PASBO/PASA Report:
Third Consecutive Year of Cuts to Student Learning Opportunities As School District Finances Continue to Weaken

June 2013

Introduction

For a third consecutive year, Pennsylvania's public school finances continue to weaken, forcing school districts to once again cut course offerings, increase class size, delay textbook purchases, reduce tutoring programs for struggling students, eliminate summer school, reduce field trips, and cut extra-curricular activities, including sports and close school buildings. The proposed, relatively modest increase in state basic education funding and continued stagnant local revenues are not keeping pace with substantially increased pension, health care and energy costs. With three-quarters of school districts having balanced their budgets in the past two years by using savings, as districts exhaust their savings, they have no choice but to continue to cut programs and staff. A recent survey of school districts shows these cuts will cause additional harm to already reduced educational opportunities available to Pennsylvania's students.

While planned cuts are not as deep as those made in the past two years, the survey indicates the cuts continue to be widespread, impacting three-quarters of the school districts across the state. About half of school district leaders indicate they believe the financial condition of their district will worsen in 2013-14. With four school districts already placed in financial recovery or moderate financial recovery status and the Philadelphia School Reform Commission facing a $300 million budget deficit, additional school districts that are teetering on the edge of fiscal distress are expected to fall into financial recovery status in 2013-14.

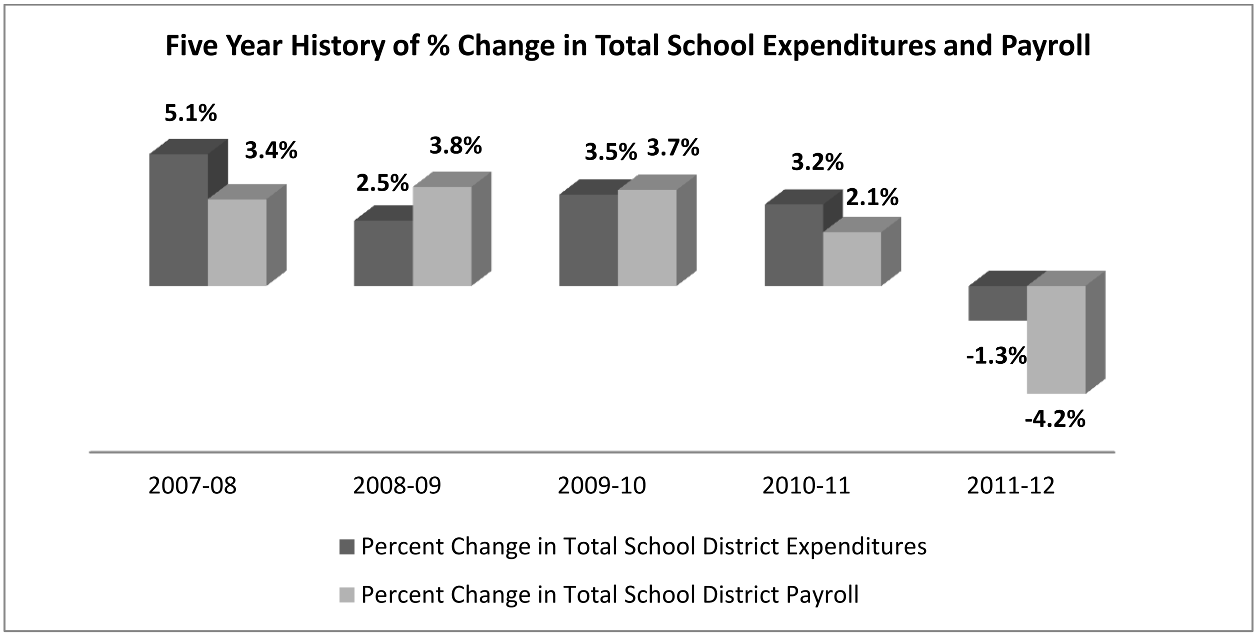
Context

Critical financial problems continue to besiege schools across the state. The past five years have seen unprecedented and historical changes in both school revenues and expenditures. School budgets were bludgeoned after elimination of the federal stimulus and jobs programs (reducing federal aid by more than a billion dollars in 2010-11), with a dramatic reduction in state revenues of $433 million in 2009-10, followed by another reduction of $85 million in 2010-11. Simultaneously, local revenues were eroded by the national economic decline. Adding to school revenue woes, schools were hit with historic increases in the spiraling cost of mandated school pension payments.

