POLICY BRIEF

A Tale of Haves and Have-Nots: The Financial Future of Pennsylvania School Districts

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*In 2014, **Temple University's Center on Regional Politics (CORP)**, **Penn State's College of Education**, the **University of Pittsburgh's Center for Metropolitan Studies**, and the **Pennsylvania Policy Forum** (a group of faculty and researchers at 18 public and private colleges and universities) formed a consortium to support state legislators, local officials, and education policymakers in a review of options for improving public school finance. CORP has been periodically publishing policy briefs, papers, and studies to support the consortium's mission.*

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EXECUTIVE SUMMARY

The focus of this study is the fiscal condition for all 500 Pennsylvania school districts for the period 2017-18 through 2021-22. The fiscal elements included in the study are: revenues by major category, expenditures by major category, and the resultant shortfalls/surpluses for each district. The report consists of five sections:

1. Introduction, Purpose, and Approach to Study
2. Annual projections for 2017-18 through 2021-22
3. Actual results for the prior five years, 2012-13 through 2016-17
4. Comparisons of the two time periods
5. Sensitivity analysis of projections to determine the impacts of each of the fiscal elements
6. Appendix with:
   a. Definitions of terms
   b. Assumptions for projections used in projections
   c. Detailed description of analytical approach
   d. Fund balance analysis for 2012-13 through 2016-17

The overall results are illustrated in **Figure ES1**.

It is important to note that this study focuses on changes in fiscal condition, not absolute measures. Even some districts whose fiscal condition is improving may be doing so from a base that is inadequate to support the needs of their students.

Fiscal Stress

The key measure of a district's fiscal condition is fiscal stress, which is defined as a condition where a district's projected revenues are less than their projected expenditures. The condition is also termed "shortfall" in this report. The greater the shortfall the greater the degree of fiscal stress faced by the district. Since Pennsylvania statutes require a balanced budget, when a shortfall occurs adjustments have to be made in a district's fiscal plans to

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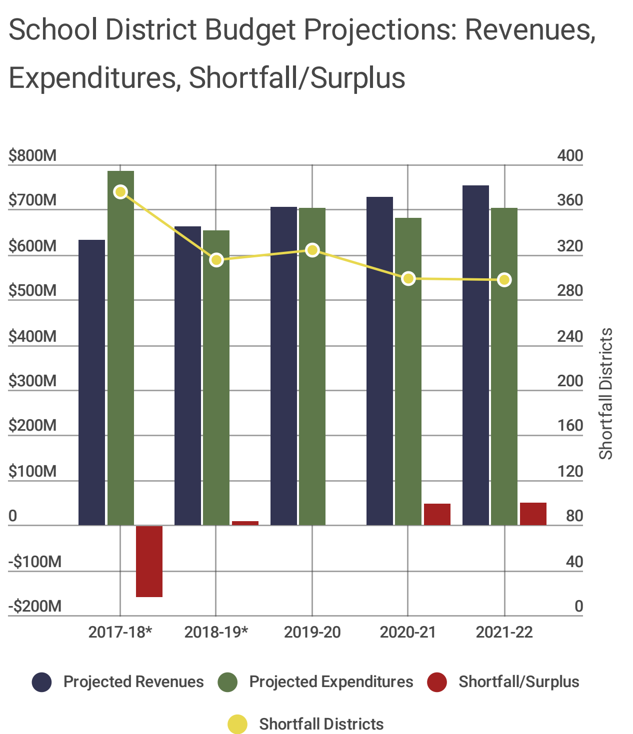
reduce expenditures or raise additional revenues. In practical terms, this translates largely to budget cuts in non-mandated expenditure areas, such as instructional programs and staff.

Figure ES1



*Actual subsidies for BEF and SEF.

Overall Results

• Over the five-year projection period, after 2017-18, statewide revenues and expenditures move into balance with revenues trending upward slightly more than expenditures creating small surpluses. But the aggregate results mask continuing fiscal stress for most districts and a persistent gulf between those with surpluses (the "Haves") and those with shortfalls (the "Have-Nots").

• For a continuing majority of districts, the growth in state mandated payments for Charter School Tuition and the Pennsylvania School Employees' Retirement System (PSERS) are expected to exceed the growth in their basic and special education subsidies.

o Charter School costs will place an increasing burden on school district taxpayers as the state does not support these mandated district costs.

o PSERS expenditures are projected to grow at a lower rate due to lower annual Employee Contribution Rate (ECR) jumps, but they will continue to place a substantial burden on district budgets.

• State Basic Education Funding (BEF) and Special Education Funding (SEF) are likely to have a limited impact in improving fiscal equity among school districts over the next five years unless significant increases are made in the historical annual increases. The number of districts facing fiscal stress drops from the prior period, but still almost 300 districts will have to raise additional revenues, likely through local property taxes, or reduce expenditures, likely through cuts to instructional programs and staff.

• Total revenues are projected to increase at $650-$750 million per year, at increasing annual amounts. This growth is driven primarily by new local revenues increasing by $520 to $600 million annually, reaching a total increase of $2.82 billion, a 17% increase over the next five years, with higher property taxes likely to carry much if not most of this burden.

• Total expenditures after 2017-18 are projected to increase at $650-$800 million per year, at varying annual amounts.

• The result is continuing shortfalls for most school districts, although net statewide shortfalls would be eliminated as the annual differences between revenues and expenditures become small.

• From 300-375 districts are projected to be in shortfall conditions annually, but decreasing over time.

• By 2021-22, 60% of districts are projected to be facing shortfalls at an average of $373 thousand each. The total projected shortfall for these districts is approximately $110 million, which indicates the level of budget adjustments required from these districts. A similar amount is projected for the preceding three years as well.

• By contrast, in 2021-22, 202 school districts (40%) are projected to have surpluses at an average of $800 thousand each. Their total surpluses this year are projected at $160 million.

• There is a real possibility of the state being permanently divided into two groups of districts—Haves and Have-Nots.

o The Have-Nots: will have lower expenditures, fewer educational resources, lower levels of staffing, and limited other opportunities for students.

o Haves will have higher levels of expenditures, appropriate educational resources, including advanced technology, adequate levels and types of staff, and additional educational opportunities for their students.

Interpretation of Projected Shortfalls

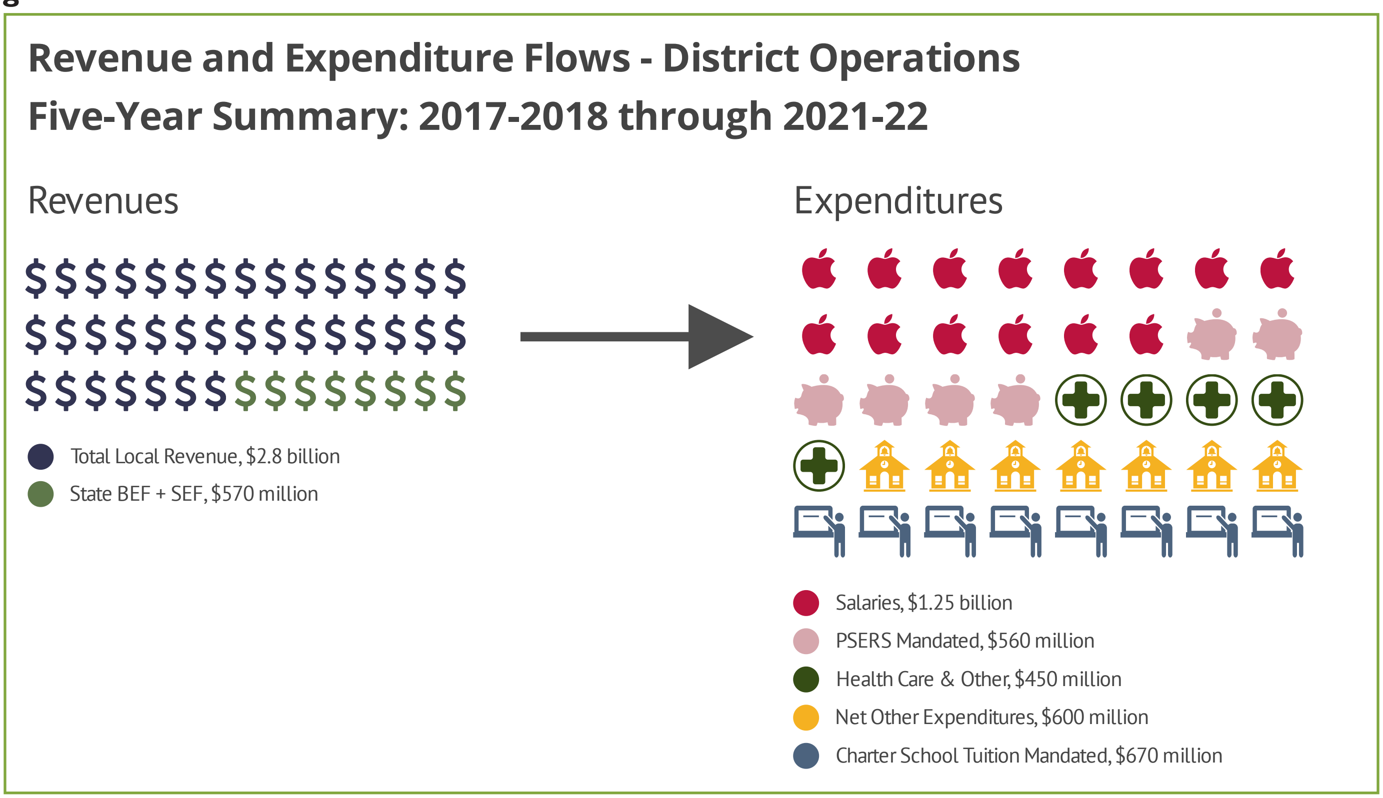
The projected shortfall for a district indicates the level of fiscal stress the district is estimated to encounter in future years, not an actual deficit that will occur. By law, districts are not permitted to have deficit budgets. For each year, expenditures must equal revenues: E = R. If expenditures are projected to be greater than revenues in any year (projected shortfall), that indicates the extent of expenditures that must be cut from the budget or revenues increased, a much less likely possibility.[1] Districts with large shortfalls relative to their total budget face a more difficult task involving more programs and staffing cuts to bring the budget back into balance. In short, the clear majority of Pennsylvania school districts will continue to face hard choices in the years ahead, and for many, the choices are likely to be extremely painful. On the other hand, those districts with projected surpluses will have funds to restore or partially restore program cuts since the 2008 recession and in some cases, upgrade and enhance their instructional programs and maintain and add staff aimed at improving student outcomes.

