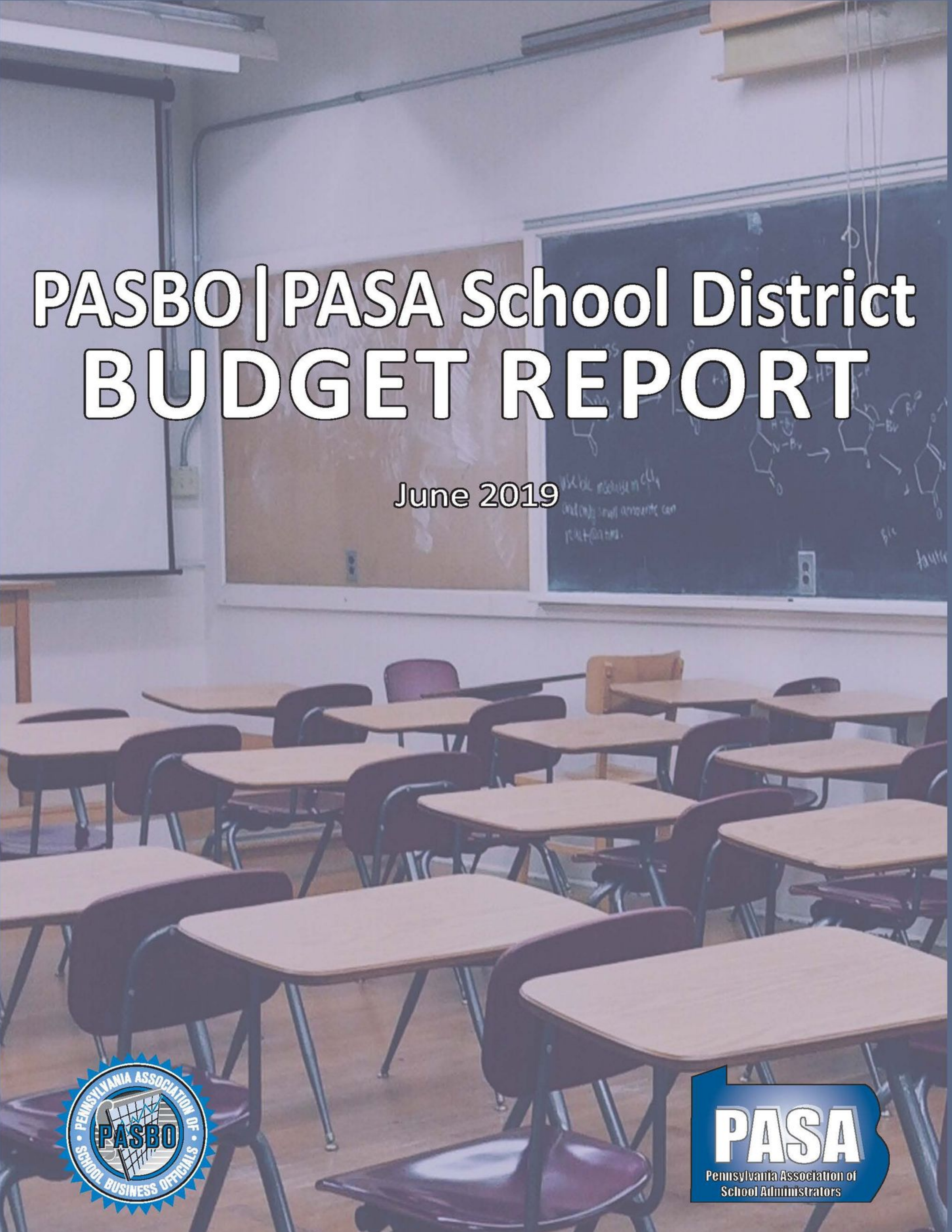
PASBO|PASA School District BUDGET REPORT

June 2019



PENNSYLVANIA ASSOCIATION OF SCHOOL BUSINESS OFFICIALS PASBO

PASA Pennsylvania Association of School Administrators

Introduction

Each spring, as school districts work to finalize their budgets for the next fiscal year, the PA Association of School Business Officials (PASBO) and the PA Association of School Administrators (PASA) conduct a survey to assess the financial pressures that impact school district budget development.

Our spring 2019 survey was conducted in April, focusing on the development of 2019-20 school district budgets. With about 50% of school districts responding to our survey, we were able to better understand the financial challenges anticipated by school districts as they plan for 2019-20 and further into the future.

To provide additional information and context for this report, we used an array of additional data to compile a thorough review of school district financial conditions. In addition to using survey data, we have used 2017-18 statewide Annual Financial Report (AFR) submissions and 2018-19 school district general fund budget submissions, both of which are publicly available from the Pennsylvania Department of Education.

Additionally, we interviewed school business officials to provide some case studies and specific examples of the financial pressures school districts face as they finalize their 2019-20 budgets. Our case studies include Coatesville Area School District in Chester County, Lebanon School District in Lebanon County, Sto-Rox School District in Allegheny County and Titusville Area School District in Venango, Crawford and Warren Counties.

The results of our survey and additional data reaffirm the fact that a severe amount of fiscal stress exists across Pennsylvania's school districts, and it continues to have significant impact on our public education system.

The current situation is unsustainable in many school districts across the commonwealth, and without continued increased investment in education—along with needed policy changes to curb some mandated costs—the fiscal stress will continue, the burden on taxpayers will grow and educational opportunities for students will diminish.