The significant cuts in personnel and programs that we have covered in this annual budget survey report in previous years, and again this year, were necessitated by this lethal combination of fiscal events. At the local level, school budgets took a hit in several ways. First, districts lost more than $300 million in investments earnings from the drop in interest rates. Then the Realty Transfer Tax revenue was cut almost in half, dropping from a high of almost $280 million in 2005-06 to less than $150 million in 2010-

11 as a result of the real estate market collapse. Finally, the Earned Income Tax fell by $14 million in 2009-10 as unemployment increased. Combined with the reductions and eliminations in state support of public education, school leaders had no choice but to implement a multi-year reduction in educational programs and staff.

For the first time in decades, school payrolls declined, dropping by more than 4% from 2010-11 to the most recently completed fiscal year (2011-12) and providing budget relief of almost $500 million statewide. To reduce costs, schools implemented extraordinary reductions in personnel via salary freezes, furloughs, unfilled positions and contracting-out for support services. As a result, total expenditures for schools statewide in 2011-12 dropped by $336 million despite growth in costs for pensions, health care benefits, fuel, food and other items.



However, skyrocketing pension rates offset much of the expenditure reduction in personnel costs. In the current fiscal year, pension rates for schools have almost tripled from 2009-10. In the coming fiscal year (2013-14), schools will pay double for pensions what they paid in 2011-12. Looking ahead, the steep pension rate escalation will continue until 2020 when the rate schools pay will be more than 30% of payroll just for pensions. As a point of comparison, the pension rate for schools in 2009-10 was 4%. Using average payroll data from PSERS during that time period, every one percent increase in the rate schools pay for pensions adds $140 million in new pension costs to school budgets. For the next fiscal year, the cost of pensions will escalate by 37% on top of this year's increase of 43%. From the current fiscal year through 2015-16, total pension costs to schools will increase by more than $10 billion statewide.

Despite the enormous fiscal challenges, there is some good news. Local tax revenues appear to be recovering, albeit slowly and certainly not at historical growth levels. Both Earned Income Tax and Realty Transfer Taxes are showing minimal growth. The massive cuts and eliminations of state and federal funding have subsided, and there may be a very small increase in Basic Education Funding for 2013-14.

School leaders will keep their financial fingers crossed to ward off any economic downtown and to urge a stronger recovery that will help boost local tax revenues. Economic growth will help those districts with a robust local tax base, but a stronger economy will not be as useful in higher aid ratio districts where there is no tax base growth.

CUTTING TO THE BONE: A THIRD YEAR OF CUTS HURT STUDENT LEARNING OPPORTUNITIES

Over the last two years, school districts across the state first were forced to cut programs and services that improved the quality of educational experiences available to students but then had to start cutting into core academic programs by increasing class size, reducing elective course offerings and cutting tutoring and summer school programs that assist struggling students. School districts have reduced teacher and support staff by nearly 20,000 through furloughs and unfilled positions. Recent survey results indicate this trend will continue into the 2013-14 school year. The PASBO-PASA survey reveals that:

- Seventy-five percent of school districts statewide plan to reduce instructional programming in the 2013-14 school year. More districts anticipate they will need to cut instructional programs in 2013-14 than in either 2012-13 or 2011-12.

