Note: Makan Delrahim served as the third Malibu Team Member from April 2016 until mid-January 2017, when he resigned due to an employment change.

## **List of Appendices**

- Appendix A: A map of SMMUSD that depicts the boundaries of the District and shows the location of current schools.
- Appendix B: A categorized listing of resources used by the Committee as the basis of discussion and decision-making, including the Committee’s agendas, minutes, consultant reports and other documents. The Appendix includes instructions on how to electronically access these resources on the District’s website.
- Appendix C: The Term Sheets that contain details of the Committee’s negotiated Agreement for each of the five topic areas.
- Appendix D: A spreadsheet and graph that illustrate a Revenue Neutrality Formula Projection (the “Illustrative Projection”), as summarized in the Report and presented in more detail in the Term Sheets. The Committee developed the Illustrative Projection, based on the best information available at the time of this writing.
- Appendix E: A glossary of definitions and explanations for the acronyms, words, and phrases that the Committee used during the course of its negotiations and writing of the Agreement, resulting in the Agreement, as reflected in the Committee’s Report and Appendices.

**APPENDIX A**

**MAP OF SANTA-MONICA MALIBU UNIFIED SCHOOL DISTRICT**





Esri, HERE, DeLorme, MapmyIndia, © OpenStreetMap contributors, and the GIS user community

# Santa Monica-Malibu Unified School District

Date: 2/21/2017

## **APPENDIX B**

### **LIST OF RESOURCES**

## List of Resources

The categorized list below contains references to resources used by the Committee as the basis for discussion and decision-making. All of the items can be accessed electronically on SMMUSD’s Website at:

<http://www.smmusd.org/superintendent/MalibuUnification/report.html>.

<b>Resource Number</b>	<b>Committee’s Working Documents</b>
B.1	Ground Rules
B.2	Glossary (Report Appendix E)
B.3	Plan of Work
B.4	Term Sheets (Report Appendix C)
B.5	Illustrative Projections of Revenue Neutrality Formula (Report Appendix D)
B.6	Committee’s Agendas and Minutes
<b>Resource Number</b>	<b>Memos/Reports/Presentations from Consultants Retained by Committee</b>
B.7	Presentation to Committee on School Financing in California by School Services of California Inc. July 14, 2016 (video)
B.8	Review of Prior Reports and Analyses of District Reorganization, prepared by School Services of California, Inc., August 1, 2016
B.9	SMMUSD Reorganization Review and Analysis, Report prepared by School Services of California, Inc., September 14, 2016 (Revised December 6, 2016)
B.10	Memorandum to the Committee with responses to questions on bond-related issues, prepared by John Lemmo, Partner, Procopio, July 21, 2016
B.11	Memorandum to the Committee with responses to the Committee’s questions on environmental liability, prepared by John Lemmo, Partner, Procopio, August 8, 2016

<b>Resource Number</b>	<b>Data and Other Information from the District</b>
B.12	Memorandum to the Board containing update on the District's leases, prepared by Carey Upton, Director of Maintenance, Operations, Transportations, and Facilities Use Departments, July 15, 2016
B.13	PowerPoint Presentation on SMMUSD's insurance program, provided by Jan Maez, Chief Financial Officer, and a representative from the Alliance of Schools for Cooperative Insurance Program (ASCIP), July 19, 2016
B.14	Presentation from District's Chief Financial Office, to the Board on 2015-2016 SMMUSD Unaudited Actuals, September 1, 2016
B.15	Unaudited Financial Statements for 2015-2016, September 1, 2016
B.16	Audit Report for the Year Ended June 30, 2016 (Audited Financial Statements)
B.17	Measure BB Report and Measure ES Report (as of May 31, 2016) presented from the Bond Advisory Committee to the Board on August 16, 2016 (two documents)
B.18	PowerPoint Presentation from Tony Hsieh, Keygent Advisors, SMMUSD Bond Program Overview, October 4, 2016
<b>Resource Number</b>	<b>Background Documents (listed in chronological order)</b>
B.19	Feasibility Analyses of Proposed SMMUSD Reorganization, prepared by WestEd for AMPS (two documents: original and second, updated version); January 2013 and Final Report July 2015
B.20	Memorandum prepared by WestEd for AMPS, Reorganization Research Findings, November 12, 2013 (further research and analysis regarding the January 2013 WestEd report)
B.21	Memorandum from Marguerite Mary Leoni, Neilsen Merksamer, LLP, to AMPS, Questions Pertaining to Formation of Malibu Unified School District, September 22, 2014

<b>Resource Number</b>	<b>Background Documents (listed in chronological order)</b>
B.22	Financial Oversight Committee’s two memorandums to the Board on the financial implications of reorganization, July 15, 2015: (1) Implications Relating to Annual Operating Budgets (2) Implications Relating to the Division of Assets and Liabilities
B.23	Financial Oversight Committee’s update to the Board on the budgetary implications of reorganization, November 19, 2015
B.24	Board of Education’s Action Item, Recommendation No. A.16, to Establish the Malibu Unification Negotiations Committee, December 17, 2015
B.25	Board’s Action to appoint members of the Santa Monica Team and recognize appointment of members by the City Manager to the Malibu Team, January 21, 2016
<b>Resource Number</b>	<b>Other Documents</b>
B.26	Map of SMMUSD and current list of SMMUSD schools by location (Report Appendix A)
B.27	California Department of Education, District Organization Procedures
B.28	Judge Anderson’s Judgment and Permanent Injunction, September 1, 2016

## **APPENDIX C**

### **TERM SHEETS**

## Appendix C: The Committee’s Final Term Sheets

This Appendix contains the Committee’s final Term Sheets, organized by the five topics in the Committee’s Plan of Work. As a package, the Term Sheets outline the principles, terms, conditions, and other provisions of the Committee’s Agreement.

The five Topics in this Appendix C are organized as shown in the table below. Appendix E, Glossary, contains a list of the acronyms and definitions of terms and phrases that the Committee adopted for its negotiations.

<b>Issue</b>	<b>Begins on Page</b>
Topic #1, Impact of Reorganization on SMUSD and MUSD Revenues	C-2
Topic #2, Division of the District’s Assets	C-12
Topic #3, Bond-related Items and Other Liabilities	C-19
Topic #4, Environmental Liability	C-23
Topic #5, Implementation	C-26

## Term Sheet for Topic #1, Impact of Reorganization on SMUSD and MUSD Revenues

### I. The Board's Objective

The Board's objective related to the impact of reorganization on SMUSD and MUSD revenues was to eliminate any significant adverse financial impact on SMUSD as a stand-alone district.

The Board anticipated the possibility of a significant adverse financial effect after receiving, in the fall of 2015, a second report on the potential financial implications of reorganization from the District's Financial Oversight Committee and the District's Chief Financial Officer. Based on updated financial data, the report concluded there was a distinct possibility that reorganization could, at least for a period of time, materially reduce revenue to SMUSD on a per ADA basis when compared to revenue per ADA without reorganization.

This concern was confirmed by the Committee's school budget and finance consultant, School Services of California, Inc. (SSC), which prepared a 12-year revenue projections for the existing District, and a future SMUSD and MUSD. SSC concluded that SMUSD could, indeed, experience a significant reduction in per-ADA revenues, as compared with the existing District over the same period, particularly in the latter years of the projections.

The reasons for a potential adverse financial effect on SMUSD are complex, and include the intricacies of how State funds are provided to local school districts in California. (See explanation below.) In addition, although a stand-alone SMUSD would keep certain revenues provided by the City of Santa Monica, which are currently shared with the Malibu schools, SMUSD would no longer receive property tax revenue generated in the Malibu community.

The major mechanism for distributing State funds to TK-12 school districts in California is the Local Control Funding Formula (LCFF). Under LCFF:

- The State sets a target amount of revenue for each school district based upon ADA and certain other factors. Each district's share of local property taxes is subtracted from this target and the State funds the difference;
- Any school district that receives enough local property tax revenue to come close to its LCFF target amount, as SMMUSD does today, is entitled to also receive an additional amount of State funding, which is known as "Minimum State Aid." A district that receives a combination of local property tax revenue, some State LCFF funding and Minimum State Aid is known as a Minimum State Aid district;
- A school district whose property tax revenue meets or exceeds its LCFF target amount (i.e. a "Basic Aid" district), as would be the case for MUSD immediately upon reorganization, but which would not occur in SMMUSD in the absence of reorganization or in SMUSD for many years, also receives Minimum State Aid; and
- A Minimum State Aid or Basic Aid district can provide a higher level of funding for its schools than a district that does not qualify for Minimum State Aid (e.g., SMUSD, at least for several years).

The relevance of the State's funding formula to reorganization is that SMMUSD would likely maintain Minimum State Aid status and then achieve Basic Aid status sooner than would



SMUSD alone due to the disproportionate amount of property tax revenue generated in MUSD on a per ADA basis that would no longer be available to SMUSD. MUSD is likely to become a Basic Aid district immediately. (See Appendix B.7 for a link to SSC’s presentation on school finance in California, which contains more explanation of these issues, including how LCFF affects the finances of reorganization.)

For further explanation of these issues, see Appendix B.7 for a link to a video of SSC’s presentation on school finance in California, and Appendix B.9 for a report that contains SSC’s long-range revenue forecasts, including a sensitivity analysis on key variables.

**II. The Committee’s Approach**

The Committee approached Topic #1 in multiple steps by first adopting common definitions and guiding principles, then studying the fiscal assumptions and projections provided by SSC, and finally, developing and evaluating a formula and calculation approach for resolving the anticipated per-ADA revenue reduction in SMUSD, consistent with the guiding principles.

Through this process, the Committee adopted an approach to calculate the revenue impacts of reorganization on SMUSD, and established a method for determining a schedule of payments to SMUSD from MUSD that will maintain predictable and stable revenue growth for both districts and, in the aggregate, would eliminate any significant adverse per-ADA revenue impacts from reorganization on SMUSD.

**III. Definitions Adopted for Key Words and Phrases**

The Committee adopted the following terms and definitions to guide its work:

<b>Definitions Adopted for Topic #1 Negotiations</b>	
Average Daily Attendance (“ADA”)	ADA is the average number of pupils actually attending class each school day and generally equals 95-98 percent of enrollment. The State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). All ADA references in this Report are to the P2 ADA.
Financial Effect	The difference in Unrestricted General Fund revenue per ADA in SMUSD vs. what that revenue per ADA would have been if reorganization had not occurred and SMMUSD continued to exist.
Revenue Neutrality	The Board’s objective to eliminate any significant adverse Financial Effect on SMUSD from the reorganization of the District into two separate districts (SMUSD and MUSD).
Revenue Neutrality Formula (the “Formula”)	The Committee’s agreed-upon method for calculating the Financial Effect of reorganization and related payment schedule that, in the aggregate, results in Revenue Neutrality in SMUSD.