Funding Flows for Education: Revenues and Expenditures

Funding streams to support district operations consist of inflows of revenues and outflows for expenditures. **Figure ES2** illustrates the composition and magnitude of the projected five-year increases of each major fiscal category of these flows for Pennsylvania districts.[2] As can be seen, the primary source for supporting schools is total local revenue (81%). State subsidies for Basic Education Funding (BEF) and Special Education Funding (SEF) contribute 19% combined. No increases in federal funding are projected. The largest type of expenditures are Salaries (35%) followed by Charter School Tuition (19%), Net Other Expenditures (17%), Net PSERS (16%), and Health Care and Other (13%) respectively.

Some of the funding problems for districts can be explained by comparing the funding from the state BEF and SEF subsidies with the state-mandated expenditures of Charter School Tuition and Net PSERS[3] individually and combined as shown in **Figure ES3**. The projected five-year state funding subsidies for BEF and SEF are equivalent to the projected charter school required payments alone. This leaves no net state funding remaining to support other mandatory expenditure categories or any other district operating expenditures. As the annual PSERS increases lessen in response to smaller ECR increases, the steadily rising Charter School Tuition amounts will utilize more of the state subsidies and continue the negative balance. The projections estimate that Charter School Tuition

Figure ES2



1. Increases in property tax are restricted by Act 1 limits and by local resistance to increases.
2. The flows are those utilized in this study. Revenues include total local funds, state BEF and SEF subsidies, and total federal funds. Expenditures are equivalent to Current Expenditures; capital expenditures are omitted.
3. PSERS is paid through a combination of local and state funding. Net PSERS refers to the amount of local funding required to pay the districts' share of the total PSERS amount.

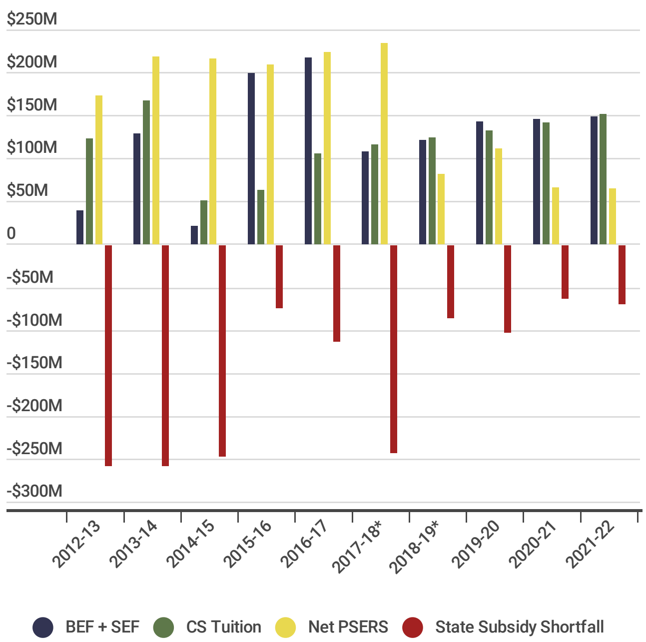
payments by themselves will slightly exceed state BEF and SEF subsidies in three of the five years. Comparing district payments of the two mandatory expenditure categories with the projected BEF funding leaves a total statewide annual deficit of approximately $70 million by 2021-22 and an aggregate five-year deficit of approximately $560 million.

Figure ES3

(BEF + SEF Increases) - (Charter School Tuition + PSERS Increases) = Statewide Subsidy Shortfall

2012-13 through 2016-17 are actual spending and 2017-18 through 2021-22 are projections.

Negative results mean districts paid more in Charter School Tuition and Net PSERS than they received in BEF and SEF.



* Actual subsidies for BEF and SEF.

These continuing and growing mandated expenditures place an escalating burden on district taxpayers since the state eliminated its support to mitigate the costs for Charter School Tuition in 2011-12. These circumstances will require districts raise local taxes or cut budgets, predominately from instructional and instructional support areas. This is an ongoing serious problem for most districts, because from 468 districts in 2017-18 to 275 districts in 2020-21 and 2021-22 annually will receive less from their state BEF and SEF subsidies than they will be required to pay in mandatory Charter School Tuition and Net PSERS expenditures. These drains on district budgets will require reductions in other budget areas to pay for these costs.

Projected Revenues

- Local revenues continue to be the main support of education with increases from $525 to $600 million annually, $2.8 billion for five years, mostly from property taxes.[4] Underlying these projections is the assumption that the property tax will remain the major source of funding education in the state. Any law that would reduce or eliminate local property taxes would require a substantial increase in replacement state funding and require major state revenue enhancement, likely through substantially higher state taxes.
- State BEF subsidies continue as a much lower contributor, from $100 to $120 million annually at a 2% annual increase, reaching a $575 million increase over five years. The new formula will have limited impact on fiscal equity with relatively small amounts involved; the new BEF funds subject to an enhanced equity distribution in the new formula are projected to reach only 14.1% of total BEF funds by 2021-22.
- State SEF subsidy continues as a minor contributor, at $20 million annually and slightly less than $100 million over five years. Again, the new SEF formula has relatively little impact due to the low amounts involved.
- No increases/decreases in Federal aid are anticipated. Even if additional funds become available, they will have little impact on the projections since new funds will be offset by new expenditures for those programs.

Projected Expenditures

- Increases are projected to be more evenly distributed across major expenditure categories than previously.
- Salary increases are projected to gain approximately $250 million annually, at an average 2.1% yearly increase. Total five-year salary expenditure increases are estimated at $1.25 billion. These reflect the recent growth trend after a number of years of lower increases. Projections are the net amounts including both salary increases and changes in number of personnel.
- Pension increases are projected to drop from $230 million annually to $65 million due to a lower increase in Employee Contribution Rate (ECR). Total five-year increase is estimated at $560 million.
- The Health Care and Other category is projected to grow by about $90 million annually, reaching a total increase of $450 million over five years. It represents the smallest increase of any of the major expenditure categories.
- Charter School Tuition payments are projected to increase at a 7% rate across the state. After several years at lower rates, they are projected to continue their upward trend, but to still be below the 10% annual increases in the prior time period. For both the annual increases as well as

4. Projected property tax increases include both millage rate increases and natural assessment growth.

the total five-year increase, Charter School Tuition is the second largest increase of any of the major expenditure categories, second only to Salaries, and more than PSERS, Health Care and Other, or Net Other Expenditures. The annual increase in district costs is estimated to rise from $116 million in 2017-18 (15% of total annual increases) to $152 million (21% of total annual increases) by 2021-22, yielding a five-year increase of $666 million (19% of total five-year increases). This is in addition to existing tuition payments from districts of $1.65 billion in 2016-17, which would raise the burden on taxpayers and school districts' budgets to $2.3 billion by 2021-22. One out of every five district taxpayer dollar increases will be used to pay Charter School Tuition.