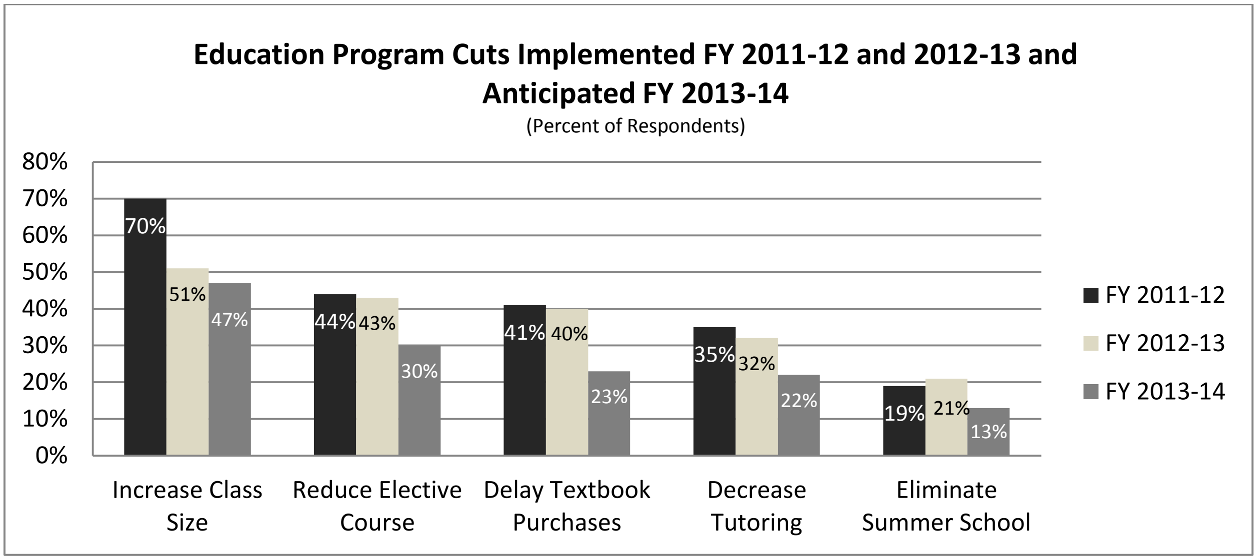
- Forty-seven percent of school districts expect to increase class size in 2013-14. This is on top of larger class sizes imposed by 51 percent of school districts in 2012-13 and 70 percent of school districts in 2011-12.

- Thirty percent of school districts plan to reduce elective course offerings such as those in foreign languages, arts, music, physical education and even some courses in math, science, English and the social studies. Elective courses were already reduced by 43 percent of school districts in 2012-13 and 44 percent of school districts in 2011-12.

- Twenty-three percent of school districts plan to delay the purchase of textbooks in 2013-14. This follows 40 percent of school districts that delayed textbook purchases in 2012-13 and 41 percent that already delayed textbook purchases in 2011-12.

- Twenty-two percent of school districts indicated they plan to reduce or eliminate programs that provide extra help or tutoring for struggling students in 2013-14. Thirty-two percent of school districts in 2012-13 and 35 percent in 2011-12 had already decreased tutoring/additional instructional time for struggling students.

- Thirteen percent of school districts indicated they plan to eliminate summer school programs that provide students the opportunity to make up academic credit that will allow them to be promoted to the next grade level or to graduate on time. This follows elimination of summer school by 21 percent of school districts in 2012-13 and 19 percent in 2011-12.