Delta	The annual measurement of the Financial Effect multiplied by SMUSD’s ADA. A <i>negative</i> value (i.e., the revenue per ADA for SMUSD is less than that which would have been realized by a theoretical SMMUSD) creates an obligation on the part of MUSD to make a payment in that amount to SMUSD. A <i>positive</i> value (the revenue per ADA for SMUSD exceeds that which would have been realized by a theoretical SMMUSD) will result in a credit to MUSD offsetting future payment obligations.
Cumulative Delta	The sum of the Delta for any fiscal year added to any amount of the Delta, plus interest where applicable, remaining unpaid from prior years. A positive Cumulative Delta balance represents a credit to MUSD that will be applied against future negative Deltas. A negative Cumulative Delta balance represents the amount of money owed to SMUSD by MUSD.

#### IV. Guiding Principles

The Committee designed the Formula based on the general principles the Committee adopted for all portions of an Agreement, plus a number of supplemental guiding principles developed specifically for achieving Revenue Neutrality.

The general principles applicable to all terms in the Agreement are that they must: (a) be financially viable for both SMUSD and MUSD; (b) ensure a degree of predictability for both SMUSD and MUSD; (c) enable each district to plan ahead with a reasonable degree of resource certainty; (d) avoid establishing potential negative incentives for either SMUSD or MUSD to pursue increased revenue or otherwise improve education in their schools; and (e) be clear and understandable, legal, and enforceable. (See Memorandum Report, page 11.)

The supplemental guiding principles developed specifically for achieving Revenue Neutrality are summarized below. Appendix D contains an illustrative Revenue Neutrality Formula Projection (the “Illustrative Projection”), which the Committee developed based on the best information available at the time of this writing.

- The Formula must provide for annual Delta calculations beginning with the first fiscal year that reorganization becomes effective through fiscal year 2029-2030. The Committee agreed on fiscal year 2029-2030 as the last year for calculating the Delta because:
  - ✓ SSC’s revenue projections indicate that SMUSD would likely reach Basic Aid status in fiscal year 2030-2031;
  - ✓ The Illustrative Projection indicates that payments to SMUSD from MUSD would continue for an estimated seven years beyond fiscal year 2029-2030 due to the MUSD “ability-to-pay” principle (explained below); and
  - ✓ The time period was negotiated considering all other elements of the Agreement.
- The Formula must provide predictable and stable operating revenue growth for both SMUSD and MUSD. The Formula assumes that a new MUSD parcel tax is passed that is

equal to at least 90% of the parcel tax currently paid by the Malibu community for SMMUSD.

- If the Delta in any year would require a payment by MUSD that would cause MUSD's operating revenue growth to be less than a specified annual cost-of-living adjustment, the unpaid amount will be deferred for payment in future years, plus interest on the deferred amount. (This is the Malibu "ability-to-pay" principle.)
- In the aggregate, the payments to SMUSD from MUSD must equal the sum of the annual Deltas, plus any interest that has accrued.
- The Formula must provide criteria for modifying the number of years that the Formula remains in place based on evidence that SMUSD can stand alone financially without any significant adverse Financial Effect from reorganization. (The Agreement refers to these criteria as the "Delta Tracking Process.") If the number of years that the Formula remains in place is shortened, then any outstanding payments due to SMUSD from MUSD must still be paid.

The timing of reorganization could affect the above guidelines. The Illustrative Projection (see Appendix D) assumes that reorganization becomes effective in fiscal year 2018-2019. If reorganization becomes effective after fiscal year 2018-2019 but before or during fiscal year 2020-2021, the Agreement provides that the Formula would continue as presented. However, if reorganization is delayed beyond fiscal year 2020-2021, the Agreement provides that the Formula will be revisited and open for renegotiation in case the revenue forecasting assumptions or other related TK-12 school finance factors underlying the Formula change. The Committee recommends that any renegotiation be conducted within the context of the basic principles outlined in this Agreement. (See page C-10 for other criteria that would trigger a renegotiation.)

## **V. Details of the Formula and Related Implementation Provisions**

The balance of this Term Sheet outlines the details of how the Formula calculations translate into a schedule of payments or payment credits, and outlines several additional provisions related to Formula implementation. It is organized into the following explanatory sections:

- The method for annually calculating the Financial Effect of reorganization on SMUSD (i.e., the "Delta").
- The method for annually calculating the payment to be made to SMUSD by MUSD based on the size of the Delta and MUSD's "ability to pay."
- The mechanics of a "Delta Tracking Provision" that could result in a reduction in the number of years during which the Delta is calculated.
- The designation of a neutral third-party to perform the above calculations and provisions for SMUSD and MUSD to share equally in the associated costs.
- Criteria for renegotiating the Formula or terms of payment, in the case of a significant change in a key underlying assumption or unexpected future event.

**A. The Method for Annually Calculating the Financial Effect of Reorganization on SMUSD**

As defined above, the Delta is the annual measurement of the Financial Effect multiplied by SMUSD’s ADA.

*1. Sources of Data for the Formula*

Average Daily Attendance Data: The student count used in the Formula will be ADA data, which is the average number of pupils actually attending classes each school day, and generally falls within a range of 95-98% of enrollment. As noted earlier, the State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). The ADA Data used in the Formula will be the P2 ADA.

Audited Financial Statement Data: The calculations in the Formula will use revenue data from audited financial statements for SMUSD and MUSD, which are generally available in December of each year following the fiscal year ending in June. Calculations related to future revenue per ADA for a theoretical SMMUSD (i.e., meaning an assumption that reorganization had not occurred) will be derived from these financial data.

As explained below, the Formula uses data for certain components of Unrestricted General Fund revenue. To ensure that the needed data are available, the Committee recommends that SMUSD and MUSD require their respective auditors to provide a supplemental schedule in the audited financial statements that separately shows the revenues noted below. This format of reporting is already the District’s practice for preparation of the unaudited financial statements.

*2. Revenue Sources to Include and Exclude in the Delta Calculation*

This section outlines the sources of Unrestricted General Fund revenue to include and exclude in the Delta calculation. The table below lists the Unrestricted Revenue Sources to include in Delta calculations. Below the table is an explanation of the Unrestricted Revenue Sources to exclude in Delta calculations.

<b>Revenue Categories</b>	<b>Unrestricted General Fund Revenue Sources to Include in Delta Calculations</b>
LCFF Revenue	<ul style="list-style-type: none"> <li>All categories of LCFF revenue (including property tax, State and Minimum State Aid revenue).</li> </ul> <p>In fiscal year 2016-2017, LCFF revenue accounts for 62% of SMMUSD’s total Unrestricted General Fund revenue.</p>
Locally-Generated Revenue	<ul style="list-style-type: none"> <li>Parcel tax revenue (SMUSD and MUSD)</li> <li>Revenue from leases and rentals (SMUSD and MUSD)</li> <li>City of Santa Monica contract revenue</li> <li>City of Malibu contract revenue</li> <li>Santa Monica Measure Y and Measure GSH revenue</li> </ul>
New Sources of Local Revenue Generated Post-reorganization	<ul style="list-style-type: none"> <li>Revenue from any new revenue sources established and generated post-reorganization by SMUSD. (See the next paragraph for information on new revenue sources generated post-reorganization by MUSD.)</li> </ul>

Other new sources of revenue that MUSD generates post-reorganization will be incorporated into the assessment of MUSD’s “ability to pay” (explained in Section B below), but will not be used in the Delta calculation. This is based on the general principle to avoid any disincentive for either new district to pursue increased revenue or otherwise improve education in their schools. New sources of locally generated SMUSD revenue are included in the Delta calculation because the relatively small amount (i.e., 16% ADA share) that would benefit MUSD is not considered a disincentive.

The other Unrestricted General Fund revenue sources to exclude in the Delta calculation are listed below with an explanation of the rationale behind exclusion.

- Education Foundation Revenue (currently SMMEF) or any similar parent, PTA, and local business generated revenue program. The rationale for excluding revenue from these sources is that these monies would be raised by local organizations in each district respectively, and exclusion aligns with the guiding principle not to create any disincentives for local fund raising efforts.
- Lottery Funding Revenue and Mandated Cost Block Grant Revenue (MBG). These two sources of State funds are allocated (as Unrestricted General Fund revenue) to each school district based on the same dollar amount per unit of annual ADA. As a result, revenue from these sources would have no effect on the calculation of the Delta.

As discussed later in this Term Sheet, if the State changes the method under which it funds TK-12 public schools from the current LCFF approach, representatives from SMUSD and MUSD will meet and confer in order to make reasonable changes, if necessary, to the Formula, consistent with the Guiding Principles adopted for this Agreement. If any of the locally-generated sources of revenue in Santa Monica is terminated, it will be removed as an item of revenue in calculating the Delta.

#### **B. The Method for Annually Calculating the MUSD Payment (or Credit) Based on the Delta and MUSD’s “Ability to Pay”**

The Delta calculation will be performed each year beginning with the first year that reorganization becomes effective through fiscal year 2029-2030. (See page C-4 and C-5 for why this year was selected and how the year of reorganization could affect the Formula.) In the aggregate, MUSD will pay SMUSD an amount equal to the sum of the annual Deltas, plus interest (as applicable). The actual payment owed to SMUSD by MUSD in any single year will be calculated to maintain predictable and stable revenue growth for both districts in an amount at least equal to an annual cost-of-living adjustment. This is further explained below.

The Formula incorporates MUSD’s “ability to pay” in several ways. Specifically, the Formula:

- Takes into account the fact that the MUSD revenue will need growth in the early years to ensure the financial viability of the new district, including the ability to fund one-time start-up costs and initiate a reserve fund.
- Provides that MUSD revenue will not experience a net reduction in its year over year revenue due solely to a required payment to SMUSD.

- Provides that MUSD’s ability-to-pay will be based on an annual Cost-of-Living Adjustment (COLA). The COLA will be the published State Revenue COLA, but if necessary, will be adjusted so that it will be no less than 50% and no more than 80% of the annual percentage change in the total assessed value of real property within MUSD.

As explained above, any sources of local MUSD revenue adopted after reorganization will be included in assessing MUSD’s ability to pay but will not be included in revenue for calculating the Delta.

The mechanics of how the Formula determines the annual payment amount to SMUSD are outlined below:

- If, in any year through fiscal year 2029-2030, the Delta is *negative*, MUSD will owe a payment in that amount to SMUSD, except to the extent that any credits remain available from prior years to offset the amount of that payment.
- The amount of the payment to be made by MUSD for any year will be the lesser of:
  - ✓ The amount of the negative Delta for that year (less any remaining credits) plus any unpaid amounts, plus interest, remaining from prior years; or
  - ✓ The amount by which MUSD’s Unrestricted General Fund revenues for the year exceed its operating revenues for the prior year adjusted by the MUSD ability-to-pay COLA.
- Any difference between the amount actually paid by MUSD and the amount of the Delta (less any remaining credits) will be carried forward into the next year with interest at the rate earned by both SMUSD and MUSD on funds deposited with the County of Los Angeles Treasurer’s pooled investments account composed of short-term securities (currently 1.00%).
- No further calculation of the Delta will be made for any year beyond fiscal year 2029-2030, but annual payments will continue to be due to SMUSD from MUSD in an amount equal to the lesser of:
  - ✓ Any Cumulative Delta from prior years, plus interest, or
  - ✓ The amount by which MUSD’s Unrestricted General Fund revenues for the year exceeds its operating revenue for the prior year adjusted by the MUSD ability-to-pay COLA.
- This procedure will continue for each year until all amounts owed to SMUSD by MUSD, including interest, have been paid in full.