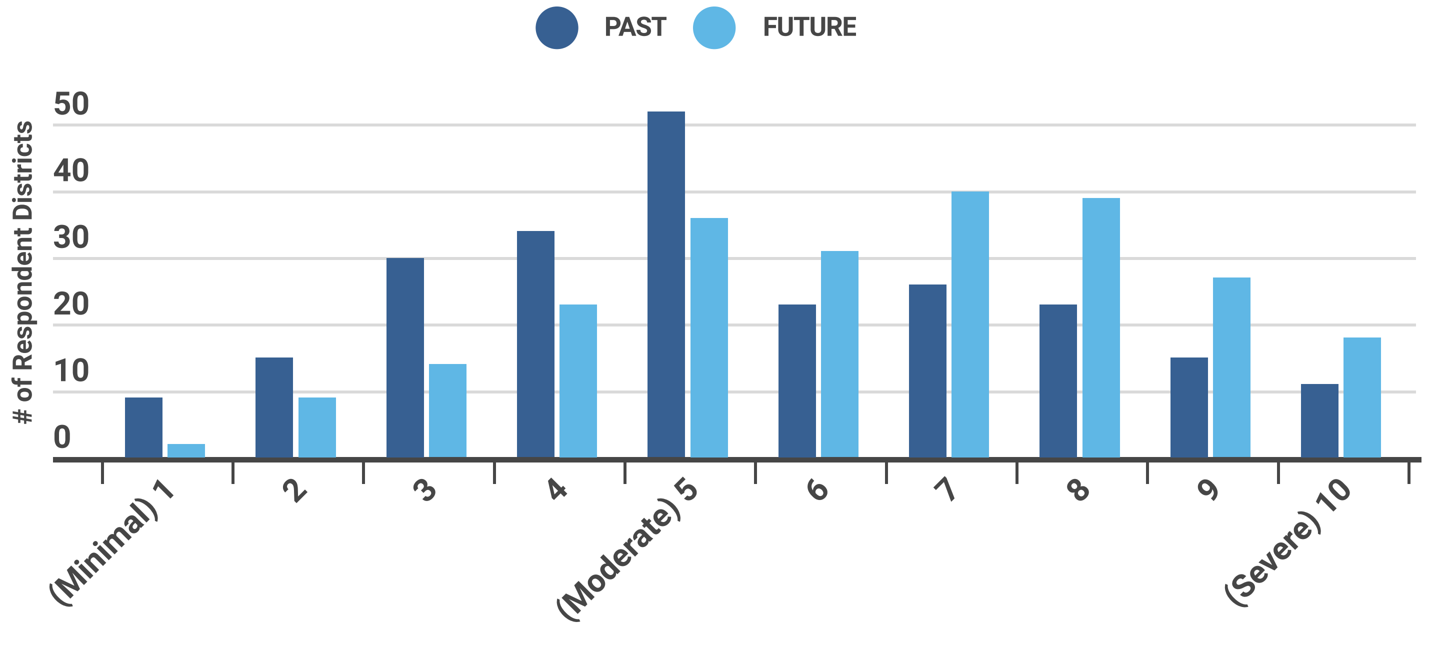
Feeling the Fiscal Stress

As part of our survey, we asked respondents to indicate the level of fiscal stress their school district experienced over the past three fiscal years and the anticipated level of fiscal stress they anticipate over the next three fiscal years. Respondents were asked to rate their district's fiscal stress on a scale of one to ten.

The graph on the next page illustrates the responses to both the past and future fiscal stress survey questions. Over the past three fiscal years, the median level of reported school district fiscal stress was 5.0; however, looking forward into the next three fiscal years, the median level of anticipated school district fiscal stress increased to 6.3, and almost 52% of respondents reported an anticipated future fiscal stress level greater than 6.0.

There were 160 school district respondents that anticipated a higher level of fiscal stress for their school district in the next three fiscal years compared to the prior three fiscal years. For those districts, the average anticipated fiscal stress level for the future increased by 2 when compared to the fiscal stress of the past. This indicates that these respondents expect financial conditions in their school district to become more challenging in the future.

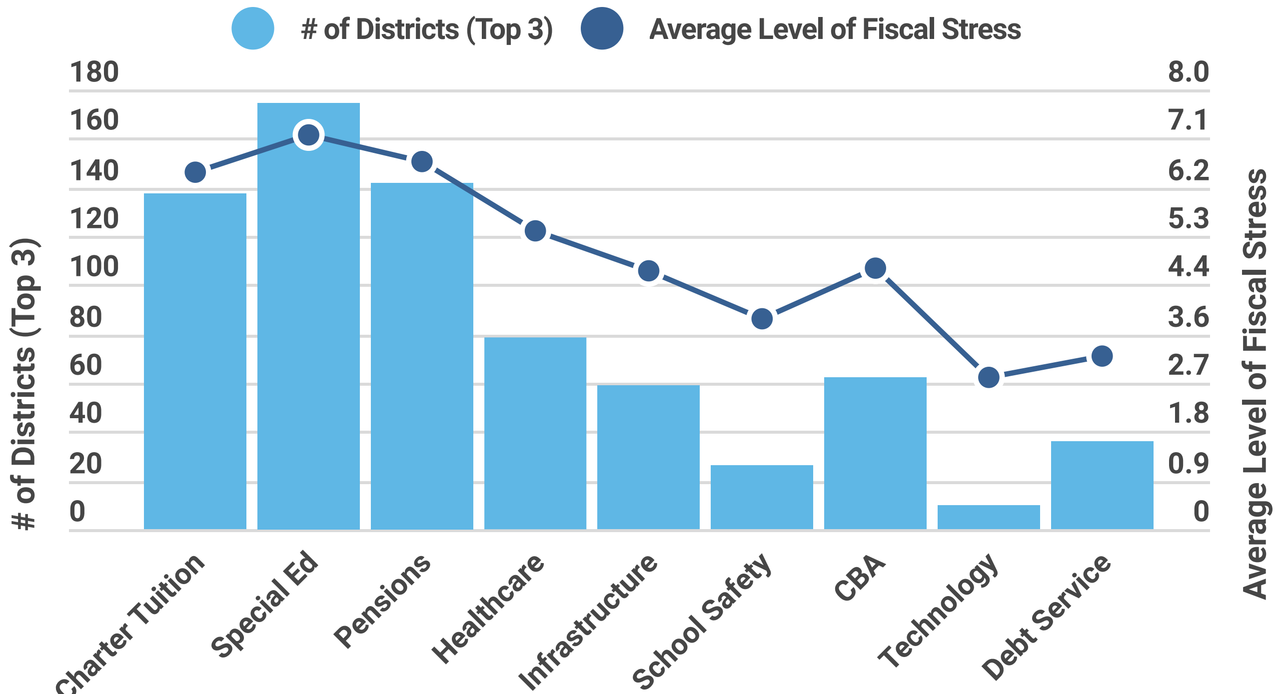
Figure 1. School district fiscal stress for the past 3 fiscal years compared to future school district fiscal stress.