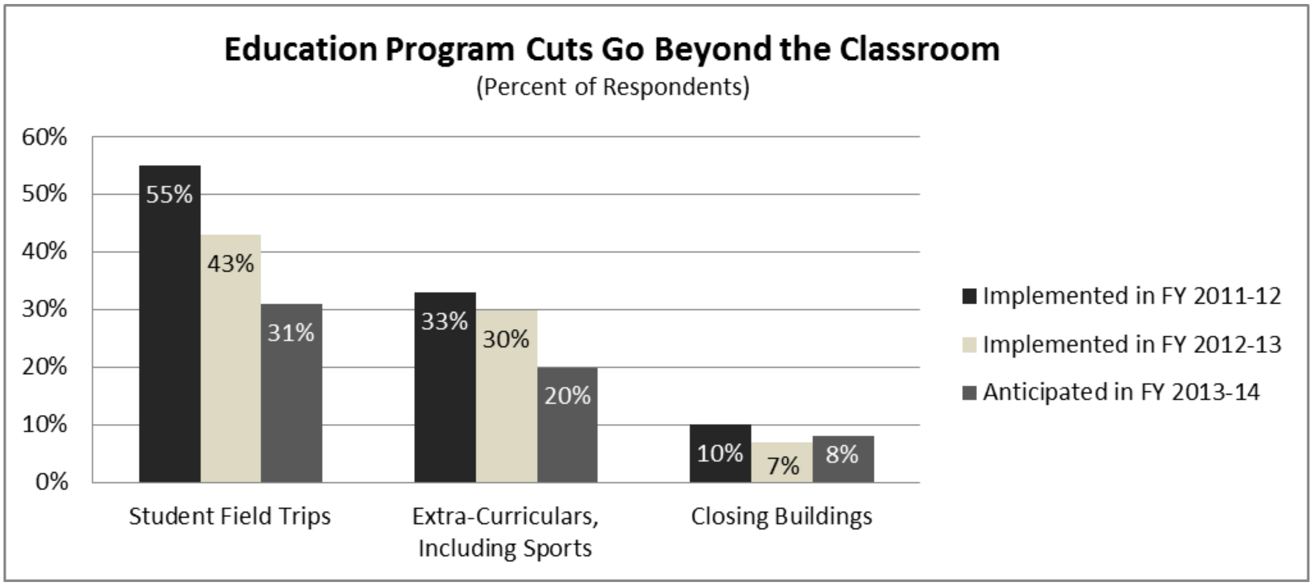
OTHER PROGRAM, ACTIVITY AND SERVICE CUTS

In addition to cuts to programs that directly impact student learning, 70 percent of school districts anticipate needing to make a third round of reductions in programs, activities and services that either supplement student learning or serve the larger community. PASBO/PASA survey results reveal that:

- Thirty-one percent of school districts plan to further reduce or eliminate student field trips in 2013-14. In 2012-13, 43 percent of school districts indicated they had reduced or eliminated student field trips. Fifty-five percent indicated they had reduced/eliminated student field trips in 2011-12.

- Twenty percent plan to reduce/eliminate extra-curricular activities, including sports, or to establish/increase fees for participation in such activities. Thirty percent reduced/eliminated extra-curricular activities and sports in 2012-13 and 33 percent did so in 2011-13.

- Eight percent of school districts plan to close school buildings in 2013-14. Seven percent closed school buildings in 2012-13 and 10 percent closed buildings in 2011-12.



Staffing Reduced

Staffing will continue to decrease in 2013-14, with over 64 percent of districts indicating they will leave positions vacant and over 20 percent planning to implement furloughs. Included in those counts are nearly 450 teaching positions and more than 300 other positions that will be eliminated.