### **C. The Mechanics of the “Delta Tracking Provision”**

The Agreement includes a provision that would end the annual calculation of the Delta before fiscal year 2029-2030 if only relatively small amounts are owed by MUSD for a specified period of time, because that would demonstrate that the two districts are operating independently with no significant adverse Financial Effect on SMUSD. This Delta Tracking Provision is outlined below.

- The tracking phase will begin either three years after reorganization becomes effective or fiscal year 2022-2023, whichever is later.
- During the tracking phase, if there are three consecutive years in which the Delta is less than 0.5% of the applicable components of SMUSD's Unrestricted General Fund revenues, then the Revenue Neutrality arrangement ends, except that any outstanding payments, plus interest if applicable, due to SMUSD from MUSD must still be paid.
- If there remains a credit at that time arising from previous calculations of the Delta, SMUSD will not be required to make any payment to MUSD.

**D. The Designation of a Third-Party to Perform the Delta Calculations and Annual Timing of Calculations and Payments**

*1. Designation of a Third-Party*

After reorganization becomes effective, the Boards of Education of SMUSD and MUSD will jointly select a neutral third party, with expertise in TK-12 public school financing in California, to perform the annual calculations provided for in the Formula. The two districts will agree on a fair and reasonable fee associated with the performance of this work, and share equally in the costs. The Committee agreed that the procedure for selecting the neutral third party be determined by Group 2, the second of two transition and implementation groups that the Committee recommends be appointed. (See Topic 5, Implementation.)

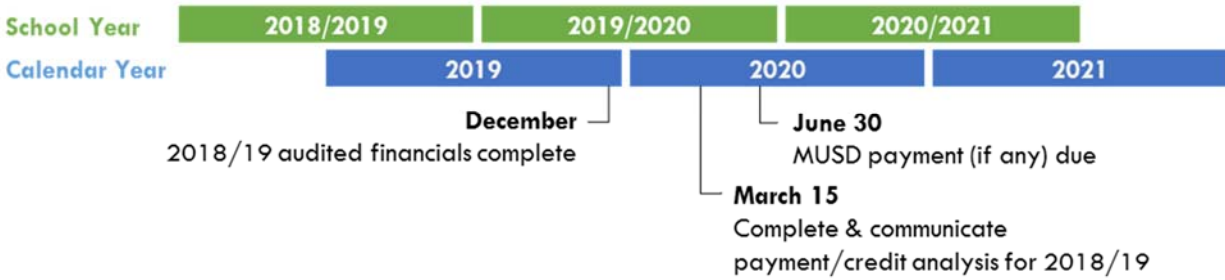
*2. Calendar of Calculations and Payments*

As noted above, the neutral third party's calculations will use data from the audited financial statements for SMUSD and MUSD, which are assumed to be available in December of each year following the fiscal year ending the prior June 30. It is expected that the initial annual calculations of the Delta and associated payment (or booking of credit) will proceed as follows:

- The audited financials for the first fiscal year of reorganization will be available in December of the second fiscal year after reorganization becomes effective.
- The neutral third-party will perform the calculations of the Delta and associated payment or credit using these audited financials by no later than March 15<sup>th</sup> of the second fiscal year of reorganization.
- These calculations will be communicated by the neutral third-party to SMUSD and MUSD no later than March 15<sup>th</sup> of the second fiscal year after reorganization becomes effective.
- Annual calculations by the neutral third party shall be conclusive and binding on both districts except for arithmetical errors identified by either district within 30 days of the communication to the districts.
- The payment from MUSD to SMUSD, if any is due under the terms of this Agreement, will be paid no later than June 30<sup>th</sup> of the second fiscal year after reorganization becomes effective.

The graphic below depicts the first cycle of annual calculations and payments after reorganization becomes effective (i.e., fiscal year 2018-2019, commencing July 1, 2018).

**Calculation and Payment Timeline**



This pattern of calculating the Delta and the amount of any payment or credit for each fiscal year will continue for the length of time as specified elsewhere in the Agreement. It is understood that that, due to the annual schedule for preparing and reporting the results of school district audits, the decision to use audited financials as the source of data for the Formula means that there will be no payment (or credit) at the beginning of the first or second fiscal year after reorganization becomes effective. As a result, the payment (or booking of a credit) at the end of the second fiscal year after reorganization becomes effective (i.e., June 30, 2020 in the above illustration) will correspond to the Delta for the first fiscal year after reorganization becomes effective (i.e., 2018-19 in the above illustration).

**E. Criteria for Renegotiating the Formula or Terms of Payment**

*1. Before Reorganization Becomes Effective*

As noted above, the mechanics of the Formula as well as the Illustrative Projection assume that reorganization becomes effective in fiscal year 2018-2019. If, however, implementation is delayed beyond fiscal year 2020-2021, then the Formula and terms of payment will be revisited and open for renegotiation. The Committee recommends that any renegotiation be conducted within the context of the basic principles outlined in this Agreement.

*2. After Reorganization Becomes Effective*

- **Provision for significant change in key underlying assumption.** If at any time when the Delta is to be calculated or MUSD is required to make a payment to SMUSD there has been a significant change in any of the key underlying assumptions in the Formula or SSC’s projections, such as the manner in which the State provides funds for TK-12 public schools or the manner in which property is taxed, either district may notify the other district that it wishes to meet and confer regarding the Formula and the terms of payment. If either district gives such a notice, the districts will meet to discuss appropriate changes in the Formula by applying the basic principles utilized by the Committee and any other principles agreed upon by the districts.
- **Provision for unexpected and costly event.** It is possible that a “force majeure” event may occur, such as an earthquake or major fire, that could adversely impact either or both districts and MUSD’s ability to make payments, due to a divergence of funds for



emergency repairs, cleanup, obtaining alternate classroom or administrative facilities, or providing for other needs in order to maintain district operations and stable revenue growth.

If such an event occurs and the Board of MUSD concludes that the financial effect of that event may prevent MUSD from making all or any portion of the next payment to SMUSD required under the Formula, then the following process applies:

- ✓ MUSD shall give written notice of that conclusion to SMUSD within 30 days of the event stating the basis for that conclusion (a "Force Majeure Notice").
- ✓ If MUSD gives a Force Majeure Notice, it shall, within 45 days thereafter provide SMUSD with written notice (the "Payment Notice") of the amount of such payment, if any, that it will be able to make given the need to divert revenue to address emergency needs, including calculations supporting that conclusion.
- ✓ MUSD will, to the extent consistent with good accounting practice, first use reserve funds, amounts in other Funds and amounts available in a timely fashion from governmental, insurance and other sources, to cover the emergency costs before applying funds classified as Unrestricted General Fund revenue.
- ✓ To the extent set forth in the Payment Notice, MUSD's obligation to make the next payment to SMUSD will be deferred for up to one year with the amount deferred being added to the Cumulative Delta. No further deferrals of that payment amount will be permitted.

## **Term Sheet for Topic #2, Division of the District's Assets**

### **I. The Board's Objective**

The Board's objective for negotiations on the division of SMMUSD's assets was to include a method(s) for the allocation of the Fund Balances in SMMUSD's General Fund Accounts and the Capital Facilities Fund ("Fund" or "Funds," as applicable) at the time reorganization becomes effective. The Board directed that the method be fair to both SMUSD and MUSD, considering the sources and uses of revenue in the various funds.

### **II. The Committee's Approach**

The Committee approached Topic #2 by separating the topic into two major categories:

- Develop a method(s) for dividing SMMUSD's ending Fund Balances at the time reorganization becomes effective ("Fund Balances"); and
- Develop a method(s) for dividing SMMUSD's buildings, land, and school buses at the time reorganization becomes effective.

The Committee added three guiding principles for the division of SMMUSD's Fund Balances, studied information about the sources and uses of revenue in each Fund, and reviewed an inventory of SMMUSD's buildings and land. The Committee posed questions to District staff to clarify its understanding of the Funds and most recent balance sheets, and reviewed what State law provides for the division of assets when school districts reorganize. Finally, the Committee developed and evaluated options, and reached unanimous Agreement on terms that align with the Board's objectives and the Committee's guiding principles.

### **III. Guiding Principles and Definitions**

The Committee's methods for dividing SMMUSD's Assets reflect its guiding principles that all terms in the Agreement must: (a) be financially viable for both SMUSD and MUSD; (b) ensure a degree of predictability for both SMUSD and MUSD; (c) enable each school district to be able to plan ahead with a reasonable degree of resource certainty; (d) avoid establishing potential negative incentives for either SMUSD or MUSD to pursue increased revenue or otherwise improve education in their schools; and (e) be clear and understandable, legal, and enforceable.

The methods for dividing SMMUSD's assets also meet three more Topic-specific principles:

- The allocation of Fund Balances between SMUSD and MUSD will be decided by Fund, and will be guided by a method representing a mutually agreed-upon fair and equitable division that considers the sources and uses of revenue in each Fund;
- The negotiated methods of asset division are intended to be applied only once at the time reorganization becomes effective; and
- In a few cases, where the data needed to make a fair and equitable division will not be available until closer to the time reorganization becomes effective, there will be a

recommendation to postpone the final allocation decision until that information becomes available.

#### **IV. Agreements on Methods for Dividing Assets**

##### **A. Agreements on Dividing SMMUSD’s Fund Balances**

The Committee’s Agreement for dividing each Fund is described below in three categories:

- Fund Balances to be divided using the “ADA Method;”
- Fund Balances to be divided using an alternative method; and
- Fund Balances to be divided based on information available closer to the time that reorganization becomes effective.

###### *1. Fund Balances to be Divided Using the “ADA Method”*

For the District Funds where the source of revenue (in relative terms) has essentially mirrored the number of students in Santa Monica and the Malibu community, the division of the Fund Balance when reorganization becomes effective should be based on a calculation of each district’s percentage share of total ADA in both districts. The current Santa Monica/Malibu community ADA ratio is 84%/16%.

To account for changes in ADA counts between now and the time of reorganization, the Committee designed a calculation titled the “ADA Method,” which is the three-year average of ADA in each district. The three years will be the three fiscal years immediately preceding the fiscal year when reorganization becomes effective.