- Net Other Expenditures (Non-Capital) are projected at an estimated inflation rate (2%) and constitute a substantial expenditure component, $125 million annually, reaching a growth of $600 million in five years.

Review of the Past Five Years - 2012-13 through 2016-17

- Local revenues were the main and only stable source of increases in funding for education from 2012-13 through 2016-17; they grew a total of $2.3 billion over five years. Local revenues provided 85% of the increases in total district revenues. The primary source of local revenues is the local property tax, which increased by $1.36 billion at an average annual rate of 2.6%; this amount includes both natural assessment growth and rate increases.[5]
- State revenues (BEF and SEF) exhibited wide variation through the first three years of this period and were less than 25% of the total annual sources for supporting district expenditures. Combined, they grew approximately $600 million during the five years and together provided 22% of the funding for this period.
- Federal revenues were much more volatile, unreliable, and were much smaller sources of new funding as they transitioned out of the American Recovery and Reinvestment Act of 2009 (ARRA) period. Both annual increases and decreases occurred and the net impact on district revenues over the five years was a loss of $200 million.
- Overall, net annual revenue increased every year ranging from almost $300 million to over $800 million annually in an up and down pattern.
- Expenditure increases over the five-year period were driven by mandated PSERS increases of $1.0 billion and mandated Charter School Tuition payments growth of $500 million.
- Reductions and slower growth in Salaries and Health Care and Other during the period were the result of loss of personnel starting in 2011-12 and may have been related to tradeoffs with the increasingly higher costs.
- Fiscal uncertainty for both revenues and expenditures made it very difficult for districts to budget and operate effectively.
- The net effects of the changes in revenues and expenditures were changeable fiscal outcomes with three years of statewide deficits and two years of statewide surpluses. However, with a large surplus figure in the final year, the five-year total showed an overall statewide surplus.

Sensitivity Analysis of Major Revenues and Expenditures: A Guide for Policy Makers

A separate fiscal analysis was conducted to estimate the impact of a 1% change in each major revenue and expenditure component, along with the number of districts affected (see **Table ES1**). For example, an increase of 1% in the growth assumption for Total Local Revenue would yield an increase of approximately $52 million in revenue and cause an additional five districts to move out of a shortfall condition in 2019-20. By 2021-22, the increase would yield an additional $263 million in local revenues and result in 285 Pennsylvania school districts remaining in shortfall conditions by 2021-22. (For the impact of -1% changes in the BEF and SEF subsidies, see Table 9 on page 20.)

Table ES1

	Change Rate	Five-Year $ Change by 2021-22	Districts Affected in 2019-20
Total Local	+1%	$263 million more revenue	5 fewer into shortfall condition
BEF	+1%	$192 million more revenue	36 fewer into shortfall condition
SEF	+1%	$45 million more revenue	14 fewer into shortfall condition
Salaries and PSERS	+1%	$733 million higher expenditures	54 more into shortfall condition
Health Care and Other	+1%	$163 million higher expenditures	18 more into shortfall condition
Charter Tuition	+1%	$110 million higher expenditures	6 more into shortfall condition
Net Other Expenditures	+1%	$161 million higher expenditures	18 more into shortfall condition

5. See the Department of Education data here: https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VZwC6mXD-Uk.

INTRODUCTION

Since 2008-09, the condition of school funding for districts in Pennsylvania has been highly changeable, uncertain from year-to-year with unpredictable shifts and serious delays in state and federal revenues. Rapidly rising expenditures, most of which were out of the districts' control, consumed increasing amounts of available funds. These fiscal trends and circumstances combined to place greater reliance on local funding sources, particularly property taxes.[6] This has left districts especially vulnerable to decisions made by the governor and legislature, who have found it difficult to agree on key aspects of both the timing and amounts of school funding.

However, while the volatility of the recent past has subsided in some key areas, fiscal stress continues to characterize the vast majority of districts. A new status of moving forward in a stable pattern has emerged. The spiking of a few very large annual expenditure categories and the reductions in a few other large categories are now projected to be replaced by steady, significant, and unrelenting annual increases for a wider set of expenditure categories, two of which, Charter School Tuition and PSERS, are mandated and largely out of district control. This will occur while state funding for school districts is expected to be under continuing strain from political resistance to state tax increases and an uncertain state economy with substantial projected general fund deficits over the next five years.[7] This will continue to leave local sources, primarily property taxes, to continue to bear the main burden for the support of education in Pennsylvania.

PURPOSE OF STUDY

This study projects the fiscal conditions for the next five years for all 500 Pennsylvania school districts for the period 2017-18 through 2021-22. These future projections are based on recent trends for major revenue sources and expenditure items. Specifically, the project includes three related components:

1. Projections of major revenues, expenditures, and district shortfalls from 2017-18 through 2021-22 for all Pennsylvania school districts using the latest trends and related assumptions.

a. Compare estimated future revenues with projected expenditures.

b. Will future revenues be adequate to support future expenditures?

c. Which revenues and expenditures will have the greatest impacts on districts' fiscal conditions over the next five years? How are these projected to change in the next five years?

d. How sensitive are the projection results to changes in the key assumptions?

e. What are the differences in projected fiscal conditions among school districts? Are the conditions expected to improve over time? Is this the case for all districts?

2. Recent history of actual major revenue and expenditure items from 2012-13 through 2016-17 for school districts.

a. What were the changes in major revenue sources and the larger expenditure items?

b. Which of the revenue and expenditure items had the greatest impact on school districts? How did the two fiscal areas interact?

c. How did school districts cope with these significant fiscal impacts? Were there sufficient new revenues to support rising major expenditures, many of which were mandated or imposed on districts?

3. Key assumptions for revenues and for expenditures in projecting future fiscal conditions.

a. What past trends are appropriate to continue into the future?

Major Revenues are composed of:
1. Total Local Revenue
2. Basic Education Funding (BEF)
3. Special Education Funding (SEF)
4. Total Federal Funding

Major Expenditures are composed of:
1. Salaries
2. Public School Employees' Retirement System, more specifically the Net PSERS amount—district cost only
3. Health Care and Other
4. Charter School Tuition Payments
5. Net Operating Expenditures (all other non-capital expenditures)

6. In 2016-17, property taxes provided 78% of total local revenue. Pennsylvania Department of Education. Available at https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VZwC6mXD-Uk.

7. Independent Fiscal Office. 2017. "Pennsylvania Fiscal Update." December 13. Harrisburg, PA.

b. What items need to be modified based on specific known changes in the future or recent and expected trends?

APPROACH TO THE STUDY

All 500 school districts in Pennsylvania were included in the study. Data collection and calculations were done at the individual school district-level and aggregated to the state-level for summary results. Almost all fiscal data were obtained from the Pennsylvania Department of Education website. There were two separate but interrelated components of the study: a review and analysis of the prior five years of the data, and projections of the next five years based on examination of prior trends.

Past Five Years - 2012-13 through 2016-17

Major revenues and expenditure items were first organized by school district and then compiled for the historical period 2012-13 through 2016-17, the latest year for which data were available.[8] Trends of the changes within each revenue and expenditure fiscal category were examined to provide baseline data to establish assumptions for projections in the upcoming five years.

For each fiscal category a most likely assumption was established for how it would change over time; these assumptions for future projections for these items were based on conservative expectations of likely changes. For some fiscal categories, the assumptions were established by individual district; others, where district patterns of increases and decreases were irregular and episodic, individual district trends were not an appropriate basis for future projections and a statewide rate of change was chosen based on overall data. Along with the most likely assumption for each fiscal category, a range of possible assumptions was established to test the results' sensitivity to changes.

Definition of Major Revenues

Revenues included in the study were the major sources from which school districts receive funding to support their programs. As defined in this study, **Major Revenues are: Total Local Revenue; Basic Education Funding (BEF); Special Education Funding (SEF); and Total Federal.** For fuller definitions of these categories, see the Appendix. Taken together, the revenues included in the study represented 80% of the total revenues that districts received in 2016-17. Excluded from the revenue analyses were the state subsidies for the state shares of Social Security and Medicare Taxes and the Public School Employees' Retirement System (PSERS), because only net amounts paid for these expenditures by the districts were included on the expenditure side of the analysis.[9]

Definition of Major Expenditures

Expenditures included in the study were the major current categories. As defined in this study, **Major Expenditures are: Salaries; Public School Employees' Retirement System, more specifically the Net PSERS amount—district cost only; Health Care and Other; Charter School Tuition Payments; and Net Operating Expenditures (all other non-capital expenditures).** Taken together the expenditures included in the study made up approximately 76% of all district expenditures in 2016-17. This grouping of expenditures represents the current expenditures of school districts. Omitted from the analysis were the financing and debt related expenditure categories because they include long-term expenditures that can distort individual year results. The definitions of the expenditures are provided in the Appendix.