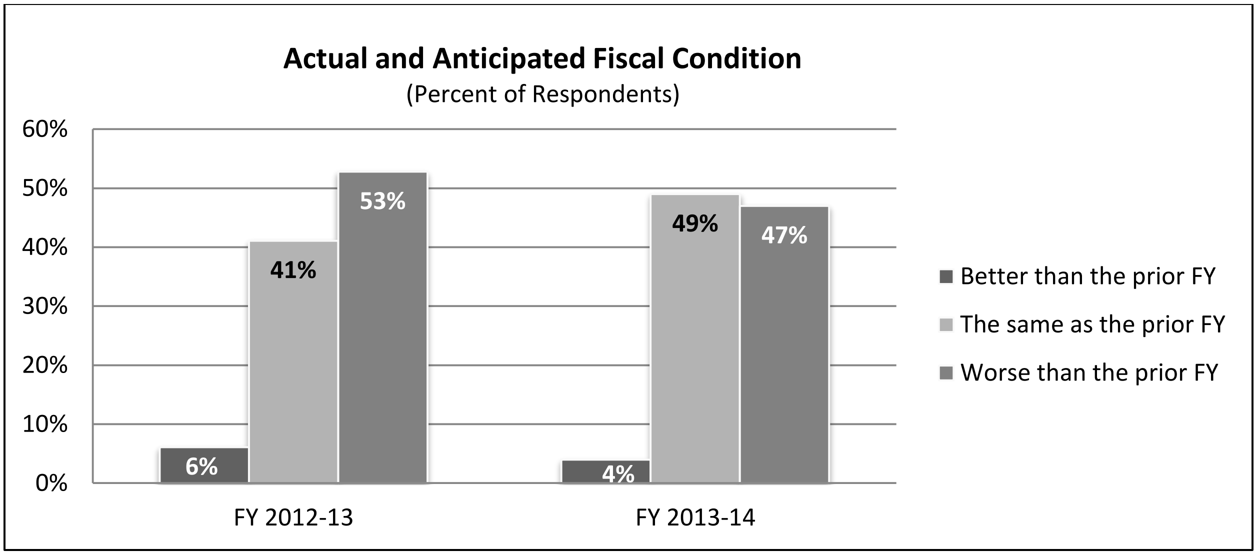
Fifty-one percent of districts implemented a wage freeze in 2011-12, 29 percent did so in 2012-13, and 26 percent anticipate implementing a wage freeze in 2013-14. Of those, 83 percent of teachers, 93 percent of administrators, and more than 70 percent of other employees were part of the wage freeze.

Districts have begun to outsource as well. Ten percent of districts have outsourced their transportation services since 2011-12, 11 percent have outsourced their food service operations, 4 percent have outsourced their custodial services, and eight percent have outsourced technology services.

Overall, school district payroll expenses fell by almost $500 million in 2011-12 and are now less than 2009-10 payroll expenses.

Fiscal Deterioration Continues

The financial conditions now plaguing school districts are not merely a casualty of the perfect storm of negative financial conditions. Unfortunately, we continue to see fiscal deterioration in many districts. In the PASBO/PASA Budget Survey, almost half of the respondents (47%) anticipate their district's financial condition will be worse in 2013-14. Only 4 percent of the respondents indicated their district will be in better financial shape in 2013-14.



As was evidenced in past surveys, more than 7 in 10 districts responded that they will use fund balance to offset expenditures exceeding revenues. Of course, in difficult economic times, the use of fund balance is an appropriate budget strategy; fund balances are built, in part, for this purpose. However, we continue to be concerned about the sustained use of reserves to balance budgets. Eventually, this practice can lead to structural deficits. Prior to Act 1, property tax rates could be increased (usually by significant amounts) to eliminate the deficit. However, schools no longer have that option, especially with the Act 1 Index below two percent for the last three years.

While a small number of districts in the survey (4%) indicated they would expect to end the 2012-13 with a negative fund balance, many other districts are using alarming amounts of their reserves. A review of the fund balance data reported to the PA Department of Education bolsters this concern.

Nine districts reported in their Annual Financial Report that they ended 2011-12 with a negative fund balance, as well as showing a negative fund balance in the previous fiscal year. Simply put, in two consecutive years these districts spent more than their revenue could support. Multiple years of negative fund balance is an indicator of financial distress, especially for districts without a strong local tax base.

Not only are some districts eliminating the fiscal safety net of reserve funds, other districts are reducing the size of the net, some substantially. According to the PDE, in 2011-12, 34 districts reported using 20 percent or more of their reserve funds to balance their budget. A one-time use of reserves in this manner is certainly acceptable. However, a sustained use of fund balance in this manner is fiscally devastating. By our calculation, if sustained at current rates, 58 districts will exhaust their fund balances within five years.