The Funds to be divided using the ADA Method are listed below, along with each Fund’s fiscal year 2015-2016 ending Fund Balance, and the Committee’s comments on why the Agreement designates the ADA Method.

<b>Name of Fund</b>	<b>Unrestricted General Fund (excluding SMMEF money)</b>
2015-2016 Ending Balance:	\$30,244,127

The bulk of the Unrestricted General Fund revenue comes from local property taxes and the State. State funding sources include LCFF revenue (the primary source of State financial support for TK-12 public education), Lottery Fund Revenue, and Mandated Cost Block Grant Revenue. Local revenue deposited into the Unrestricted General Fund includes: parcel taxes; revenue from leases and rentals; revenue from SMMUSD’s contract with the City of Santa Monica; revenue from SMMUSD’s contract with the City of Malibu; and Santa Monica sales tax revenue from Measure Y and the recently adopted Measure GSH.

While the individual Unrestricted General Fund revenue line item categories do not each (by themselves) mirror the Santa Monica/Malibu community ADA ratio, the Committee’s analysis revealed that the total net contributions of revenues generated by each community to the Unrestricted General Fund closely mirror the ADA split. For this reason, plus the fact that it greatly simplifies the calculation required, the Committee agreed that a fair and equitable

division of the Fund Balance in the Unrestricted General Fund should be based on the ADA Method.

As a double-check on the fairness of using the ADA Method for this Fund, the Committee recommends that a similar analysis be repeated directly before reorganization becomes effective to ensure the mathematical finding cited above still holds.

Funds raised by the Santa Monica-Malibu Education Foundation (SMMEF) are also deposited into the Unrestricted General Fund, and the money SMMEF raises each year is for programs in the following fiscal year. The Agreement provides that any SMMEF monies remaining at the time of reorganization be divided between SMUSD and MUSD based on the relative contributions to SMMEF (i.e., calculated as a percent of the total collected) made by each community during the fiscal year immediately before reorganization becomes effective.

**Name of Fund**                                  **Restricted General Fund**  
2015-2016 Ending Balance:    \$5,197,573

After also analyzing the degree to which each Restricted General Fund line item category originated in Santa Monica or the Malibu community, the Committee agreed that the Fund Balance in the Restricted General Fund should be divided between SMUSD and MUSD according to the ADA Method. Similarly, the Committee agreed that the source of line item revenue analysis for the Restricted General Fund be repeated directly before reorganization becomes effective to ensure the fairness of using the ADA Method.

**Name of Fund**                                  **Cafeteria Special Revenue Fund**  
2015-2016 Ending Balance:    \$195,976

The Cafeteria Special Revenue Fund is for operation of the food service program. The ADA Method is recommended for allocating the Fund Balance at the time of reorganization because food service programs exist in both Santa Monica and Malibu, and students in both jurisdictions have contributed to the Fund.

*2. Fund Balances to be Divided Using an Alternative Method*

For Funds where the relative source of revenue (i.e., Santa Monica vs. Malibu community) has not mirrored the ADA ratio, or if there is a more equitable way to divide a Fund balance, the Committee designed an alternative method. Provided for each Fund listed below is the Fund Balance from 2015-2016, a description of the agreed-upon allocation method, and any comments from the Committee on this method.

**Name of Fund**                                  **Adult Education Fund**  
2015-2016 Ending Balance:    \$659,900

The Adult Education Fund is a Special Revenue Fund. The revenue source for this Fund is the State, which pays school districts a set amount per student participating in Adult Education.

The agreed-upon allocation method is to divide the Fund Balance between SMUSD and MUSD based on the ratio (calculated as a three-year average) of students enrolled from each

community in Adult Education. The three years will be the three fiscal years immediately preceding the fiscal year when reorganization becomes effective. If MUSD decides not to offer Adult Education, then the entire Fund Balance will be transferred to SMUSD.

**Name of Fund**                      **Child Development Fund**  
2015-2016 Ending Balance:    \$234,491

The Child Development Fund is a Special Revenue Fund. The source of revenue for this Fund is a combination of the State (which pays school districts a set amount per student participating in Child Development programs) and fees paid by the parents of children enrolled in pre-school programs on selected school campuses.

The agreed-upon allocation method is to divide the Fund Balance between SMUSD and MUSD based on the revenue produced by Child Development programs in the fiscal year during which reorganization is approved. Specifically, the ending Fund Balance of revenue produced by Child Development programs located in Santa Monica schools will be allocated to SMUSD, and the ending Fund Balance of revenue produced by Child Development programs located in Malibu schools will be allocated to MUSD.

**Name of Fund**                      **Deferred Maintenance Fund**  
2015-2016 Ending Balance:    \$212,196

The Deferred Maintenance Fund is a Special Revenue Fund that funds routine maintenance needs across all of SMMUSD's buildings, located in both Santa Monica and Malibu.

The agreed-upon method of allocation is to divide the Fund Balance between SMUSD and MUSD based on the respective percentages of total floor area in SMMUSD buildings located in Santa Monica versus the Malibu community at the time reorganization becomes effective.

**Name of Fund**                      **Capital Facilities Fund (developer fees)**  
2015-2016 Ending Balance:    \$1,236,679

The Capital Facilities Fund is the repository of statutory developer fees paid to SMMUSD. The agreed-upon allocation method will be to divide the Fund Balance between SMUSD and MUSD based on a three-year average of the percentage of payments generated from developments located in Santa Monica versus the Malibu community. The three years will be the three fiscal years immediately preceding the fiscal year when reorganization becomes effective.

Development contributions by location are tracked annually, so the allocation method recommended for this Fund should be relatively easy to implement.

**Name of Fund**                      **Special Reserve for Capital Projects Fund**  
2015-2016 Ending Balance:    \$5,244,209

The Special Reserve for Capital Projects Fund is the repository of the tax increment pass through funding from the former City of Santa Monica Redevelopment Agency (RDA). This fund pays for the annual debt service on the existing Certificates of Participation (COPs) for the 16<sup>th</sup>

Street District Headquarters building. The annual debt service for principal and interest is \$1.869 million.

\$5.0 million of this Fund is reserved to cover shortfalls occurring in the Measure BB facilities bond program, and the balance is used to fund other capital projects as the District identifies them as a priority. There has been no pattern established for using these funds for capital projects based on project location in the Malibu community or Santa Monica.

The agreed-upon allocation method is to divide the undesignated Fund Balance between SMUSD and MUSD at the time reorganization becomes effective based on the ratio of total Measure ES funds allocated to bond-funded projects in Malibu schools and bond-funded projects in Santa Monica schools. To be specific, the SMUSD/MUSD allocation ratio will be 78%/22%. This is based on an allocation to the Malibu community of (at least) \$77.0 million out of \$350.6 million, which is the amount remaining from the \$385.0 million Measure ES total bond authorization after subtracting \$34.4 million allocated for District-wide technology improvements.

*3. Fund Balances to be Divided Based on Information Available Closer to Reorganization*

The Committee agreed that the decision on a fair and equitable allocation of the Fund Balances in the following two Funds should be deferred until a time closer to reorganization. The reasons for this are somewhat different for each Fund, as explained below.

<b>Name of Fund</b>	<b>Building Fund</b>
2015-2016 Ending Balance:	\$92,741,212

The Building Fund will contain the end-of-year Fund Balance of SMMUSD bond proceeds in the year prior to when reorganization becomes effective.

A fair and equitable allocation of the Fund Balance in the Building Fund will depend on the status of projects in Santa Monica and the Malibu community at the time reorganization becomes effective. Because this information is so time-dependent, the Agreement is that developing a recommendation for the allocation of the Building Fund be assigned to Group 1, the first of two transition and implementation groups the Committee recommends be appointed. (See Topic #5, Implementation.)

The guiding principles recommended for the eventual Fund Balance allocation is that it should be consistent with the decisions and commitments regarding projects and division of bond proceeds made before reorganization (including that the Malibu community receives \$77.0 million, at minimum, out of Measure ES's total of \$385.0 million), and the status of projects underway at the time of reorganization. The allocation of this Fund must also be made in conjunction with the allocation of authorized but not-yet-issued bonds (see note below).

Note: Since SMUSD will retain the obligation to pay for the completion of the Court-ordered PCBs remediation in Malibu schools, the projected costs for any remaining remediation at the time of reorganization must be included in SMUSD's allocation when calculating the division of bond fund proceeds and authorized but-not-issued bonds. (See Topic #4, Environmental Liability.)

**Name of Fund**                      **Retiree Benefit Fund**

2015-2016 Ending Balance:    \$5,120,174

The Committee recommends the details of allocating the Fund Balance in the Retiree Benefit Fund also be assigned to Group 1.

The most equitable allocation of the Fund Balance in the Retiree Benefit Fund will need to be based on the most recent actuarial data available at the time reorganization becomes effective, and will be linked to how the liability for providing retiree health benefits is divided between SMUSD and MUSD at that time. The Committee believes that a professional actuary will need to be engaged to make the determination of a fair and equitable split of this Fund.

**B. Agreement on Dividing SMMUSD’s Buildings, Land, and School Buses**

The Committee considered the allocation of SMMUSD’s buildings, land, and school buses in four categories: (1) schools; (2) school buses and bus yards; (3) land and buildings used for SMMUSD activities that serve students and/or faculty in both the Malibu community and Santa Monica; and (4) land and buildings that are a source of revenue for SMMUSD. The agreed-upon method and related provisions for dividing these assets between SMUSD and MUSD at the time of reorganization are described below.

*1. School Buildings and Land*

The Committee agreed that school buildings and associated land area should be allocated to the respective district where they are now located.

As a related provision to the allocation of school buildings, the Committee agreed that if MUSD decides not to provide for a continuation high school program in its own facilities, MUSD will be provided assurance that MUSD students who require enrollment in a continuation high school will be able to participate in SMUSD’s continuation high school, which is currently located at Olympic High School in Santa Monica. In such a case, MUSD will pay the cost of transporting MUSD students to the continuation high school program in SMUSD.

*2. School Buses and Bus Yards*

The Committee agreed that, at the time of reorganization, the school buses used to transport students in Santa Monica will be allocated to SMUSD, and the school buses used to transport students in the Malibu community will be allocated to MUSD. In addition, each district will make its own decision about how to store and maintain its bus fleet.

*3. Buildings/Land Used for SMMUSD Activities That Serve Students and/or Faculty in Both Malibu and Santa Monica*

The agreed-upon allocation method for the property in this category located in Santa Monica is as follows:

- The District Headquarters building will be allocated to SMUSD, and SMUSD will assume sole responsibility for paying the outstanding debt owed on the Certificates of Participation (COPs) used to fund the purchase of this property. However, should

SMUSD ever elect to sell the District Headquarters, any net cash proceeds (minus the outstanding COPs balance at the time of reorganization) will be divided between SMUSD and MUSD according to the ADA Method calculated at the time reorganization becomes effective.

- The Washington West property will be treated as if it were a school, and therefore will be allocated to SMUSD as the district where it is located.