The five-year projections were based on a series of assumptions about the future changes of each of the key revenue and expenditure variables in the model. The bases for the assumptions were analysis of trends for these variables over the past five years and known or likely changes over the projection period. The only exceptions were for the state Basic Education Funding subsidy and Special Education Funding subsidy where actual data existed for 2017-18 and 2018-19. The assumptions are indicated on the projections' data tables and are provided in more detail in the Appendix. However, it should be noted that the projected outcomes are very sensitive to these assumptions, particularly the growth in Total Local Revenues, Salaries, and future PSERS rates, and to a lesser extent on Basic Education Funding, Health Care and Other, and Charter School Tuition Payments, and Other Expenditures increases. Consequently, a sensitivity analysis was conducted to examine the impact of changes in the assumptions.

8. A separate analysis of district fund balances is presented in the Appendix.
9. See footnote 4 for an explanation of local and state shares of PSERS funding. While it varies from district to district, the state share of PSERS averages 56% for the state.

SUMMARY RESULTS
PROJECTED FISCAL CONDITIONS
2017-18 THROUGH 2021-22

The five-year projections for Pennsylvania school districts are shown in **Table 1**; both the annual changes and the five-year totals, along with the projection assumptions, are shown by Major Revenue and Major Expenditure category. (View an interactive map of projected district changes at: www.cla.temple.edu/center-on-regional-politics/pa-school-districts-financial-future-2019/.)

Projected Revenues

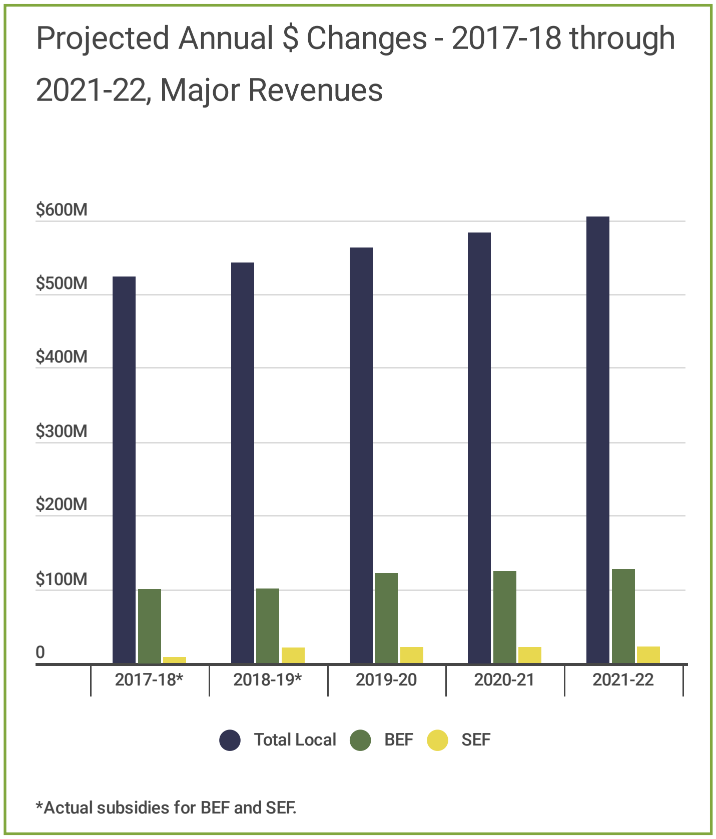
Revenues for school districts are projected to grow by approximately $630 million to $750 million per year, reaching a five-year total increase of $3.48 billion. Projected revenue growth trends are illustrated in **Figure 1**, while **Table 2** presents the five-year total gain by each major revenue source and its share of the total growth. This growth is driven primarily by new local revenues increasing by $520 to $600 million annually, reaching a total increase of $2.82 billion, a 17% increase over the next five years.

Table 1

ANNUAL $ CHANGES FIVE-YEAR PROJECTIONS: 2017-18 THROUGH 2021-22							
Changes in Revenues	**Projection Rates**	**2017-2018***	**2018-19***	**2019-20**	**2020-21**	**2021-22**	**5-Year Totals**
Total Local	Modified 3-Year	$523,542,129	$542,744,326	$562,723,548	$583,513,179	$605,148,093	$2,817,671,275
BEF	2.0%	$100,368,086	$100,481,501	$121,901,584	$124,339,612	$126,826,404	$573,917,186
SEF	2.0%	$7,812,041	$20,727,217	$21,141,761	$21,564,596	$21,995,888	$93,241,503
Total Federal	0.0%	$0	$0	$0	$0	$0	$0
Major Revenues		$631,722,256	$663,953,044	$705,766,893	$729,417,387	$753,970,385	$3,484,829,965
*Actual Subsidies BEF & SEF							
Changes in Expenditures							
Salaries	2.1%	$239,659,876	$244,692,733	$249,831,281	$255,077,738	$260,434,370	$1,249,695,998
Net PSERS		$225,091,368	$78,618,381	$107,430,930	$63,509,201	$62,636,931	$537,286,811
Health Care and Other	3.0%	$85,263,392	$87,821,294	$90,455,933	$93,169,611	$95,964,699	$452,674,930
Charter Tuition	7.0%	$115,849,497	$123,958,962	$132,636,089	$141,920,615	$151,855,058	$666,220,221
Net Other Expenditures	Modified 3-Year	$111,679,557	$115,972,828	$120,451,342	$125,123,542	$129,998,266	$603,225,534
Major Expenditures		$786,713,165	$654,198,752	$705,088,899	$681,332,850	$703,386,690	$3,509,103,494
Surplus or (Shortfall)		($154,990,909)	$9,754,292	$677,994	$48,084,537	$50,583,695	($45,890,391)
$ Negative		($223,473,469)	($114,954,676)	($123,563,203)	($105,971,905)	($111,030,555)	($678,993,810)
$ Positive		$68,482,560	$124,708,968	$124,241,198	$154,056,442	$161,614,250	$633,103,418
# Negative		376	315	324	299	298	
# Positive		124	185	176	201	202	
Average per Deficit District		($594,344)	($364,935)	($381,368)	($354,421)	($372,586)	
Average per Surplus District		$552,279	$674,103	$705,916	$766,450	$800,071	

Local revenues are primarily generated from property taxes, which are estimated to be 78% of local revenues or approximately $2.22 billion. So, absent substantial increases in state subsidies or extensive reductions in expenditure growth, local taxes would underwrite 81% of the projected revenue growth to support education.

Figure 1



According to projections, Total Local Revenues will support approximately 81% of the increases in funding for education in the next five years. The Commonwealth's long-standing reliance on local taxes for school funding is continued in the projections and would maintain the significant imbalance, compared to national averages, of local and state funding mix across the state. The two primary instructional subsidies from the state, BEF and SEF, are both projected to increase at 2% annually, or $120 million and $20 million per year respectively, and will continue to play minor roles in funding education in Pennsylvania. Since the actual subsidy amounts have been established in the most recent state budgets, the state subsidies are projected only for the remaining three years, 2019-20 through 2021-22. No increase in Federal revenues is expected throughout the years covered by study projections. The projected five-year totals for additional support from local and state sources and their relative shares are shown in **Table 2**.