Fiscal deterioration can be remedied for some districts by a strong rebound in the economy. For others, it will take a combination of an economic rebound, additional state support and more drastic cuts in programs and personnel to reduce costs. If state assistance is not forthcoming, we see no solutions to distressed districts becoming financially and likely educationally insolvent.

Unfortunately, there is no relief in sight. The federal government budget sequestration threatens the poorest districts in the state—many of whom are either distressed or on the brink. Moreover, pension expenditures will continue to mount. As a result, we see both a revenue and an expenditure problem in many districts. While one or the other might impose fiscal challenges, the simultaneous attack on both sides of the financial ledger is severely deteriorating school district fiscal conditions.

SEQUESTRATION: THE NEXT FISCAL CHALLENGE

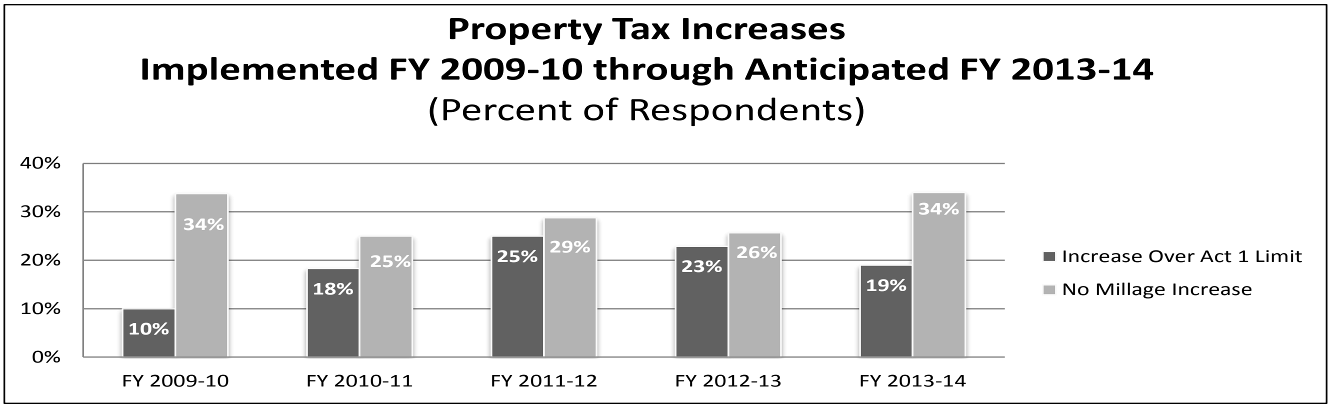
As previously noted, another factor that will have a tremendous impact on school district budgets is the federal sequestration. The failure of Congress to agree on a budget that would reduce the federal deficit by March 1, 2013 set in motion the sequestration, the automatic across-the-board funding cuts proposed in the Budget Control Act of 2011. These spending cuts, which will total approximately $85 billion in fiscal year 2013 and which are scheduled to continue through 2021, will significantly impact federal funding provided to states for elementary and secondary education. The federal sequester cuts several key education line items, including Title I-Education for the Disadvantaged, Title II-School Improvement Programs, and IDEA Part B-Special Education, cuts that will begin during the 2013-14 school year and will be taken from the appropriations available to states beginning in July 2013. The U.S. Department of Education has estimated that the funding for these programs will be cut by 5.1%, with only school nutrition immune to these mandatory reductions.

In Pennsylvania, these across-the-board funding cuts will translate to an over $40 million cut in Title I and Title II funding for next fiscal year, and based upon 2010-11 allocations, a nearly $1 million cut in School Improvement Funding. Additionally, local education agencies will lose approximately $21.4 million in IDEA Part B funding based upon estimates from 2012 allocations.

Unfortunately, these funding cuts will disproportionately impact Pennsylvania's poorest districts, as these federal programs target disadvantaged and special education students. As a result, many districts will be forced to engage in further employee furloughs and will have to shoulder the tremendous burden of the absent federal funds, both of which will impose significant challenges to school districts already facing years of flat state special education appropriations.