Source: PASBO/PASA budget survey results

What caused this anticipated increase in fiscal stress for so many school districts? Respondents were asked to rank the factors contributing to their anticipated future fiscal stress. Not surprisingly, when we looked at the survey responses, the factors most consistently ranked as the top three reasons for projected school district fiscal stress were special education costs, charter school tuition costs and pension costs. As each of these areas represents a mandated cost for school districts that is entirely or, at least largely, beyond their control, district efforts to balance growth in these areas is limited to increasing local property tax revenue, identifying other budgetary areas for program cuts or reductions or both.

Figure 2. Reasons for anticipated future school district fiscal stress.



Source: PASBO/PASA budget survey results

Annual Cost Growth

Given the fact that mandated costs drive school district budgets and budgetary decision-making, we reviewed recent changes in overall school district expenditures to see the extent to which these mandated costs have contributed to past fiscal stress.

On a statewide basis, school district operating expenditures increase year to year. Using recently released 2017-18 AFR data, total school district operating costs increased by nearly $1 billion over 2016-17, primarily fueled by the growing mandated costs for special education, charter school tuition and pensions, which accounted for more than 70% of this total increase.

The annual growth in the big three mandated costs for charter school tuition, special education and pensions from 2016-17 to 2017-18 explains the resulting fiscal stress for school districts. Charter school tuition grew by 10%, and school districts paid charter schools $1.8 billion in 2017-18. Likewise, pension costs increased by nearly 11% to $3.7 billion and special education costs grew by 4.26% to $4.6 billion in 2017-18.

Figure 3. Statewide increase in mandated charter school tuition, special education and pension costs between 2016-17 and 2017-18.

10.18%

$1.82 Billion (2017-18)

Percent increase in charter school tuition costs for school districts from 2017-18 over 2016-17.

4.26%

$4.56 Billion (2017-18)

Percent increase in special education costs for school districts from 2017-18 over 2016-17.

10.76%

$3.74 Billion (2017-18)

Percent increase in pension costs for school districts from 2017-18 over 2016-17.

Source: PDE AFR data 2016-17 and 2017-18.

The statewide annual rates of increase noted above are not sustainable for many districts. While these rates are a statewide total average, for those districts exceeding the averages, balancing their budget is just that much more difficult. While the extent of the growth in these mandated costs varied by district, the median school district experienced a 7.8% increase in these three combined mandated costs in 2017-18.

Looking just at the growth in these mandated cost increases between 2016-17 and 2017-18, costs for charter school tuition, adjusted special education and pension costs grew by $704 million statewide. The growth in these three mandated costs consumed nearly $0.87 of every new dollar in state funding and local property tax revenue last year.

Drilling down to look at some individual school districts, Lebanon School District has experienced recent significant growth in special education costs, which is responsible for much of their fiscal stress. Lebanon School District is a growing urban school district of about 5,200 students in Lebanon County. The district's median household income is $38,500, well below the state median, and more than 73% of the students are economically disadvantaged.

In 2017-18, Lebanon School District spent nearly $11.7 million on special education costs, an expenditure that has grown an average of 12% annually over four years. With 21% of the student population receiving special education services, there are multiple reasons for these cost increases. In conjunction with having a high transient population, Lebanon School District has experienced a significant increase in special education enrollment over the past several years.

They have also experienced an increase in the number of students requiring more extensive special education programs and services. As a result, costs for special education transportation, autism support services and occupational/physical therapy services have increased. The district has also had to hire additional personal care aides and continues to pay for students to attend specialized education programs outside of the district.

While mandated special education costs increases aren't unique to Lebanon School District, for them, the increases over the past several years have consumed more than 75% of all of their property tax increases during that same time frame, leaving little room for mandated cost growth or growth of any other operating costs.

Similarly, Coatesville Area School District has experienced significant growth in its mandated charter school costs. Coatesville Area School District in Chester County has 8,700 students and a growing budget that topped more than $156 million in 2017-18. The district's median household income is just over $71,000, among the lowest in the county, and approximately 61% of the students are economically disadvantaged.

From 2013-14 to 2017-18, the district's charter school costs increased by more than $18 million, increasing by an average of 25% per year and resulting in extraordinary fiscal stress. This rapid cost growth is due to an increase in the charter school tuition rate and an increase in the number of students attending charter schools, which has grown to more than 2,800 students in 2018-19—an increase of more than 1,000 students over the past several years.

In addition to property tax increases, the district has closed schools, reduced program costs and used reserves to balance their budget, but the fiscal stress of this mandated cost continues—and increases—going into the future.

Sto-Rox School District in Allegheny County has grappled with increases in two major categories of mandated costs. With a budget of about $27 million, Sto-Rox School District is responsible for about 1,700 students each year. In Sto-Rox, the median household income is just $33,500, far below the statewide median of nearly $57,000, and 84% of the students are economically disadvantaged. As their mandated costs for special education have increased, it has driven corresponding increases in their charter school tuition costs.

With nearly 25% of their school district and charter school population requiring special education services, Sto-Rox School District has experienced a recent increase in the number of special education students requiring extensive special education programs and services that must be provided outside of the district. This has dramatically increased their special education costs. As a result of the rising special education costs in the school district, their charter school special education tuition rate has grown rapidly as the required charter school tuition calculation ties the two together. While the regular charter school tuition rate is $7,798 per student for 2018-19, the special education tuition rate is now $26,595 per student. With more than 500 charter school students, this has added to the district's massive fiscal stress.

The Education Deficit

In our last budget report, we compared changes in mandated school district costs for special education, charter school tuition and pensions to the changes in corresponding state funding. The difference represents the education deficit—the amount of mandated school district costs that are borne by the school district and local taxpayers.