4. *Buildings/Land That Are a Source of Revenue for SMMUSD*

- The buildings/land that are currently a source of SMMUSD revenue (and located in Santa Monica) will be allocated to SMUSD, i.e., former Madison School site; 9<sup>th</sup> & Colorado properties; 16<sup>th</sup> & Colorado property other than the District Headquarters; and the Doubletree Hotel site.
- However, should SMUSD ever elect to sell any of the buildings/land that were a source of revenue for SMMUSD, any net cash proceeds will be split between SMUSD and MUSD according to the ADA method calculated at the time of reorganization.

The Agreement acknowledges that SMUSD will retain sole discretion regarding the leasing, financing, disposition and use of the District Headquarters building and all assets that are currently a source of SMMUSD revenue and will have no obligation to MUSD to maximize or generate any cash proceeds from any disposition thereof or to pay to MUSD any portion of any proceeds received from the leasing or financing thereof.

And finally, the District's land on Malibu Canyon Road will be allocated to MUSD.



## **Term Sheet for Topic #3, Bond-Related Items and Other Liabilities**

### **I. The Board's Objective**

The Board's stated objectives for the Committee were to develop a method(s) that is (are) fair to SMUSD and MUSD to: (a) allocate the District's existing bond debt; (b) address the refinancing of existing debt; (c) allocate authorized but not-yet-issued Measure ES bonding authority; and (d) allocate other District liabilities between SMUSD and MUSD existing at the time of reorganization.

### **II. The Committee's Approach**

The Committee divided Topic #3 into three assignments:

- Develop a method for allocating the amount of outstanding bond indebtedness between SMUSD and MUSD arising from bonds issued by SMMUSD before the date that reorganization becomes effective and provide a method for each district to independently refinance the amount of its share of the indebtedness.
- Develop a method for allocating the amount of authorized but-not-yet-issued Measure ES bonds between SMUSD and MUSD.
- Develop a method for allocating other SMMUSD liabilities between SMUSD and MUSD other than liabilities that might arise due to contamination of SMMUSD buildings. (See Topic #4, Environmental Liability.)

The Committee adopted common definitions and added supplemental guiding principles tailored for the negotiations on bond-related items, studied information available in background and other resource materials about the status of Measure BB and Measure ES bond funds, posed a series of legal questions on bond-related issues to the Procopio law firm retained to advise the Committee on these issues (Appendix B.10), and spent time discussing and evaluating different methods and approaches to addressing the three assignments.

In sum, the Committee's unanimously approved Agreement on these issues (detailed below) aligns with the Board's objectives and the Committee's guiding principles.

### **III. Guiding Principles and Definitions for Bond-Related Issues**

The Committee's Agreements on bond-related issues align with the Committee's guiding principles that all terms in the Agreement must: (a) be financially viable for both SMUSD and MUSD; (b) ensure a degree of predictability for both SMUSD and MUSD; (c) enable each school district to be able to plan ahead with a reasonable degree of resource certainty; (d) avoid establishing potential negative incentives for either SMUSD or MUSD to pursue increased revenue or otherwise improve education in their schools; and (e) be clear and understandable, legal, and enforceable.

The Committee developed the following additional principles specific to its Topic #3 negotiations:

- Post-reorganization, each district (SMUSD and MUSD) should, to the maximum extent possible, be provided sole discretion to make its own decisions regarding refinancing of existing bond debt and the issuance of new bonds; and
- Post-reorganization, any decisions regarding the allocation of authorized but-not-yet-issued bonds should be consistent with decisions and commitments regarding projects and division of bond authority made before reorganization, and place priority and mutual respect on the needs and preferences delineated by SMUSD and MUSD at the time the allocation decisions are made.

<b>Definitions for Terms Used in Topic #3 Negotiations</b>	
ES Funds*	Refers to the facility bond funds made available to SMMUSD as a result of Measure ES, which was approved by the voters in November 2012. Approval of Measure ES authorized the Board to issue bonds backed by assessments on real property in both Santa Monica and the Malibu community in an aggregate amount not to exceed \$385,000,000. At least 20% (\$77,000,000) was to be made available for Malibu schools.
BB Funds*	Refers to the facility bond funds made available to SMMUSD as a result of Measure BB, which was approved by the voters in November 2006. Approval of Measure BB authorized the Board to issue bonds backed by assessments on real property in both Santa Monica and Malibu in an aggregate amount not to exceed \$268,000,000.
* ES and BB Funds can only be used for capital projects and technology.	

#### **IV. Agreement on Allocation**

##### **A. Agreement on Bonds Issued by SMMUSD Before Reorganization Becomes Effective**

With respect to the Measure BB and Measure ES bonds issued by SMMUSD before reorganization becomes effective, the Committee reached the following agreements:

- SMMUSD’s bond debt should be allocated between SMUSD and MUSD based upon the respective assessed values of real property in Santa Monica and the Malibu community as reflected by the most recent assessment rolls when reorganization becomes effective. This means that Santa Monica property will be assessed for SMUSD’s proportionate share of the bond liability and property within MUSD will be assessed for its share.
- With respect to refinancing this debt post-reorganization, State legislation and related reorganization documents, to the extent that the rights of bond holders are not prejudiced, should provide that SMUSD or MUSD can, without need to coordinate with the other, make decisions regarding refinancing of its portion of the bond liability.

To accomplish the above, Procopio advises that language in State legislation needs to specify that each successor district is treated as the issuing district for purposes of Government Code Section 53580 and related statutes. In addition, the State legislation should specify that each new district is separately responsible for Internal Revenue Service tax compliance and continuing disclosures under Securities and Exchange Commission regulations.

#### **B. Agreement on the Allocation of Authorized But-Not-Yet-Issued Measure ES Bonds**

As of this writing, an additional \$295 million remains in bonding authority under Measure ES that has been authorized but not issued.

The Committee agreed that the allocation of this remaining bonding authority should occur at the time reorganization becomes effective because it will depend on the status of projects and plans of SMUSD and MUSD at that time. The Committee's recommended process is to delegate the task of making a final recommendation for allocating this outstanding bonding authority to Group 1, the first of two transition and implementation groups that the Committee recommends be appointed. (See Topic #5, Implementation.)

The Committee agreed that Group 1 should be directed to develop its recommendation for allocating the authorized but-not-yet-issued bonding authority consistent with the following guidelines:

- Allocate the authority consistent with decisions and commitments regarding projects and division of bonding authority made prior to reorganization, including that Malibu receives \$77 million (at minimum) out of ES's total of \$385 million, and mutual respect for the needs and preferences delineated by SMUSD and MUSD at the time of reorganization.
- To be specific, the allocation decision should take into account: (a) the status of current projects in Malibu schools; (b) previous decisions regarding authorized but-not-yet-issued bonds; and (c) the bond fund balance.

Finally, since SMUSD will retain the obligation to pay for the completion of Court-ordered remediation of contamination in Malibu schools, the projected costs for any remaining remediation at the time reorganization becomes effective must be included in SMUSD's allocation when calculating the split of bond fund proceeds and authorized but-not-yet-issued bonds. (See Topic #4, Environmental Liability.)

#### **C. Allocation of District's Other Liabilities**

This final section of the Topic #3 Term Sheets provides the Committee's Agreement on three other balance sheet items. All three are liabilities (as opposed to assets), but are not addressed elsewhere in the Committee's Agreement.

### *1. Certificates of Participation (COPs)*

The Certificates of Participation liability on SMMUSD's balance sheet reflects the debt owed on the financing for the District's Headquarters. Consistent with the Committee's recommendation that the District's Headquarters be allocated to SMUSD, that district will assume sole responsibility for paying the outstanding debt owed on the COPs used to fund the purchase of this property.

### *2. Compensated Absences*

Compensated absences are an employer's accrued liability for absences that employees will be paid for, such as vacation and sick leave. The Committee agreed that the liability associated with compensated absences should "move" with the individual teachers and other staff members who have accrued this unused leave. In other words, when reorganization becomes effective, SMUSD should inherit the liability for personnel who are SMUSD employees, and MUSD should inherit the liability for personnel who are MUSD employees.

Because the allocation of this liability depends on decisions that will be made closer to when reorganization becomes effective, the Committee recommends the details of allocating the compensated absences liability between SMUSD and MUSD be assigned to Group 1, the first of two transition and implementation groups the Committee recommends be appointed. (See Topic #5, Implementation.)

### *3. OPEB (Other Postemployment Benefits)*

OPEB is a Government Accounting Standards Board (GASB) term for the outstanding liability for paying benefits (other than pensions) to retired public sector employees.

The Committee agreed that the most equitable allocation of OPEB liability should be based on the most recent actuarial data available at the time of reorganization, and should be linked to how the funds already set aside for providing retiree health benefits are divided between SMUSD and MUSD at the time reorganization becomes effective. Because the allocation of this liability depends on decisions that will be made closer to the time of reorganization, the Committee recommends the details of allocating the OPEB liability between SMUSD and MUSD between SMUSD and MUSD also be assigned to Group 1.

## Term Sheet for Topic #4, Environmental Liability

### I. The Board's Objectives

The Board's objectives on the issue of environmental liability, as stated in the Board's Action Item of December 17, 2015, were:

- Establish a structure under which MUSD assumes responsibility for any remaining remediation of any contamination in Malibu schools and indemnifies SMUSD for any future claims arising from such remediation work.
- Dismissal of the pending lawsuit against SMMUSD or the creation of an enforceable agreement from the plaintiffs that SMUSD will be dismissed from the lawsuit.
- Receipt by the Board of a legal opinion from a firm selected by the Board with respect to any potential continuing exposure of SMUSD following reorganization and a conclusion by the Board that any such exposure is reasonable.

With respect to the Board's second objective regarding the lawsuit brought by America Unites for Kids against SMMUSD, the Committee's understanding is that the September 1, 2016 ruling by Judge Anderson on this lawsuit (the "Court Order") essentially eliminated the Committee's need to address this objective. (See Appendix B.28 for a copy of the Court Order.)

While the Court Order is on appeal, the Committee understands that the issues on appeal are limited to (a) whether attorneys' fees should be awarded to the plaintiff and (b) whether the injunction imposed in the Court Order on certain private parties should be reversed. The portion of the Court Order regarding the obligations of SMMUSD to complete remediation work has not been appealed.

The Committee expressed no opinion with respect to any legal opinion the Board may wish to obtain in accordance with the final objective.

### A. The Committee's Approach

The Committee approached the first objective by dividing the assignment into two categories: remediation of contamination required under the Court Order; and any other environmental contamination, whether or not known at the time reorganization becomes effective.

The Committee studied information in background and other resource materials that addressed issues of environmental liability specific to a possible reorganization of the District, posed legal questions to the Procopio law firm, and spent time discussing and evaluating different methods and approaches to addressing the Board's objectives.