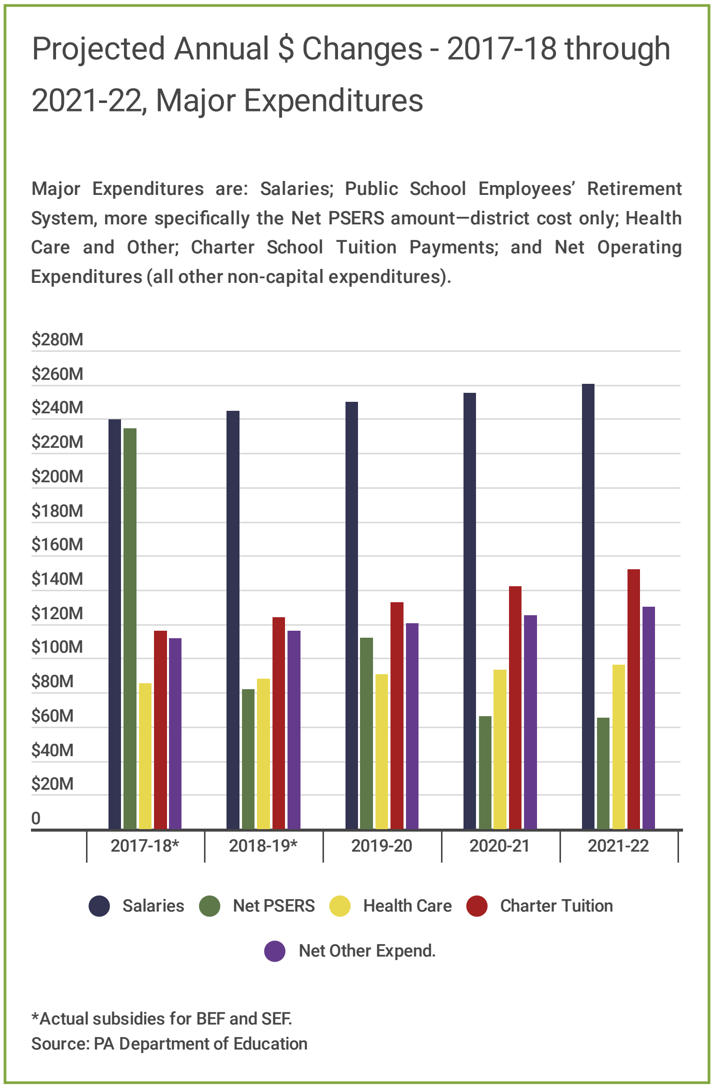
Projected Expenditures

Total expenditures are projected to increase by $650 million to $790 million per year totaling $3.53 billion over the five-year period. The pattern of expenditure growth is depicted in **Figure 2**. For the most part the expenditure categories show relatively steady annual growth over the five-year projections. The one exception is Net PSERS, the basis for district retirement costs, which drops sharply in 2018-19 and declines slightly after that.

Table 2

5-YEAR PROJECTED TOTAL $ CHANGES 2017-18 THROUGH 2021-22			
	5-Year Totals	% of $ Change	5-Year Growth
Changes in Revenues			
Total Local	$2,817,671,275	81%	17%
BEF	$573,917,186	16%	10%
SEF	$93,241,503	3%	9%
Total Federal	$0	0%	0%
Major Revenues	$3,484,829,965	100%	14%
Changes in Expenditures			
Salaries	$1,249,695,998	35%	11%
Net PSERS	$558,903,673	16%	38%
Health Care and Other	$452,674,930	13%	16%
Charter Tuition	$666,220,221	19%	40%
Net Other Expenditures	$603,225,534	17%	10%
Major Expenditures	$3,530,720,356	100%	15%

Figure 2



The largest contributor to expenditure increases is the Salary component, which is projected to have a steady annual statewide increase of 2.1% producing gains of approximately $250 million per year over five years, with the total gain in Salaries estimated at $1.25 billion. The projected annual percentage increase for salaries may be a conservative estimate if the economy continues a modest improvement coupled with demand for higher wages due to several years of low salary gains or freezes in districts and new hiring to replace some of the staff lost to prior budget cuts.

The expenditure area with the next largest anticipated increase is Charter Tuition with a total five-year increase of $666 million coming from annual increases of from $110 million to $150 million per year. After several years of low, but increasing growth, Charter Tuition is projected at a 7% annual growth, the statewide increase across all districts in 2016-17. The total tuition paid by school districts to charter schools has reached $1.65 billion annually in 2016-17 and would exceed $2.32 billion by 2021-22; this represents one of the largest mandated expenditures imposed on districts by the state.

With a few exceptions of several districts with a high proportion of their students attending charter schools, there are essentially no marginal cost savings to the district when a student leaves the district to attend a brick and mortar or cyber charter school. From the public school perspective, there is no recognition in the charter school formula of economies of scale for new students enrolling in a charter school (at full district tuition payment). The current charter tuition formula assumes the next student enrolled costs the same as all previous students. This violates a basic principle of economics but is the basis of mandated school district payments to charter schools.

Net Other Expenditures, which include Social Security and Other Benefits, Purchased Services, Supplies, and Property, are projected at an approximate 2% annual growth. They have the third largest five-year expenditure increases of $600 million.

Net PSERS expenditures are projected at a total five-year cost of $560 million; the annual amounts show a substantial drop-off after the first year and decreasing annual amounts in later years. The projections reflect the change in the Employer Contribution Rate (ECR), which is the PSERS established percentage that is applied against district salary expenditures to calculate the district's annual retirement costs; approximately half of retirement costs are borne by the district and half are paid through a state subsidy. As shown in **Table 3**, in 2016-17 the ECR climbed to 30.03%, a 16% rise over the prior year and yielding an increase in district costs of $223 million that year. This relatively large jump occurred again in 2017-18, but the ECR rates in succeeding years were much smaller. By 2021-22 the ECR is scheduled to reach 35.68%, which reflects only a 5.56% increase since 2016-17, a significantly smaller increase than the 21.38% jump in the prior five-year period. The net result is much lower PSERS expenditure increases for school district budgets through 2021-22. However, the lower annual future ECR increases are offset by the larger and growing salary dollar base amounts to which they will be applied. To be clear, PSERS expenditures will continue to be a very large burden for districts, but they will not be increasing as rapidly as in the past. Once these rates are entrenched as school district expenditures, PSERS costs cannot be cut or reduced by districts when fiscal stress is present, except through reducing staff or salary negotiations.

In summary, the projected annual expenditure changes are shown in **Table 4** and the five-year trends shown in **Figure 2**. The overall picture is one of steady consistent growth across the board for all expenditure categories except PSERS, where after 2017-18 net retirement costs decrease by about two-thirds and continue to decline during the remainder of the projection period. In rounded numbers the total annual growth amounts to approximately $700 million annually.

Table 3

TOTAL EMPLOYER CONTRIBUTION RATE %				
Year	**ECR**	**Change in ECR Rate**	**Annual % Increase**	**Annual $ Increase**
2008-09	4.76%			
2009-10	4.78%	0.02%	0%	$4,869,227
2010-11	5.64%	0.86%	18%	$256,922,762
2011-12	8.65%	3.01%	53%	($63,453,936)
2012-13	12.36%	3.71%	43%	$172,952,243
2013-14	16.93%	4.57%	37%	$218,404,073
2014-15	21.40%	4.47%	26%	$216,449,606
2015-16	25.84%	4.44%	21%	$209,240,190
2016-17	30.03%	4.19%	16%	$223,482,933
5-Year Gain		21.38%	173%	$1,040,529,044
2017-18	32.57%	2.54%	8%	$234,260,842
2018-19	33.43%	0.86%	3%	$81,752,935
2019-20	34.79%	1.36%	4%	$111,714,254
2020-21	35.26%	0.47%	1%	$66,041,345
2021-22	35.68%	0.42%	1%	$65,134,297
5-Year Gain		5.65%	17%	$558,903,673
Total 14-Year Gain		30.90%	546%	$1,797,770,770

Table 4

PROJECTED ANNUAL EXPENDITURE INCREASES 2017-18 to 2021-22	
Salaries	$260 million
PSERS	$230 million - $65 million*
Health Care and Other	$90 million
Charter Tuition	$115 million - $150 million
Net Other Expenditures	$110 million - $130 million
Major Expenditures	$650 million - $790 million

* Payments decrease over time

Definitions and Projections of Surpluses and Shortfalls

If projected Major Revenues are greater than projected Major Expenditures, the net result will be a Surplus; conversely, if projected Major Expenditures exceed projected Major Revenues, a Shortfall will occur. A key measure of school district fiscal condition in this report is the extent and longevity of surpluses or shortfalls a district may have over the five-year projection period. Because Pennsylvania law does not permit districts to have a fiscal deficit, the shortfalls indicate the level of fiscal stress facing these districts; they project the amounts that shortfall (negative) districts will have to cut their budgets, raise local taxes beyond what is projected, or adopt a combination of cuts and higher taxes to bring their budgets into balance, unless additional state revenue is forthcoming.

On a statewide basis, comparing the projected revenues with the projected expenditures indicates that Major Revenues are anticipated to exceed Major Expenditures in all but 2017-18. However, the differences between the two are relatively small and show growing surpluses in the last two years. The projections indicate that the five-year totals of shortfalls and surpluses are almost evenly balanced.