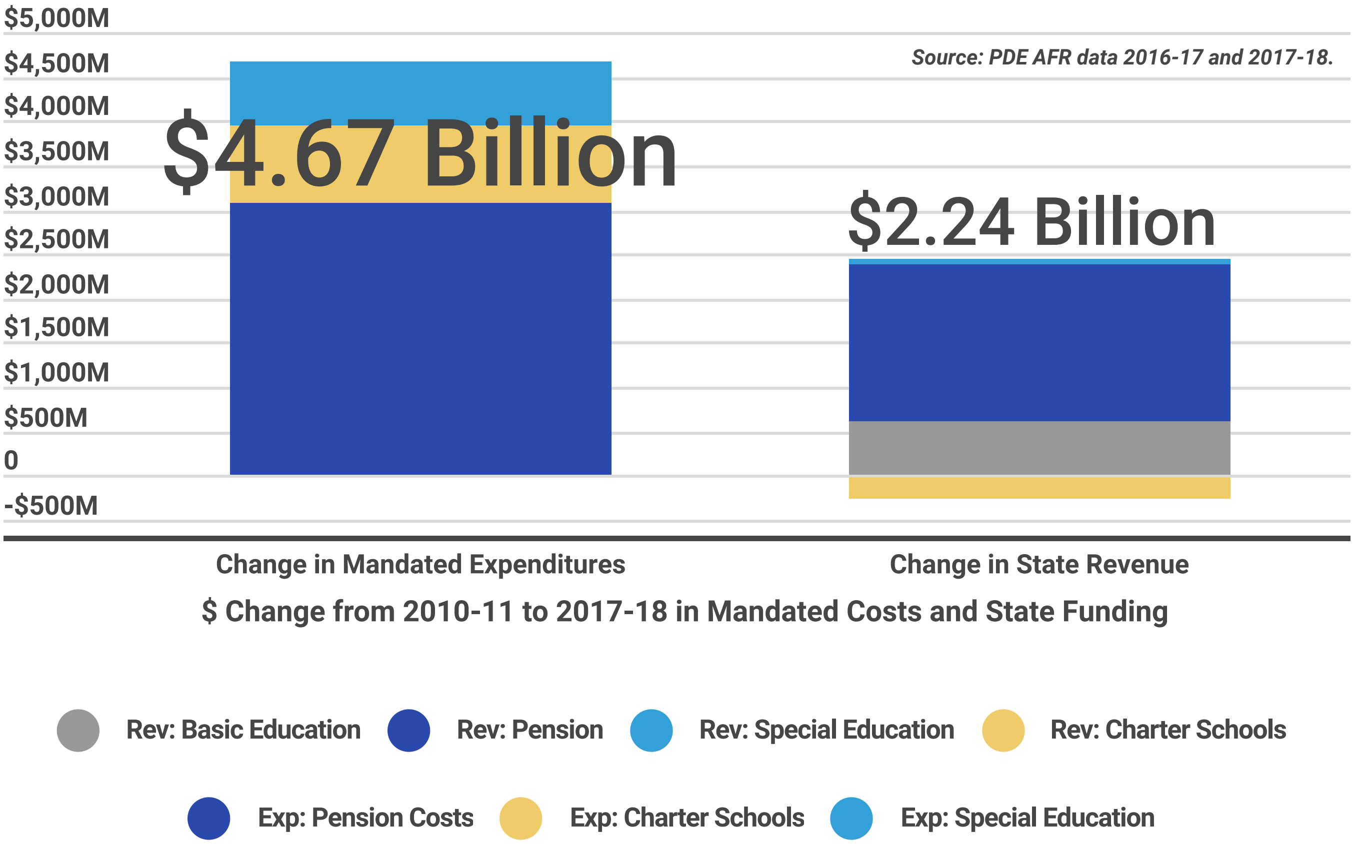
While shared local and state school funding is public policy in the commonwealth, for many districts, annual increases in state funding are simply passed through to state mandated costs, leaving local funding and/or local program reductions to balance the budget.

To calculate the education deficit, we examined school district mandated costs for pension, charter school tuition and special education (excluding special education pension costs and special education charter tuition costs to avoid double-counting costs included under total pension and total charter tuition). Between 2010-11 and 2017-18, these costs increased by a whopping $4.67 billion.

During the same time, state support for these costs through increases in basic education funding, special education funding and pension reimbursement (we also factored in the elimination of the charter school reimbursement) resulted in a total increase of $2.24 billion in state funding.

Comparing mandated costs increases to state funding increases, the education deficit grew to $2.43 billion—an increase of more than $370 million in 2017-18. That means that school districts made up the $2.43 billion increases in mandated costs through property taxes increases, cuts to programs, services and staff or both.

Figure 4. Education Deficit: Increase in mandated costs and supporting state revenues from 2010-11 to 2017-18.



The Education Deficit: Property Taxes & Board Authority

To cover the massive education deficit, many school districts turn to property taxes to raise the revenue necessary to balance their budgets. The ability to raise property tax revenue, however, is different for every school district, and this difference highlights another component that adds to school district fiscal stress.

As discussed in our fall 2018 budget report, not all school districts are equal when it comes to their tax base. In examining assessed value (AV)—the value upon which property taxes are based—not all school districts experience AV growth from year to year. In fact, on average over the last seven years, about 20% of school districts experience an AV decline from one year to the next, meaning that they need to increase property taxes just to generate the same property tax revenue as the prior year.

Exacerbating the funding variability in school districts with AV decline is the Act 1 index, which establishes a maximum amount by which property taxes can be increased without a voter referendum or an exception granted by the Department of Education.

When we examine the extent to which an increase in property taxes will cover a school district's total mandated cost increases, we can see just how difficult it is for school districts to make up this education deficit. By measuring a school district's ability to cover its mandated cost increases within its Act 1 index, we identify a school district's board authority—i.e. the percentage of the prior year budget that the school district can raise in additional revenue within its Act 1 index.

To illustrate the measurement of board authority, we'll examine a fictional school district that relied on property taxes to fund just about 50% of its $60 million operating costs in 2018-19. With an Act 1 index for 2019-20 of 2.5%, the district's board authority would be 1.25%—meaning, effectively, that for 2019-20, the district could raise up to 1.25% of its $60 million budget in additional property tax revenue (without exceptions)—or just around $750,000.

Figure 5. School district board authority example.