The Committee's Agreement on environmental liability issues aligns with the Board's objectives and the Committee's guiding principles. The details are explained below. See Appendix B.11 for the legal advice provided by Procopio to the Committee on environmental liability issues.

## **B. Major Negotiated Terms**

### *1. Agreement on Remediation Obligations of SMMUSD Under the Court Order*

SMMUSD's obligations to complete remediation of PCBs (polychlorinated biphenyl) in Malibu school buildings, to the extent required by the Court Order is included in SMMUSD's building replacement and renovation program and is scheduled to be completed by December 31, 2019. The Committee agreed that this ongoing remediation program, including the use of ES Measure bond funds to pay for it, would not be affected by reorganization.

The Committee agreed that if any part of this remediation program has not been completed by the effective date of reorganization, SMUSD would be obligated to complete it under the terms of the Court Order, with the terms of project management and completion being subject to negotiation by Group 2, the second of two transition/implementation groups the Committee recommends be appointed. (See Topic #5, Implementation.) p

### *2. Agreement on the Obligation to Remediate Contamination Beyond that Covered by the Court Order*

The Committee agreed that after reorganization becomes effective:

- SMUSD will have no obligation to conduct, be responsible for or be liable for any inspection, remediation or contamination of any land or building in MUSD beyond that mandated in the Court Order;
- SMUSD will be responsible for any remediation obligation arising from contamination in any land or building located in Santa Monica which is owned by SMUSD and in charge of, and responsible for, developing, approving, funding and implementing any required remediation plan arising from such contamination;
- Except to the extent of the obligations imposed on SMMUSD by the Court Order which have not been satisfied, MUSD will be responsible for any remediation obligation arising from contamination in any land or building owned by MUSD and in charge of, and responsible for, developing approving, funding and implementing any required remediation plan arising from such contamination;
- Except to the extent arising out of the performance by SMMUSD of the obligations imposed on SMMUSD by the Court Order, MUSD will indemnify SMUSD for, and defend SMUSD against, any liability, cost or claim (other than liability, cost or claim for personal injury) arising from any contamination in any land or building owned by MUSD or the performance of, or failure to perform, any remediation work associated with such contamination;
- SMUSD will indemnify MUSD for, and defend MUSD against, any liability, cost or claim (other than liability, cost or claim for personal injury) arising from any contamination in any land or building owned by SMUSD or the performance of, or failure to perform, any remediation work associated with such contamination;

- MUSD will indemnify SMUSD for, and defend SMUSD against, any liability, cost or claim for personal injury arising from any contamination in any land or building owned by MUSD whenever such liability, cost or claim is brought by an individual whose first exposure to such contamination occurred following the effective date of reorganization;
- SMUSD will indemnify MUSD for, and defend MUSD against, any liability, cost or claim for personal injury arising from any contamination in any land or building owned by SMUSD whenever such liability, cost or claim is brought by an individual whose first exposure to such contamination occurred following the effective date of reorganization; and
- Each of SMUSD and MUSD will reserve all rights against the other in connection with any liability, cost or claim for personal injury arising from contamination in any land or building owned by SMMUSD whenever such liability, cost or claim is brought by an individual whose first exposure to such contamination occurred prior to the effective date of reorganization.

## Term Sheet for Topic #5, Implementation

### I. Introduction

In its action creating the Committee, the Board outlined the process that will occur directly after the Committee submits its report to the Board. (See Memorandum Report, page 8.) With respect to the implementation of District reorganization, there are several different avenues available. In sum, these avenues are a petition procedure outlined in the State Education Code, State legislation, or some combination of the two.

As stated in the Report, the Committee recommends that the Board consider supporting processing the reorganization matter entirely through State legislation, rather than the petition procedure outlined in the State Education Code or some combination of State legislation and the Education Code procedure. The Committee believes that State legislation would be the best approach for ensuring a comprehensive and legally enforceable result.

The Committee arrived at this recommendation after considering (a) the complexities and inter-relationships of the financial topics addressed by the Committee, and (b) advice of the Committee's legal and education finance consultants that some aspects of dividing the District's finances could only be accomplished via State legislation.

Negotiations on the details of the implementation process were beyond the scope of the Board's objectives for the Committee. However, the Committee agreed it was important to offer a recommendation on how to resolve the financial items identified in the report that, due to various reasons, cannot be finalized until the actual time reorganization becomes effective or in the period post-reorganization.

For this purpose, the Committee recommends the appointment of two groups.

#### A. Group One

The SMMUSD Board should appoint Group One to work on the things that need to happen between the time the Board approves moving forward with reorganization and the time that reorganization becomes effective. The Committee recommends that Group One consist of senior officials and domain experts from both Santa Monica and Malibu who can collaborate to meet the interests of the future SMUSD and MUSD, consistent with the Guiding Principles behind the Agreement outlined in this Report.

Candidate tasks for Group One are:

- Monitoring of any State legislation being drafted after the Board resolves to support and implement reorganization consistent with the Committee's Agreement.
- Making final recommendations about the division of the Fund Balances in the Funds where the allocation method depends on the status of capital projects and expenditures at the time reorganization is scheduled to become effective. (This must be done in conjunction with the next task.)



- Making final recommendations about the apportionment of bonding authority for authorized but-not-yet-issued Measure ES Bonds based on the allocation of Fund Balances as described in the bullet above, as well as the funding necessary for SMUSD to complete the required remediation of Malibu schools.
- With the assistance of a professional actuary, making final recommendations regarding the allocation of the Fund Balance in the Retiree Benefit Fund, and liabilities associated with Compensated Absences and Other Post-Employment Benefits.

## **B. Group Two**

After reorganization becomes effective, the respective Boards of Education of SMUSD and MUSD should appoint Group Two to work on the logistics and any outstanding issues that need to be resolved to ensure a smooth transition. The Committee recommends that Group Two include the Superintendents and Chief Financial Officers from SMUSD and MUSD, as well as Board Member representation from each district.

Candidate tasks for Group Two are:

- Determining the process for SMUSD and MUSD to jointly select a neutral third party to perform the annual Delta calculations, negotiate reasonable and appropriate fees for this work, and evenly split the costs.
- Monitoring negotiations between SMUSD and MUSD for project management and completion of the Court-ordered remediation of environmental contamination in MUSD schools.

## **APPENDIX D**

### **ILLUSTRATIVE REVENUE NEUTRALITY FORMULA PROJECTION**

APPENDIX D

Illustrative Revenue Neutrality Formula Projection

FISCAL YEAR	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
1 SMMUSD ADA	10,462	10,462	10,462	10,462	10,462	10,462	10,462	10,462	10,462	10,462
2 SMUSD ADA	8,715	8,715	8,715	8,715	8,715	8,715	8,715	8,715	8,715	8,715
3 MUSD ADA (For Information Only)	1,747	1,747	1,747	1,747	1,747	1,747	1,747	1,747	1,747	1,747
4 SMMUSD Revenue (Theoretical)	\$134,996,705	\$139,670,720	\$144,679,933	\$149,990,648	\$155,445,435	\$161,138,521	\$167,080,899	\$173,284,090	\$179,900,659	\$186,662,251
5 SMMUSD Rev per ADA (Theoretical)	\$12,904	\$13,350	\$13,829	\$14,337	\$14,858	\$15,402	\$15,970	\$16,563	\$17,196	\$17,842
6 SMUSD Revenue before Payments	\$112,610,966	\$117,730,454	\$121,468,058	\$124,470,259	\$127,663,840	\$130,517,084	\$133,868,096	\$136,875,354	\$140,778,632	\$146,094,552
7 SMUSD Rev per ADA before Payments	\$12,922	\$13,509	\$13,938	\$14,282	\$14,649	\$14,976	\$15,361	\$15,706	\$16,154	\$16,764
8 Delta per ADA	\$18	\$159	\$109	(\$54)	(\$209)	(\$426)	(\$610)	(\$857)	(\$1,042)	(\$1,078)
9 Delta	\$156,724	\$1,382,688	\$947,544	(\$474,159)	(\$1,824,496)	(\$3,713,676)	(\$5,312,752)	(\$7,472,844)	(\$9,081,265)	(\$9,397,851)
10 MUSD Revenue before Payments	\$29,329,594	\$30,416,809	\$31,552,342	\$32,734,109	\$33,964,018	\$35,244,062	\$36,576,315	\$37,962,938	\$39,406,183	\$40,908,395
11 Malibu COLA allowance assumption				2.67%	2.67%	2.67%	2.67%	2.67%	2.67%	2.67%
12 Payment from MUSD to SMUSD	\$0	\$0	\$0	\$0	\$1,096,297	\$1,586,327	\$2,342,762	\$2,699,783	\$2,964,970	\$340
13 Payment Per SMUSD ADA	\$0	\$0	\$0	\$0	\$126	\$182	\$269	\$310	\$310	\$340
14 Interest Accrued in Period	\$0	\$0	\$0	\$0	\$0	\$0	(\$24,291)	(\$61,798)	(\$113,717)	(\$178,669)
15 Cumulative Delta	\$156,724	\$1,539,412	\$2,486,956	\$2,012,797	\$188,302	(\$2,429,078)	(\$6,179,794)	(\$11,371,674)	(\$17,866,873)	(\$24,478,423)
16 MUSD Revenue less Payment	\$29,329,594	\$30,416,809	\$31,552,342	\$32,734,109	\$33,964,018	\$34,147,765	\$34,989,988	\$35,620,176	\$36,706,400	\$37,943,425
17 SMUSD Revenue plus Payment	\$112,610,966	\$117,730,454	\$121,468,058	\$124,470,259	\$127,663,840	\$131,613,380	\$135,454,423	\$139,218,115	\$143,478,415	\$149,059,521
18 SMUSD Revenue per ADA	\$12,922	\$13,509	\$13,938	\$14,282	\$14,649	\$15,102	\$15,543	\$15,975	\$16,463	\$17,104