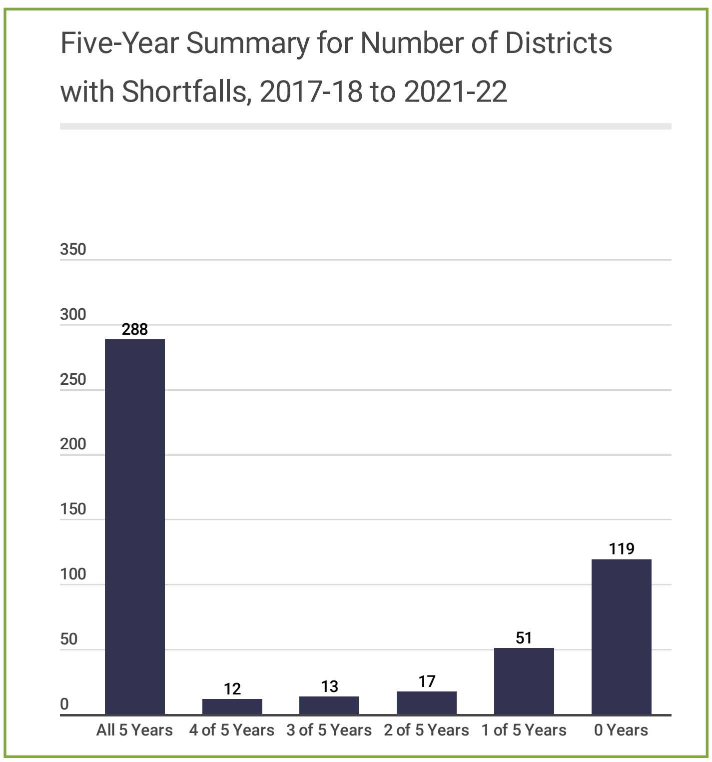
While the overall situation is projected to be moving slowly in a positive direction, troubling conditions remain. In particular, positive impacts are not shared evenly across districts. Of concern is that there are still projected to be about 300 districts with shortfalls in their budgets during the final two years when overall revenues and expenditures seem to be stabilizing. These districts, which are likely to remain with shortfalls, comprise 60% of all districts in the state. Their total annual projected combined shortfalls are estimated from $100 million to $120 million and average annual shortfalls of $373,000 per district. On the other side, however, by 2021-22, there are 202 districts with projected surpluses with an average surplus of over $700,000.

The ten-year history and projections of the number of districts with surpluses and shortfalls are pictured in **Figure 3**. In the projections, the number of districts facing shortfalls declines from a high of 376 (75%) in 2017-18 to a low of 298 (60%) in 2021-22 and is steady the final two years.

The cumulative number of districts with projected shortfalls over the five-year projection period is shown in **Figure 4**. They range from shortfalls in all five years to shortfalls in zero years. Several issues regarding the fiscal condition of Pennsylvania districts are illustrated. First, the number of districts with serious, persistent shortfalls is almost 60% of all districts. This means that 288 districts are facing budget cuts each year in order to balance their budgets. Conversely, the number of districts with ongoing surpluses (zero to one year) are projected to be 170, or one-third of the districts in the state.

Figure 3

Figure 4



Understanding the Impact of Long-term Shortfalls

By necessity, continuing the current system as projected, the 288 (58%) districts will likely have to reduce their budgets each year to meet the balanced budget requirement; they will remain in deepest fiscal stress in the next five years. The result will be a future of continual budget reductions, which in turn will be achieved by reduction in staff, program cuts, postponement of new technology introductions and supporting infrastructure, and aging, inefficient facilities.

On the other hand, one-third of districts are projected to have surpluses for four or five years. Surpluses permit districts to meet rising and inflationary cost increases, add to their programs, increase staff in most productive areas, keep up to date with technology, and replace or modernize instructional equipment and facilities for greater productivity. In comparing the different results between shortfall and surplus districts, it is clear that both annually and over time, the current educational funding system exacerbates the growing disparity between the best-off and worst-off districts.

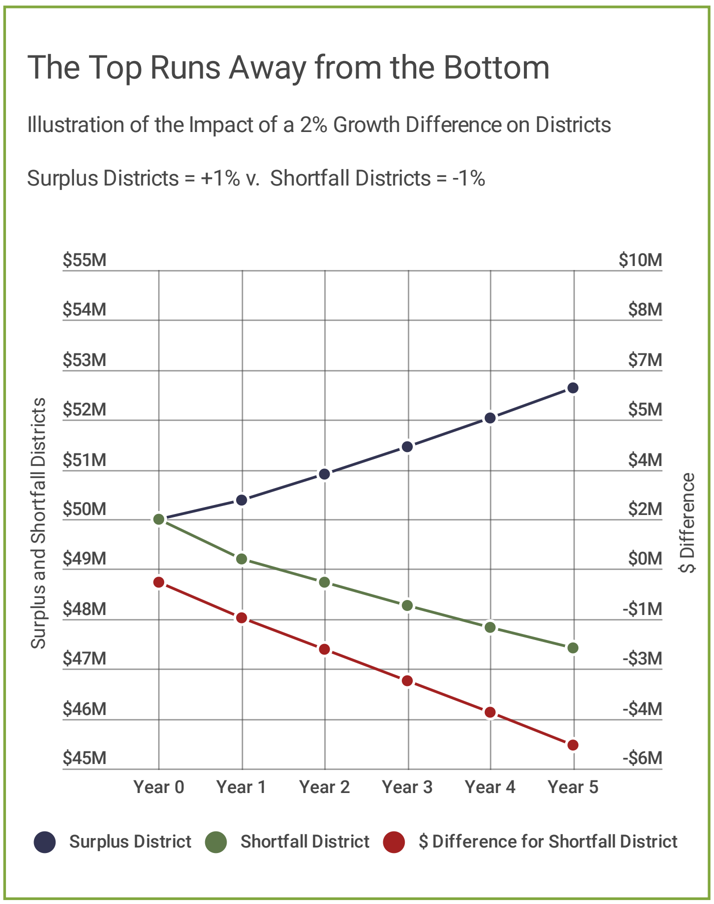
Five-Year Impact on Budgets for Shortfall and Surplus Districts

To illustrate the impact on district finances over time, an example of two districts with identical beginning total expenditure budgets are extended out five years. One of the districts is a shortfall district and the other district is a surplus district. Their major expenditures for each of five years are projected at the average annual % change that was calculated in the main body of this report. The shortfall district has a negative annual change, meaning that its estimated expenditures will be reduced each year. Conversely, the surplus district has a positive annual change and its annual expenditures will grow each year. The net result after five years demonstrates the serious impact of relatively small annual differentials accumulating over time. As shown in **Table 5**, what was an equal condition between the two districts at the beginning has been transformed in five years into a 11.0% difference in expenditures between the shortfall and surplus districts. The shortfall district is forced to cut its budget every year (likely reducing staff, program offerings, technology expenditures), while the surplus district has the additional resources each year to be enhancing its instructional and instructional support offerings. The growing annual differences are illustrated in **Figure 5**.

Table 5

THE TOP RUNS AWAY FROM THE BOTTOM ILLUSTRATIONS OF THE IMPACT OF SURPLUS/SHORTFALL ON DISTRICTS							
Average Annual % Change		Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Change
Shortfall District		-1.6%	-1.0%	-1.0%	-0.9%	-0.9%	-5.3%
Surplus District		0.8%	1.1%	1.0%	1.1%	1.2%	5.2%
Major Expenditures	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year $ Change
Shortfall District	$50,000,000	$49,216,021	$48,726,594	$48,257,017	$47,833,706	$47,407,328	($2,592,672)
Surplus District	$50,000,000	$50,384,534	$50,918,833	$51,448,011	$52,031,855	$52,641,396	$2,641,396
Difference	$0	($1,168,513)	($2,192,239)	($3,190,993)	($4,198,149)	($5,234,068)	($5,234,068)
% Difference		-2.4%	-4.5%	-6.6%	-8.8%	-11.0%	
Annual Expenditure Change		Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Change
Shortfall District		($783,979)	($489,427)	($469,577)	($423,312)	($426,377)	($2,592,672)
Surplus District		$384,534	$534,299	$529,178	$583,844	$609,541	$2,641,396
Difference		($1,168,513)	($1,023,726)	($998,754)	($1,007,156)	($1,035,919)	($5,234,068)
Cumulative Difference		($1,168,513)	($2,192,239)	($3,190,993)	($4,198,149)	($5,234,068)	

Figure 5



Cautions on Interpretation of District Surpluses

The overall state projections calculate that there will be about 300 (60%) of the districts with projected shortfalls through 2021-22 and around 200 districts (40%) are projected to have surpluses by that time.