Total 2018-19 School District Budget	$60 million
Total Local Share of Operating Costs	50%
2019-20 Act 1 Index	2.5%
Board Authority (Total Local Share x Act 1 Index)	1.25%
Revenue generated by Board Authority (Board Authority x 18-19 Budget)	$750,000

For most districts, the amount that can be generated through their board authority doesn't begin to cover increases in their mandated costs for pension, charter schools and special education, let alone pay for other needs or priorities. With limited board authority to generate additional property tax revenue, many school districts must rely on state revenue increases or cost avoidance/reductions to balance their budgets. They have little room to maneuver.

From a school district's perspective, the gap that exists after accounting for maximum additional property tax revenue illustrates exactly why state funding is so critical to school districts each year. This funding is especially critical for those school districts that are experiencing AV decline, as some or all of their board authority could be consumed just to maintain the prior year's revenue before any consideration of mandated costs.

Overall, the growth in mandated costs is unsurmountable at the local level for many districts, as board authority doesn't begin to allow districts to cover these costs with property tax increases alone. Even by maximizing board authority, without increasing state support each year, most school districts would have to turn to massive reductions to programs, services and staff just to cover mandated cost growth.

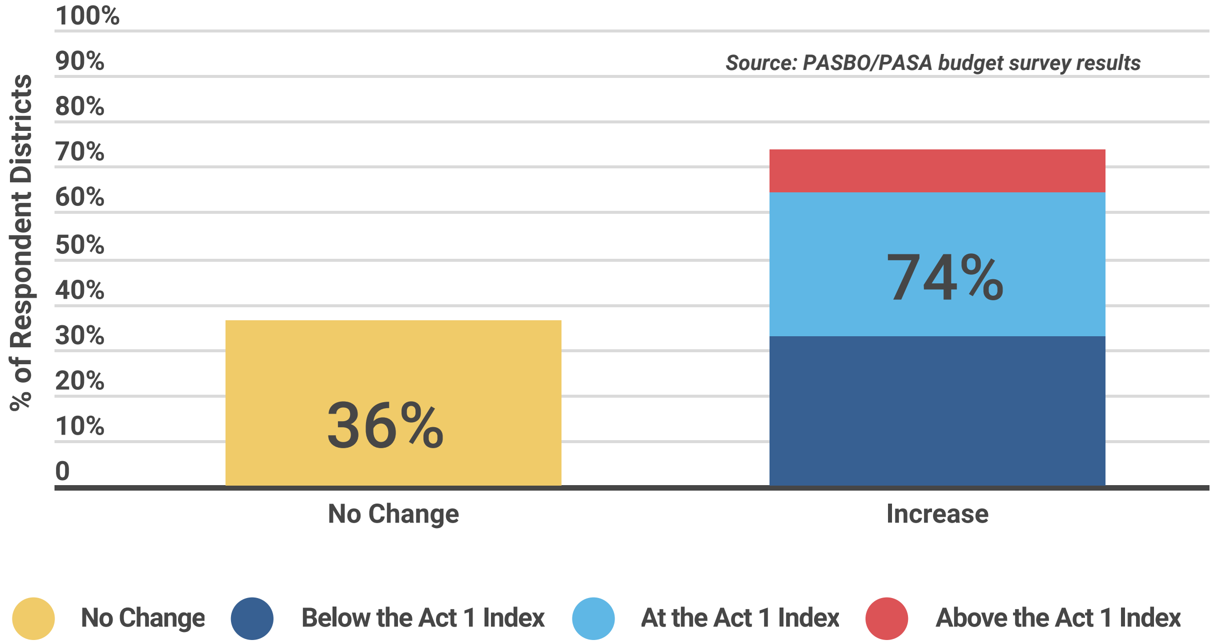
Building 2019-20 School District Budgets

As school districts are finalizing their 2019-20 budgets, they are grappling with how to mitigate the fiscal stress of mandated cost increases, how to move forward with educational or operational priorities and how to pay for all of it without overburdening taxpayers or reducing programming, services or staff. While this process and the priorities are different in all 500 school districts, one thing is universal: expenditures have to equal revenues—the budget must be balanced.

To balance school district budgets in 2019-20, about 74% of survey respondents indicated that they anticipate the need to raise property taxes to some degree, with the majority of those respondents expecting to either raise taxes to or just below their Act 1 index. We note that this is the first year of our survey in which no respondents indicated they were reducing property tax rates.

While about 20% of respondents indicated that they applied to the Department of Education for Act 1 exceptions, just less than 10% of respondents indicated that they anticipated raising property taxes above their Act 1 index. The majority of those indicating they anticipate using an exception to raise property taxes above the Act 1 index in 2019-20 noted that they expect to use the special education exception, which comes as no surprise.