**Assumptions:**

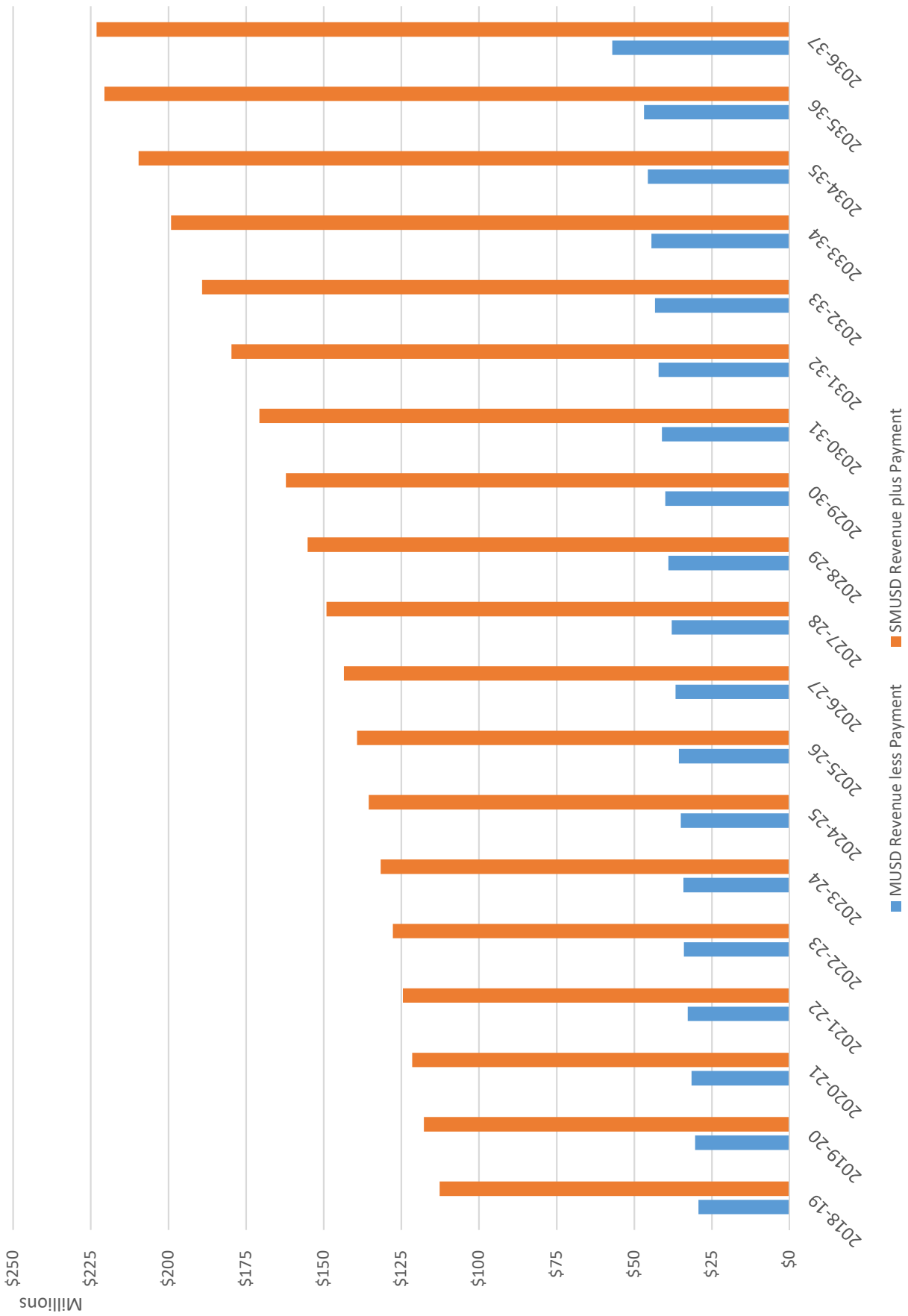
- All Revenue and ADA assumptions are from the revised (Dec. 2016) SSC report baseline case with the following adjustments:
  - Includes Measure GSH revenues
  - Updated ground lease revenues provided by SMMUSD Administration
  - Property Tax revenue adjusted to account for small rounding differences
  - Malibu Revenue assumes Malibu community voters pass a Parcel Tax measure in place of and equal to the current Parcel Tax per parcel amount
  - Malibu COLA, MUSD ADA, and SMUSD ADA remain unchanged from the SSC baseline case assumptions beyond 2029-30
  - Interest paid by MUSD on the Cumulative Delta balance is assumed at the current LA County investment pool rate of 1.0%

APPENDIX D

Illustrative Revenue Neutrality Formula Projection

FISCAL YEAR	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36	2036-37	Total
1 SMMUSD ADA	10,462	10,462								
2 SMUSD ADA	8,715	8,715								
3 MUSD ADA (For Information Only)	1,747	1,747								
4 SMMUSD Revenue (Theoretical)	\$193,722,605	\$201,858,954								
5 SMMUSD Rev per ADA (Theoretical)	\$18,517	\$19,294								
6 SMUSD Revenue before Payments	\$151,652,690	\$158,022,103								
7 SMUSD Rev per ADA before Payments	\$17,401	\$18,132								
8 Delta per ADA	(\$1,115)	(\$1,162)								
9 Delta	(\$9,721,092)	(\$10,129,377)								(\$54,640,556)
10 MUSD Revenue before Payments	\$42,472,018	\$44,085,955	\$45,761,221	\$47,500,147	\$49,305,153	\$51,178,749	\$53,123,541	\$55,142,236	\$57,237,641	
11 Malibu COLA allowance assumption	2.67%	2.67%	2.67%	2.67%	2.67%	2.67%	2.67%	2.67%	2.67%	
12 Payment from MUSD to SMUSD	\$3,515,503	\$4,089,301	\$4,696,657	\$5,339,159	\$6,018,466	\$6,736,308	\$7,494,487	\$8,294,886	\$143,903	\$57,018,807
13 Payment Per SMUSD ADA	\$403	\$469	\$539	\$613	\$691	\$773	\$860	\$952	\$17	
14 Interest Accrued in Period	(\$244,784)	(\$309,288)	(\$372,782)	(\$329,543)	(\$279,447)	(\$222,056)	(\$156,914)	(\$83,538)	(\$1,425)	(\$2,378,251)
15 Cumulative Delta	(\$30,928,795)	(\$37,278,160)	(\$32,954,285)	(\$27,944,669)	(\$22,205,649)	(\$15,691,398)	(\$8,353,825)	(\$142,478)	\$0	
16 MUSD Revenue less Payment	\$38,956,515	\$39,996,654	\$41,064,564	\$42,160,988	\$43,286,687	\$44,442,441	\$45,629,054	\$46,847,350	\$57,093,738	
17 SMUSD Revenue plus Payment	\$155,168,193	\$162,111,403	\$170,683,073	\$179,691,292	\$189,157,947	\$199,106,019	\$209,559,632	\$220,544,115	\$223,090,494	
18 SMUSD Revenue per ADA	\$17,805	\$18,601	\$19,585	\$20,619	\$21,705	\$22,846	\$24,046	\$25,306	\$25,598	

# SMUSD & MUSD Revenues after Payments



## **APPENDIX E**

### **GLOSSARY**

## Glossary

This glossary contains definitions and explanations for the acronyms, words, and phrases that the Committee used during the course of its work. The glossary includes four sections:

Section A:	Acronyms
Section B:	Terms Related to Schools and the Financing of California Schools
Section C:	Terms Adopted for Negotiations and Drafting the Agreement
Section D:	Explanations of Assessed Value of Property, Parcel Tax, and Property Value Within the Context of Reorganization

### Section A: Acronyms

ADA	Average Daily Attendance
AMPS	Advocates for Malibu Public Schools
COLA	Cost-of-Living Adjustment
COPs	Certificates of Participation
EPA	Education Protection Account- Proposition 30
FOC	SMMUSD's Financial Oversight Committee
LACOE	Los Angeles County Office of Education
LCFF	Local Control Funding Formula
MBG	Mandated Cost Block Grant Revenue
MUSD	Malibu Unified School District
OPEB	Other Post-Employment Benefits
PCB	Polychlorinated Biphenyl
SBE	California State Board of Education
SMMEF	Santa Monica-Malibu Education Foundation
SMMUSD	Santa Monica-Malibu Unified School District
SMUSD	Santa Monica Unified School District
SSC	School Services of California, Inc.
TK	Transitional Kindergarten

### Section B: Terms Related to Schools and the Financing of California Schools

#### Average Daily Attendance (“ADA”)

ADA is the average number of pupils actually attending class each school day, and generally equals 95-98% of enrollment. The State requires school districts to collect and report ADA data at two times during the school year: P1 (October) and P2 (April). Whenever ADA is referenced in this Report, it means the P2 ADA.

#### Local Control Funding Formula (“LCFF”)

The Local Control Funding Formula (LCFF), enacted in 2013-2014, is the primary mechanism for distributing State funds to TK-12 school districts in California. It replaced the previous Revenue Limit financing approach, which had been operating for about 40 years. (LCFF definition continues on the next page.)

For school districts and charter schools, the LCFF establishes base, supplemental, and concentration grants in place of many previously separate tax revenue categories, general-purpose block grants, and categorical programs. Under LCFF:

- The State sets a target amount of revenue for each school district based upon ADA and certain other factors. Each district’s share of local property taxes is subtracted from this target and the State funds the difference;
- Any school district that receives enough local property tax revenue to come close to its LCFF target amount, as SMMUSD does today, is entitled to also receive an additional amount of State funding, which is known as “Minimum State Aid.” A district that receives a combination of local property tax revenue, some State LCFF funding and Minimum State Aid is known as a Minimum State Aid district;
- A school district whose property tax revenue meets or exceeds its LCFF target amount (i.e. a “Basic Aid” district), as would be the case for MUSD immediately upon reorganization, but which would not occur in SMMUSD in the absence of reorganization or in SMUSD for many years, also receives Minimum State Aid; and
- A Minimum State Aid or Basic Aid district can provide a higher level of funding for its schools than a district that does not qualify for Minimum State Aid (e.g., SMUSD, at least for several years).

The relevance of the State’s funding formula to reorganization is that SMMUSD would likely maintain Minimum State Aid status and then achieve Basic Aid status sooner than would SMUSD alone due to the disproportionate amount of property tax revenue generated in MUSD on a per ADA basis that would no longer be available to SMUSD. MUSD is likely to become a Basic Aid district immediately. (See Appendix B.7 for a link to SSC’s presentation on school finance in California, which contains more explanation of these issues, including how LCFF affects the finances of reorganization.)

#### **Minimum Guarantee for K-14 Education**

The Minimum Guarantee is a formula, established in 1987 by Proposition 98 that determines the minimum amount of State aid that must be allocated to K-14 educational agencies each year out of the state budget.

#### **Other Postemployment Benefits (“OPEB”)**

OPEB is a term coined by the Governmental Accounting Standards Board (GASB) that refers to benefits (other than pensions) that U.S. state and local governments provide to their retired employees. These benefits principally involve health care benefits, but may include other services such as life insurance and disability.

#### **Proposition 30**

Proposition 30, approved by California state voters in 2012, established higher temporary tax rates for the sales tax and personal income tax on high-income taxpayers. The sales tax rate increase generated about \$1.5 billion/year and expired at the end of 2016. The high-bracket income tax increase generates about \$6 billion/year and was scheduled to expire at the end of 2018, but under Proposition 55 approved by the voters in 2016, was extended until 2030.



### **Transitional Kindergarten**

SMMUSD is considered a Transitional Kindergarten (“TK”) through 12<sup>th</sup> grade school district. TK is a public school educational opportunity for children who turn five between September 2 and December 2, and is the first-year of a two-year Kindergarten program. TK evolved from the Kindergarten Readiness Act of 2010, which changed the Kindergarten and First Grade entrance date beginning in the 2012-2013 school year. Current SMMUSD locations for TK are McKinley Elementary, Will Rogers Learning Community and Webster Elementary.