In accordance with the Pennsylvania school accounting regulations, the projected revenues and expenditures are for the current operations of districts. Expenditures that have been delayed or not made over the past five years of fiscal turmoil and budget delays will likely be demanding attention in upcoming budgets. Even those districts with projected surpluses will likely have greater expenditure needs in the near future than have been projected under the conservative assumptions in this analysis. A variety of important budget items for many districts will require greater attention and funding than was the case in the prior five years and could well consume some or all of the projected surpluses for many districts. These include:

- Deferred maintenance for buildings and equipment
- New capital construction in growing districts
- New technology requiring equipment modernization and electrical, plumbing and building infrastructure upgrades
- Personnel contracts in districts with salary increases beyond the annual 2.1% growth assumed in the projections. There have been several earlier years of actual payroll cost reductions across the state, including years in which teach-

ers have had no salary increases. Consequently, there will be significant pressures in some areas where the projected 2.1% average growth will not hold true.

- Late and uncertain State PlanCon[10] process for major capital programs including a moratorium on new projects, may compel some districts to utilize capital reserves of set aside funds for specified projects or use surplus funds to finance immediate capital needs.
- Health Care and Other cost growth in the districts has been tempered by thousands of lost positions, the economy itself, and cost shifting and buy-downs within district health care plan design.
- The Independent Fiscal Office (IFO) in recent reports has projected large statewide deficits in coming years that could impact BEF & SEF funding.

It should not be assumed that all districts with surpluses have extra funds that are not needed and do not require modest local tax increases and state funding as projected in the analysis. For example, Philadelphia, which is projected to have a five-year operationing surplus of 0.48%, reports unmet capital needs of $4.5 billion.

PAST FISCAL CONDITIONS 2012-13 THROUGH 2016-17

School districts experienced turbulent fiscal times during the 2012-13 through 2016-17 period. There were substantial changes from year to year in many of the major accounts, both in revenues and expenditures as shown in **Table 6**. However, the changes were not consistent either within or across the major categories.

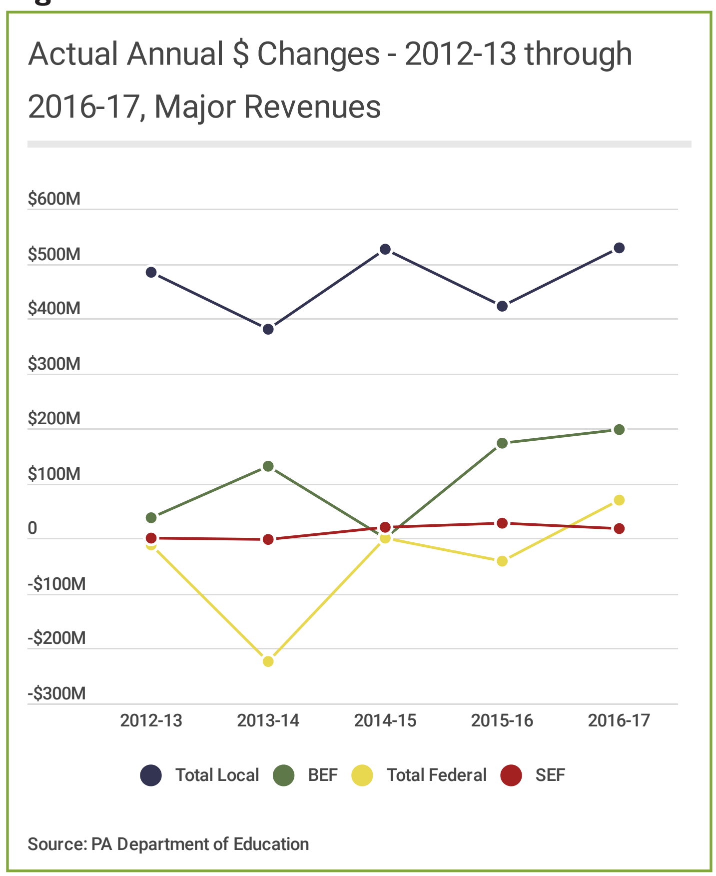
Actual Changes in Revenues

The composition of revenues for school districts during the 2012-13 through 2016-17 period changed considerably as illustrated in **Figure 6**. The most consistent funding stream was Total Local Revenues, which showed a generally steady rising trend of $380 million to $530 million annual increases and were the main and mostly stable source of funding for school districts. Revenues received from state and federal sources were volatile from year to year, the least consistently reliable, and made several large scale reversals during this period. BEF funding showed a small gain in the first year but had an up and down pattern in the following years, ending with relatively large gains in the final two years. State SEF funding had both small positive and negative changes during the first two years and rose to annual gains of approximately $20 million beginning in 2014-15 as a new SEF subsidy formula was implemented. Federal revenues had substantial variability across the period as federal ARRA funding came to an end and the level of federal support was adjusted downward. Overall annual increases in Total Revenues averaged approximately $550 million with a low of $280 million in the second year to over $800 million in the last year.

Actual Changes in Expenditures

Different expenditure categories had quite different patterns in the 2012-13 through 2016-17 period. The general pattern for most categories was fluctuating between substantial increases and substantial reductions on an annual basis, yielding unstable and almost unpredictable levels of

Figure 6



10. When a school district undertakes a major construction project and seeks reimbursement from the Commonwealth, a process known as PlanCon is initiated. PlanCon, an acronym for Planning and Construction Workbook, is a set of forms and procedures used to apply for Commonwealth reimbursement. The Commonwealth placed a moratorium on new project applications for this process in FY 2012-13 and it continues for FY 2018-19.

Table 6

	ACTUAL ANNUAL $ CHANGES 2012-13 THROUGH 2016-17					
Changes in Revenues	**20012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**5-Year Totals**
Total Local	$484,721,963	$380,095,453	$525,152,672	$423,078,981	$529,224,322	$2,342,273,391
BEF	$38,518,473	$130,537,837	($121,483)	$172,319,064	$198,387,924	$539,641,815
SEF	$747,886	($1,389,769)	$21,618,726	$26,724,107	$18,810,439	$66,511,390
Total Federal	($11,126,828)	($224,789,670)	$2,050,950	($41,160,824)	$69,286,980	($205,739,391)
Major Revenues	$512,861,494	$284,453,851	$548,700,865	$580,961,329	$815,709,666	$2,742,687,206
Changes in Expenditures						
Salaries	($91,227,247)	($55,175,670)	$132,094,364	$134,136,722	$233,367,551	$353,195,720
Net PSERS	$172,952,243	$218,404,073	$216,449,606	$209,240,190	$223,482,933	$1,040,529,044
Health Care and Other	$56,319,971	($72,828,019)	$54,262,526	$56,161,468	$17,814,478	$111,730,425
Charter Tuition	$123,081,922	$167,383,172	$50,720,723	$63,009,394	$105,548,648	$509,743,859
Net Other Expenditures	$115,188,909	$106,711,861	$139,176,588	$166,314,551	($110,859,300)	$416,532,609
Major Expenditures	$376,315,798	$364,495,417	$592,703,807	$628,862,326	$469,354,310	$2,431,731,657
Surplus or (Shortfall)	$136,545,696	($80,041,566)	($44,002,942)	($47,900,997)	$346,355,356	$310,955,548
$ Negative	($280,869,896)	($392,883,664)	($345,440,864)	($301,589,141)	($111,861,212)	($1,432,644,776)
$ Positive	$417,415,592	$312,842,099	$301,437,922	$253,688,144	$458,216,568	$1,743,600,325
# Negative	216	341	324	271	175	
# Positive	284	159	176	229	325	
Average per Shortfall District	($1,300,324)	($1,152,152)	($1,066,176)	($1,112,875)	($639,207)	
Average per Surplus District	$1,469,773	$1,967,560	$1,712,715	$1,107,808	$1,409,897	

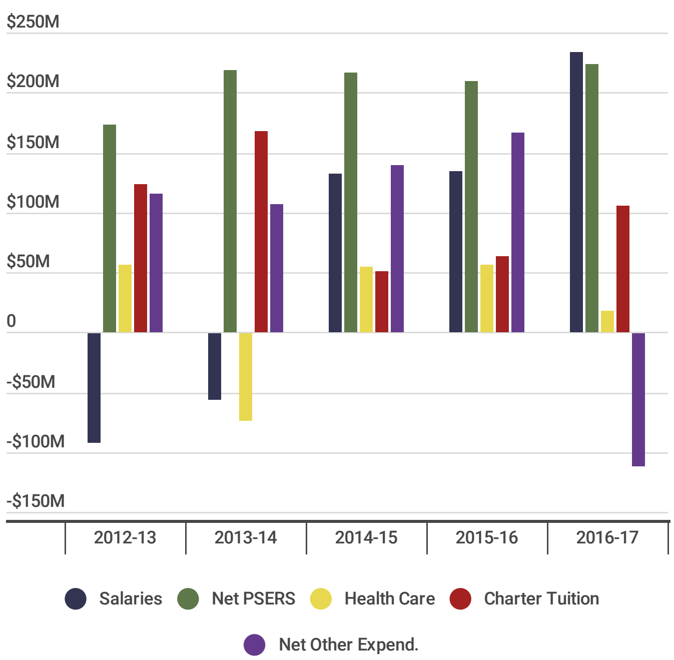
expenditures. The one exception was PSERS which had steady annual growth throughout the period. **Figure 7** illustrates the annual shifting patterns of changes in expenditures.