IMPACT ON HOMEOWNERS

Cuts in operating costs, administration and instructional programs, combined with the use of reserve funds, have helped many districts to balance their budgets. Many districts have also needed to increase local taxes as well. However, despite the severe financial pressures this year, a significant number of districts (34 percent) have indicated they will <u>not</u> increase real estate taxes this year, while only 19 percent indicate they plan to raise taxes above the Act 1 index.



PlanCon: Financial Challenges of School Construction

School construction funding is another important issue putting a strain on many school district budgets. School districts engaging in school construction and renovation projects are eligible to receive state reimbursement for a portion of their construction costs if they comply with the Department of Education's PlanCon program. While the state reimbursement is based largely on the need of the school district, most school districts simply cannot afford to engage in a needed school construction project without relying on state aid.

Currently, the PlanCon program, administered by the Department, is over-obligated, and a massive backlog of 166 projects waiting to receive state reimbursement has built up. As a result, many school districts that budgeted wisely when planning the financing of their school construction project have been waiting for so long for their reimbursement that they have been forced to increase taxes, make cuts to programs and services, and pay down their fund balances to cover the non-existent state reimbursement. And there is no immediate relief for these districts in sight.

School districts that are contemplating needed school construction but have yet to enter the PlanCon program are also facing significant financial challenges, as a moratorium on new projects entering PlanCon has been in place since October 2012. Consequently, a school district that desperately needs to fix a leaking roof, a failing mechanical or electrical system, address ADA compliance concerns, or provide a more secure entrance to the school will be forced to find a way to finance the project without state reimbursement, increase taxes, pay down fund balances, make budget cuts, or delay or significantly scale back the project. In fact, in 2013-14, 14 percent of school districts reported that they plan to delay construction or renovation of school buildings. Twenty percent did so in 2012-13 and 16 percent did so in 2011-12.

Where Is Mandate Relief?

With rising employee pension and health care costs, increasing special education and charter school costs, and recent cuts in state funding for elementary and secondary education, one critical avenue of relief that could help alleviate future financial troubles for schools and reduce the burden placed on local property taxpayers is mandate relief. With literally hundreds of state statutory and regulatory mandates governing every facet of school district operations, eliminating or reducing these mandates has the potential to diminish the need for school districts to make cuts to instructional programs and personnel to balance their budgets.

Over the past two years there have been several legislative efforts to reduce the burden of many costly mandates on school districts. However, these efforts have not resulted in providing any significant mandate relief to school districts. Despite important discussion surrounding the need to revise the current charter school funding formula, end the payment of prevailing wage on school construction projects, allow school districts to furlough employees for economic reasons, and revise the popular mandate waiver program within the Department of Education, none of these cost-saving measures have been approved by the General Assembly and implemented, much to the dismay of school districts and taxpayers.

Going forward, to ensure that school districts are able to meet the financial challenges of rising costs without being forced to cut valuable programs and services, it is imperative that meaningful mandate relief, such as the elimination of the pension double dip in the charter school funding formula, a local option or significant threshold increase for the implementation of prevailing wage rate requirements, and the restoration of the expired mandate waiver program be enacted. As a critical piece of the puzzle in helping school districts manage their increasing costs, mandate relief should not be delayed further.

This report is based on a recent survey of school districts that was conducted by the Pennsylvania Association of School Business Officials (PASBO) and the Pennsylvania Association of School Administrators (PASA). PASBO and PASA surveyed all 500 school districts in May 2013 to obtain the data included in this report. Responses were received from 187 school districts across the state. The Pennsylvania Association of School Business Officials (PASBO) is a statewide association, 3,000 members strong. It is devoted to providing members with education, training, professional development and timely access to legislative and policy news. The Pennsylvania Association of School Administrators (PASA) represents school superintendents and other school leaders from across the Commonwealth. PASA's mission is to promote high quality public education for all learners through its support and development of professional leadership.

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