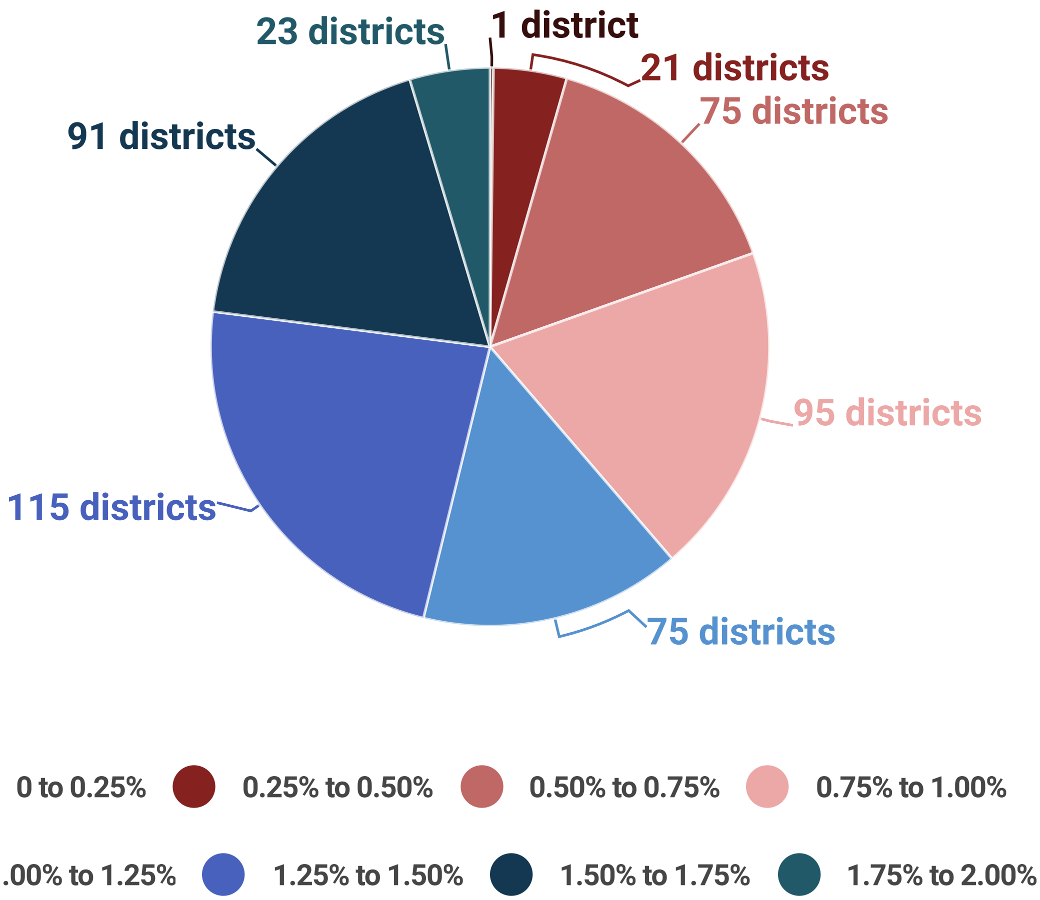
Figure 6. Anticipated school district property tax increases for 2019-20.



In the context of property tax increases, it's important to recall the discussion of limited board tax authority and assessed value changes from year to year.

For 2019-20, the median board authority across all school districts is 1.19%—meaning that a school district generally has the ability to raise 1.19% of its 2018-19 budget to begin to cover its mandated and all other cost increases in the 2019-20 school year. Recalling that board authority represents the percentage of a school district's 2018-19 budget that can be raised in local property tax revenue for 2019-20, the graph below illustrates the number of school districts at each range of board authority.

Figure 7. Number of school districts at each range of school district board authority for 2019-20.



Source: PDE General fund budget data, AFR data and 2019-20 Act 1 index data

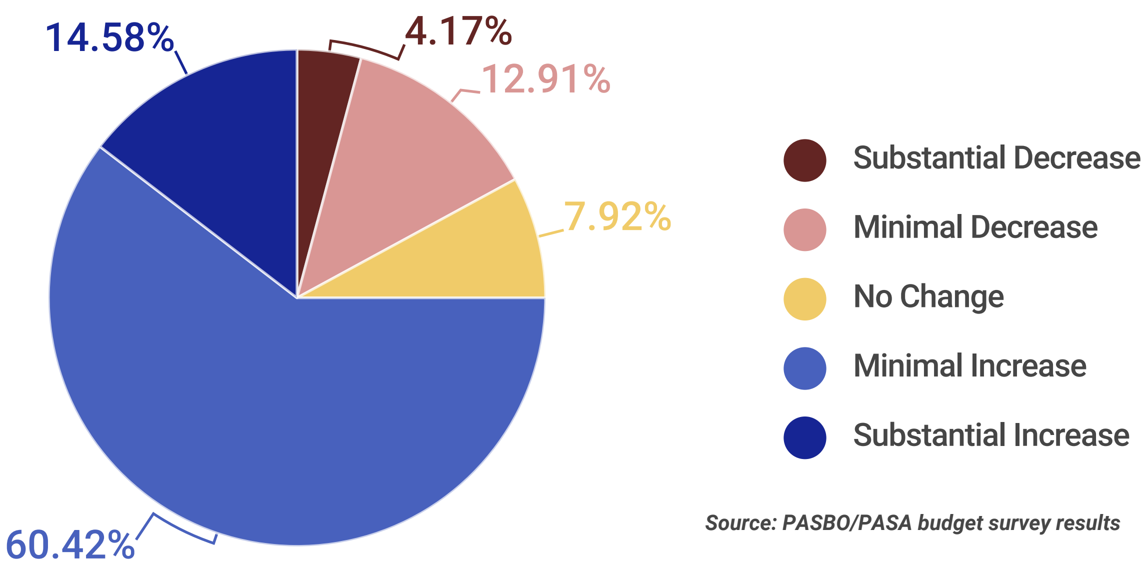
While 1.19% is the statewide median, the board authority across school districts varies widely, and nearly 40% of school districts have a board authority that is less than 1.00%—meaning that those districts can't even raise 1% of their 2018-19 budget to cover increasing mandated costs in 2019-20. With the average increase in mandated costs statewide being 2.75% of total operating costs, for the school districts with minimal board authority, the fiscal stress related to mandated cost increases is most significant.

For those districts whose mandated costs exceed or significantly consume their board authority, two concepts emerge. Those districts are totally dependent on state funding increases to avoid program reductions, and for many, it means that a yearly property tax rate increase is required.

Additionally, each school district's AV—the value upon which property taxes are based—changes have an impact on the ability to generate new revenue from year to year. School districts anticipating AV increases are able to generate at least some revenue through this natural growth. In some cases, this natural growth could mitigate the need for or the extent of property tax increases. About 69% of survey respondents anticipated at least some minimal AV growth in 2019-20, which could allow them to get a head start on covering some mandated cost increases through some natural growth in their tax base.

Other school districts, however, aren't as lucky. While about 8% of survey respondents indicated that they anticipated no change in their AV between 2018-19 and 2019-20, about 17% of respondents indicated that they expect their AV to decrease to some extent.

Figure 8. Percentage of school district respondents anticipating changes in assessed value for 2019-20.