### **Unification**

Under California State law, the organization or reorganization of a school district is referred to as “unification,” regardless of whether it combines existing separate school districts into a new district, or divides an existing school into separate districts.

### **Unified School District**

In California, a unified school district operates both primary schools, from kindergarten through middle school, and high schools.

## **Section C: Terms Adopted by the Committee for Negotiations and Drafting the Agreement**

### **ADA Method**

A method developed by the Committee for dividing Fund Balances between SMUSD and MUSD at the time of reorganization that accounts for changes in ADA between now and the time of reorganization. The ADA Method is the three-year average of the percentage share of ADA in each district. The three years will be the three fiscal years immediately preceding the fiscal year when reorganization becomes effective. The current Santa Monica/Malibu community ADA ratio is 84%/16%.

### **Agreement**

The Committee’s integrated set of principles, terms, conditions, and related provisions for addressing the topics assigned to it by the Board pursuant to a December 17, 2015 Action Item. The substance of the Agreement is detailed in the Committee’s Report to the Board, which consists of a Memorandum and five Appendices.

### **Board**

SMMUSD’s Board of Education

### **Committee**

The Malibu Unification Negotiations Committee

### **Compensated Absences**

The Governmental Accounting Standards Board defines “compensated absences” as an accrued liability for absences that public sector employees will be paid for, such as vacation and sick leave.

### **Cumulative Delta**

The sum of the Delta for any fiscal year added to any amount of the Delta, plus interest where applicable, remaining unpaid from prior years. A positive Cumulative Delta balance represents a credit to MUSD that will be applied against future negative Deltas. A negative Cumulative Delta balance represents the amount of money owed to SMUSD by MUSD.

**Delta**

The annual measurement of the Financial Effect multiplied by SMUSD’s ADA. A *negative* value (i.e., the revenue per ADA for SMUSD is less than that which would have been realized by a theoretical SMMUSD) creates an obligation on the part of MUSD to make a payment in that amount to SMUSD. A *positive* value (the revenue per ADA for SMUSD exceeds that which would have been realized by a theoretical SMMUSD) will result in a credit to MUSD offsetting future payment obligations.

**Delta Tracking Provision**

This is a provision in the Agreement for ending the annual calculation of the Delta before fiscal year 2029-2030 if relatively small amounts are owed to SMUSD by MUSD for a specified period of time, because that would demonstrate that the two districts are operating independently with no significant adverse Financial Effect on SMUSD. (Appendix C contains the details on the mechanics of the Delta Tracking Provision.)

**District**

Santa Monica-Malibu Unified School District

**Financial Effect**

The difference in Unrestricted General Fund revenue per ADA in SMUSD vs. what that revenue per ADA would have been if reorganization had not occurred and SMMUSD continued to exist.

**Formula**

The Revenue Neutrality Formula (see definition below).

**Group One**

The first of two transition/implementation groups that the Committee recommends be appointed. Specifically, the Committee recommends the SMMUSD Board appoint Group One to work on the things that need to happen between the time the Board approves moving forward with reorganization and the time that reorganization becomes effective.

**Group Two**

The second of two transition/implementation groups that the Committee recommends be appointed. Specifically, after reorganization becomes effective, the Committee recommends that the respective Boards of Education of SMUSD and MUSD appoint Group Two to work on the logistics and any outstanding issues that need to be resolved to ensure a smooth transition to the interactions of the two districts.

**Illustrative Revenue Neutrality Formula Projection (the “Illustrative Projection”)**

This is the spreadsheet in Appendix D that illustrates the application of the Revenue Neutrality Formula. The Committee developed the Illustrative Projection based on the best information available at the time of this writing.

**Malibu Ability-to-Pay Cost-of-Living Adjustment (“COLA”)**

The Malibu Cost-of-Living-Adjustment used in the Formula. The COLA will be the published State Revenue COLA, but if necessary, will be adjusted so that it is no less than 50% and no more than 80% of the annual percentage change in the total assessed value of real property within MUSD.

### **Measure BB Funds**

The facility bond funds made available to SMMUSD as a result of Measure BB, which was approved by District voters in November 2006. Approval of Measure BB authorized the Board to issue bonds backed by assessments on real property in both Santa Monica and the Malibu community in an aggregate amount of \$268,000,000.

### **Measure ES Funds**

The facility bond funds made available to SMMUSD as a result of Measure ES, which was approved by District voters in November 2012. Approval of Measure ES authorized the Board to issue bonds backed by assessments on real property in both Santa Monica and the Malibu community in an aggregate amount of \$385,000,000. At least 20 percent (\$77,000,000) was to be made available for Malibu public schools.

### **Procopio**

Procopio, Cory, Hargreaves & Savitch LLP is the law firm retained by the Committee to provide advice and legal support.

### **Reorganization**

The reorganization of SMMUSD into two separate Transitional Kindergarten (TK) through 12<sup>th</sup> grade public school districts: Santa Monica Unified School District (SMUSD) and Malibu Unified School District (MUSD).

*Note: While the Committee chose to adopt the term “reorganization” for its negotiations and Agreement, this process is also referred to in other contexts as “unification” or “separation.”*

### **Revenue Neutrality**

The Board’s objective to eliminate any significant adverse Financial Effect on SMUSD from the reorganization of the District into two separate districts (SMUSD and MUSD).

### **Revenue Neutrality Formula (the “Formula”)**

The Committee’s agreed-upon method for calculating the Financial Effect of reorganization and related payment schedule that, in the aggregate, results in Revenue Neutrality in SMUSD.

### **School Services of California, Inc. (“SSC”)**

SSC is the education finance consulting firm retained by the Committee.

### **State**

The word “State” refers to the State of California.

### **Theoretical SMMUSD**

After a reorganization of SMMUSD becomes effective, “theoretical SMMUSD” is the term used to refer to what would have been SMMUSD had reorganization not occurred.

### **Topics**

The Committee’s Plan of Work organized the issues the Board directed the Committee to address into five major “topics:” Topic #1: Impact of Reorganization on SMUSD and MUSD Revenues; Topic #2: Division of the District’s Assets; Topic #3: Bond-related Items and Other Liabilities; Topic #4: Environmental Liability; and Topic #5: Implementation.

## **Section D: Explanations of Assessed Value of Property, Parcel Tax, and Property Value Within the Context of Reorganization**

### **Assessed Value of Property**

Assessed Value is the taxable value of property, which includes land and any improvements made to the land, such as buildings, landscaping, or other developments; it is generally not the market value. The Assessed Value of land and improvements is the basis for the 1.0 percent tax rate (the so-called “general levy”) and voter-approved debt rates which are levied as a percentage of this value and account for most of the annual total property tax bill (see **Property Tax**). Thus, owners of properties with higher Assessed Values pay higher property taxes. The County Assessor determines the Assessed Value of individual properties.

Assessed Value of vacant land and property with existing improvements is generally equal to the price of the property at the time of sale (i.e., market value at that time) and adjusted upward by a maximum of two percent per year (pursuant to Proposition 13), until resold, at which point the Assessed Value is re-set at the new purchase price. Assessed Value of single-family homes and certain other land uses is generally increased by the cost of new construction. The Assessed Value of newly constructed income-producing properties (e.g., apartment buildings, office buildings and shopping centers) is based on factors related to their projected annual net operating income.

Factors that affect the overall Assessed Value of property within a school district (and hence the general levy component of its Property Tax revenue), and the degree to which the total Assessed Value (and associated Property Tax revenue) changes year-over-year, include the mix of residential and non-residential properties and vacant land, the overall proportion and mix of properties that remain unsold versus sold, the number and type of properties that are re-sold and newly constructed, and the market value of properties that are re-sold and newly constructed.

Post-reorganization, the Assessed Value of properties within SMUSD and MUSD, and the degree of change year-over-year, will be a function of how the factors noted above play out within each new district. The SSC projections of each new district’s future Property Tax revenues assume, based on historical trends, that SMUSD would account for about 66.4 percent of SMMUSD’s current Assessed Value and would grow at an annual average rate of 5.04 percent; MUSD would account for about 33.6 percent, and grow at an annual average rate of 4.22 percent. The SSC projections used for estimating the Delta assume that in the absence of reorganization, SMMUSD’s Assessed Value would have continued to grow at an annual average rate of 4.78 percent.

### **Parcel Tax**

A Parcel Tax is an annual tax on all parcels of real property within a designated geographic area to pay for a specified governmental purpose. In order to become effective, a Parcel Tax must be approved by at least two-thirds of the voters within that geographic area voting in the election. SMMUSD’s Measure R is a Parcel Tax that is based on a fixed amount charged on all land parcels located within SMMUSD, which is adjusted each year for changes in inflation. The

Measure R Parcel Tax is a “local revenue” separate from LCFF revenue that is also recorded in SMMUSD’s Unrestricted General Fund.

Post-reorganization, the SSC revenue projections assume that SMUSD would continue to levy the existing Measure R parcel tax on the land parcels located within that new school district, and that voters within MUSD would approve a new parcel tax in an amount equal to Measure R, which would be applied to the land parcels in that new school district.

### **Property Tax**

State law imposes a tax on owners of real property and certain other assets (e.g., office equipment). The annual tax amount on real property includes three categories: (1) the “general levy” equal to 1.0 percent of Assessed Value (see **Assessed Value**); (2) voter-improved indebtedness, also based on Assessed Value (e.g., school facility bonds); and (3) special assessments, which are based on particular formulas as approved by voters within particular geographic areas where the special assessment applies (e.g., parcel taxes). Certain properties—including property owned by governments, hospitals, religious institutions, and charitable organizations—are exempt from the general levy, but not necessarily the other Property Tax categories.

Property Tax revenue remains within the county in which it is collected and is used exclusively by local governments. Each dollar of the general levy (i.e., 1.0% x Assessed Value) component of property tax is divided among a number of local government agencies, whose mix and particular allocation varies by location within a county. SMMUSD currently receives approximately 17.0 percent of each dollar from the general levy, which represents the largest source of its LCFF funding (see **Local Control Funding Formula**). SMMUSD also receives an annually-determined amount from the Property Tax to help retire outstanding debt on issued school facility bonds (the revenue from which is recorded in a special Fund). In addition, SMMUSD receives Property Tax revenue from the Measure R parcel tax (see **Parcel Tax**), which is a special assessment.

SMMUSD receives additional property tax associated with the former City of Santa Monica Redevelopment Agency. Although the Agency is in the process of dissolution, these revenues will continue after reorganization becomes effective.

Post re-organization, SMUSD and MUSD would receive Property Tax revenue based on their respective Assessed Values, amounts of bond debt and approved parcel taxes. Because all of the properties generating redevelopment-related property tax revenues are located in the City of Santa Monica, the Agreement allocates all of these revenues to SMUSD.