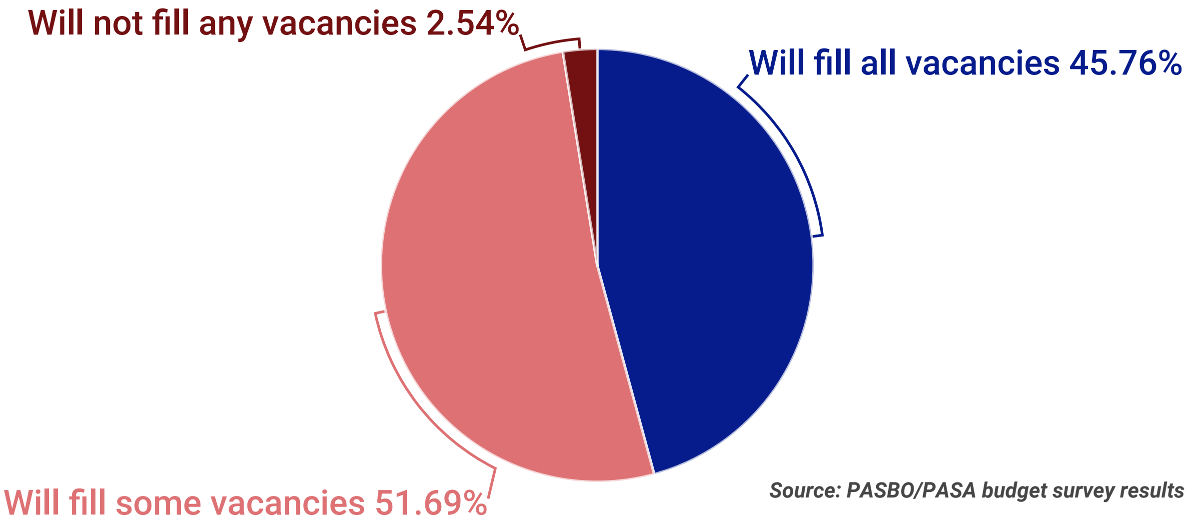
Source: PASBO/PASA budget survey results

The school districts facing AV decline are likely facing the greatest challenges in finalizing their 2019-20 budgets. With an Act 1 index and limited board authority, a decline in AV means that the district needs to raise property tax rates just to maintain level revenue from the prior year. Depending on the extent of the AV decline, there may be no room to even begin to cover mandated cost increases through local revenue increases.

In addition to property tax rate increases, school districts are also expecting to make some other changes to their programs, staff and services to balance their 2019-20 budgets. With pension costs one of the big three mandated cost increases for school districts, staff reductions are always on the table. Survey respondents were asked if they anticipated reducing professional staff, support staff or administrative staff in 2019-20 by attrition or other reductions. Nearly 40% of respondents indicated that they had planned on some staff reduction for 2019-20.

Additionally, we asked if respondents planned to fill all vacancies created in 2018-19 by retirements or resignations. While it's positive that nearly 46% of respondents indicated that they planned to fill all vacant positions in 2019-20, the remaining 54% of respondents indicated that they anticipated leaving at least some vacancies unfilled in 2019-20. For perspective, according to the 2017-2018 AFR data, for every dollar of salary, districts paid an additional $0.64 in benefits. Districts are clearly using caution and deliberate strategy to hire or replace staff only as needed. Salary pressures in today's economy continue, but the associated benefit cost per employee (new or existing) has never been higher.

Figure 9. Anticipated school district efforts to fill vacancies in 2019-20.



Source: PASBO/PASA budget survey results

School District Snapshots

As school districts finalize their 2019-20 budgets, conversations about cost increases, educational priorities, property tax increases, cuts and reductions to programs, staff and services and balancing all of the above are happening in board rooms across the state.

In Lebanon School District, they are trying to tackle their increasing special education costs in 2019-20 by maximizing state and federal education funding. They have applied for an Act 1 exception for special education and have built a budgetary reserve to cover emergencies or a situation in which special education costs increase dramatically and unexpectedly in the middle of the school year. They have larger class sizes at both the elementary and middle levels in comparison to their counterpart districts in the county. Additionally, they are continuing to defer needed renovations and expansion of their middle school because there is no capacity to cover those costs when special education cost increases are consuming every available additional dollar and the state PlanCon program remains in a moratorium.

In Coatesville Area School District, they are focused on trying to mitigate the extraordinary increase in their charter school costs for 2019-20 by minimizing the number of additional students enrolling in charter schools. While Coatesville's board authority would allow them to generate up to $2.8 million in additional revenue for 2019-20, they anticipate that their charter school costs alone could increase by up to $12 million next year, depending on the extent of additional charter school enrollment. In addition to raising property taxes, they are focused on refinancing, examining transportation efficiencies, closing a school and using a significant portion of their reserves just to try to balance their 2019-20 budget.

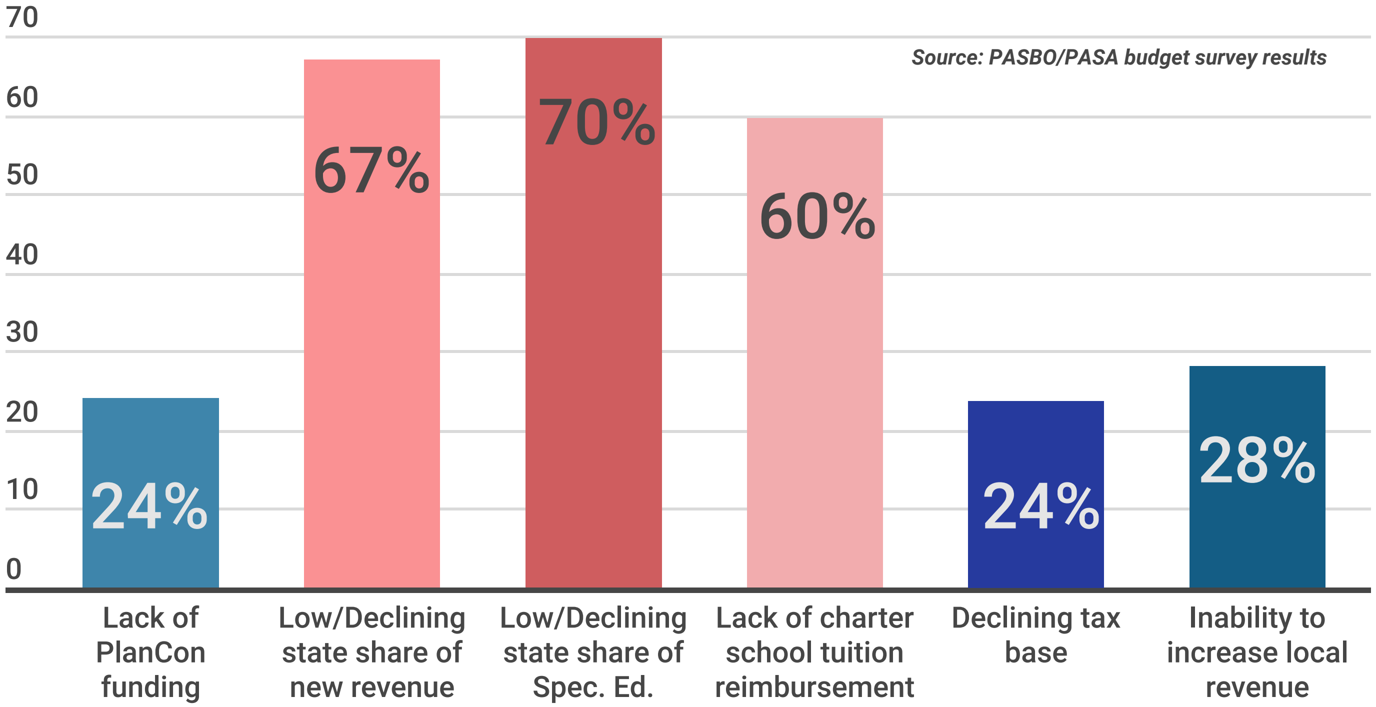
Sto-Rox School District is grappling with its increasing fiscal stress and a $3.7 million deficit in 2019-20. The school district's board authority is only 0.81%, meaning that they can only generate about $222,600 based on their 2018-19 budget and their 2019-20 Act 1 index. To balance their 2019-20 budget, they will defer needed building maintenance and improvements. They will continue without technology upgrades for students and staff. They will continue with large class sizes, especially at the elementary level, and they will not fill all of their vacant positions.

Conclusion

While this report highlights the fiscal challenges faced by school districts across the commonwealth and the limited ability school districts have to cover mandated cost increases locally, the real takeaway is the extraordinary need for increased state support as well as policy changes to mitigate these constant and compounding mandated cost increases.

This fact came through loud and clear when respondents were asked to assess their greatest concerns in terms of revenue for the next three fiscal years. While respondents had a mix of options involving both state and local revenues, there was stark consistency in the responses. Nearly 70% of respondents ranked a low or decreasing state share of special education costs as one of their top three revenue-related concerns, while more than 66% of respondents ranked a low or decreasing share of new state revenues in their top three. Not surprisingly, 60% of respondents identified the lack of any state reimbursement for charter school costs as one of their top three revenue-related concerns going forward.

Figure 10. Most significant school district revenue concerns in the next three fiscal years.



Titusville Area School District exemplifies these state revenue-related concerns. With a $35 million budget for 2018-19, Titusville Area School District is responsible for 2,000 students in Venango, Crawford and Warren Counties. The district's median household income is slightly more than $43,000 (below the statewide median), and nearly 62% of their students are economically disadvantaged.

Responsible and conservative in budgeting, the school district operates efficiently in every way while still offering students a wide array of programs, supports and services. They planned carefully to cover increasing pension costs and consistently use committed fund balance for this purpose. They right-sized the district when enrollment was declining, and they have instituted appropriate programs and supports to assist students and the community as they deal with rising poverty rates.

However, with minimal board authority and so much of their budget reliant on state funding, this otherwise stable district anticipates major future fiscal stress if the state's share of education funding doesn't begin to increase. Titusville Area School District simply has no wiggle room. They don't have a fund balance to offset a reduction in state revenue, and they can't cut programs, services and supports at the time when their students and community have an increasing need. They're stuck, and there's no way forward unless state support increases each year.

With limited board authority and rising mandated costs, Titusville Area School District is not alone in its predicament, as school districts become ever reliant on additional state funding to close the gaps in their budgets. For most districts, without additional state funding, they can't move ahead—and many will fall behind.

While state funding has increased in some areas over the past several years, the state's share has ceased or declined in others, such as in PlanCon and pupil transportation. Additionally, the growth in mandated costs experienced by school districts has dwarfed increases in state funding by more than $2.4 billion, and the result is that school districts have continued to return to local taxpayers and program cuts and reductions to make ends meet. For all school districts to move forward, the state's share of support for education must increase.

Additionally, to escape the never-ending cycle of rising mandated costs, state policy must change as well. Charter school tuition costs, for example, will continue to be one of the biggest factors behind school district fiscal stress until the charter school tuition calculation is revised. Current law builds every dollar of mandated cost increases in school district budgets—for special education, pensions *and* charter school tuition—into the charter school tuition calculation, further increasing this mandated cost and exacerbating school district fiscal stress each year.

While the fiscal stress in Lebanon School District, Coatesville Area School District and Sto-Rox School District may seem extreme, these examples are not unique. These districts—and their students and communities—are on the brink, and nothing but additional state support and needed policy changes will alleviate their financial challenges or allow them to move forward with the educational and programmatic priorities they know are critical for their students.

If nothing changes, state funding and state policy have set up school districts, students and taxpayers for a widening of the educational gap and eventual, inevitable defeat. While this defeat won't come all at once, it's already started.

School districts like Titusville Area School District have little wiggle room and rely on increases in state funding from year to year to balance their budgets. School districts like Coatesville and Sto-Rox can't overcome the challenges and fiscal stress of the mandated cost of charter school tuition increases without state funding and policy change. School districts like Lebanon School District can't do anything but continue to pay for their rapidly rising special education costs—at the expense of every other area of their budget.

Without intervention by state policymakers, the fiscal stress experienced by school districts across the commonwealth and the burden on local taxpayers will only increase. The number of school districts in financial distress will grow, and the quality of education provided to students in every district will diminish as dollars are yanked out of the classroom to plug holes made by increasing mandated costs.

We know the problem, and we know the solution. What are we waiting for?

PASBO
Pennsylvania Association of School Business Officials

PASA
Pennsylvania Association of School Administrators