Coming out of the difficulties following the loss of federal ARRA revenues, the increase in the state BEF funding made up only about 50% of the revenue decline. Without sufficient revenues many districts were forced to cut their budgets to reach a balance. The largest reductions came through elimination of personnel by not replacing retirements or by layoffs where necessary. This had a direct impact on district budgets by reducing Salaries in 2011-12. This effect carried over into 2012-13 and 2013-14 with continued reductions approaching $150 million for those two fiscal years alone. But in the following three years the Salaries category began to have a strong annual growth in the range of $130 million to $230 million by 2016-17. Despite those salary gains, total school district salaries in 2016-17 still remained below the 2010-11 salary level of $11.54 billion. Salary reduction during this time period also served to reduce health care costs (lost positions) as well as pension cost correlated with salary reductions that

Figure 7

Annual $ Changes - 2012-13 through 2016-17, Major Expenditures

Major Expenditures are: Salaries; Public School Employees' Retirement System, more specifically the Net PSERS amount—district cost only; Health Care and Other; Charter School Tuition Payments; and Net Operating Expenditures (all other non-capital expenditures).



Source: PA Department of Education

served to mitigate early increases in the ECR. Health Care was quite variable with both substantial annual increases and decreases during the time period, likely resulting from a growing number of staff in districts and district efforts to implement lower cost health care programs. Charter School Tuition grew by more than $500 million over the five-year period with large increases in the first two years followed by a drop off in 2014-15 but building back up to a $100 million increase by the final year. This was the second largest increase of the major expenditure area, ranking below PSERS, but ahead of Salaries. Net Other Expenditures increased from $100 million to $170 million per year but declined $110 million in the final year.

Several key observations arise from a look back at this period. First and foremost, local revenue, even during a period of substantial cost reductions, carried the largest burden of revenue growth; 85% of the increases in total funding came from local sources. Second, although not directly linked, there were several revenue/expenditure relationships of interest. Local revenue grew $2.3 billion during the period, while Net PSERS growth of over $1.0 billion claimed nearly 50% of that increase. BEF increases of $539 million during the period were almost completely matched by mandated charter tuition growth ($509 million) as the state ceased funding to districts to support a portion of charter school tuition costs in 2011-12.

Actual Surplus or Shortfall

As would be expected with the substantially changing revenues and expenditures during this period, there was considerable variation in the Surplus/Shortfall results. The middle three years had total statewide net shortfalls and the beginning and ending years had surpluses. The primary causes for the surplus/shortfall outcomes were the timing and interactions of several key categories.

On the revenue side, Total Local Revenue provided a regular and ongoing revenue stream for districts of approximately $400 million to $500 million as a bulwark against shortfalls. The combination of increases and decreases in state BEF and federal revenues played against one another, although large reductions in federal amounts were important contributors to the shortfall years. By 2016-17 all of the revenue sources showed substantial increases and resulted in the overall surplus that year.

For expenditures, declining Salaries in the early years were important to reach balanced district budgets and a surplus in 2012-13. However, in the later years of this period, salaries showed modest gains of from 1.2% to 2.1% annually. At the same time, other expenditures showed varying patterns. PSERS increases held relatively steady to more or less match salary increases. Health and Other expenditures had some year-to-year variation reflecting systemic medical plan changes that shifted some of these costs to employees and away from districts. Annual Charter School Tuition payments were high in earlier years, dropped in 2014-15, and built back up in the later years. For 2016-17 large jumps in Salaries and Charter School Tuition were counterbalanced by a substantial increase in Total Local revenues and decreases in Health Care and Net Other Expenditures to yield a substantial statewide surplus for the year.

The statewide surplus/shortfall is a net amount combining the number of districts that had an annual surplus with the number of districts that experienced a shortfall. Beyond the net dollar amounts, also of interest is the number of districts that suffered a shortfall as they are the ones that are under fiscal stress and will have to reduce their budgets and programs or raise taxes to reach a balanced budget as required by law. At the beginning in 2012-13 there were 216 districts that reported a shortfall. The next three years the shortfall (negative) districts rose to 341 but declined to 271 by 2015-16; however, this still left over half the total number of districts in a shortfall condition. The final year's overall statewide surplus yielded a turnaround in district results. The shortfall districts dropped to 175, while those districts with surpluses reached 325. Overall, the fiscal conditions of a majority of Pennsylvania school districts tended to improve during the 2012-13 through 2016-17 period, although there were still many districts in substantial fiscal stress.

Summary 2012-13 through 2016-17

The five-year totals in **Table 7** indicate the main trends over the period. The primary burden of maintaining adequate revenues was squarely on Total Local Revenues, most of which came from property taxes. Total Local Revenues increased steadily throughout the period, with five-year increases totaling $2.3 billion. Of the additional funding from 2012-13 through 2016-17, 85% came from increased local taxes; the state provided only 22% of the increased funding through the BEF and SEF subsidies and the federal funds had a small negative change from the beginning to the end of the period as a result of its increases and withdrawal of federal funding through adjustments in levels of funding provided.

Table 7

5-YEAR ACTUAL TOTAL $ CHANGES 2012-13 THROUGH 2016-17			
	5-Year Total Gains	5-Year % Change	% of $ Change
Changes in Revenues			
Total Local	$2,342,273,391	16%	85%
BEF	$539,641,815	10%	20%
SEF	$66,511,390	7%	2%
Total Federal	($205,739,391)	-20%	-8%
Major Revenues	$2,742,687,206	12%	100%
Changes in Expenditures			
Salaries	$353,195,720	9%	15%
Net PSERS	$1,040,529,044	173%	43%
Health Care and Other	$111,730,425	4%	5%
Charter Tuition	$509,743,859	45%	21%
Net Other Expenditures	$416,532,609	8%	17%
Major Expenditures	$2,431,731,657	12%	100%
Surplus or (Shortfall)	$310,955,548		

Expenditures presented a somewhat more distributed picture. All major categories, with the exception of Health Care and Other, had five-year gains of at least $350 million. Net PSERS had the largest gain of $1.0 billion growing by 173% from 2012-13 to 2016-17. Throughout this period, Charter Tuition continued to be a major expenditure for school districts and their taxpayers increasing by $500 million or 45% during this five-year period since the state stopped any contribution to districts to offset their mandate for charter school funding. Salaries had steady annual gains even after starting from reductions in the first two years and increased by $350 million or 9%. The other expenditure categories all had substantial five-year dollar increases and increases of less than 10%. Overall, Major Expenditures increased by almost $2.5 billion or 12% for the five-year time period.

COMPARISON OF MAJOR REVENUES AND MAJOR EXPENDITURES

Difference between Two Periods

A comparison between the two time periods under study is instructive in understanding what differences there are between actual revenues and expenditures in the past five years with those that are projected for the next five years. **Table 8** shows the dollar amounts for the major budget categories for revenues and expenditures for the ending years of the two periods, along with the dollar and percentage change for each from 2016-17 to 2021-22. Total Local Revenues remain the single largest revenue source by far in both years and have the greatest projected dollar and percentage gains in the next five years. The projected increases in local funding reach $2.82 billion, approaching 17% growth. BEF funding is approximately one-third of local funding in both years; over the five years with an annual projected gain at 2% per year, BEF is projected to increase by $570 million or a 10% overall increase. SEF and Federal funding remain relatively minor contributors to the overall support of K-12 funding in Pennsylvania.

Salaries dominate the expenditure categories with $12.7 billion projected by 2021-22 and a $1.25 billion increase over the five years; the relatively small percentage growth (11% overall) is due to starting from a very large base.

Table 8

TOTAL BUDGET COMPARISONS				
	Actual	Projected	5-Year Changes	
Revenues	2016-17	2021-22	$ Change	% Change
Total Local	$16,838,909,078	$19,656,580,354	$2,817,671,275	16.7%
BEF	$5,894,229,409	$6,468,146,595	$573,917,186	9.7%
SEF	$1,028,548,799	$1,121,790,303	$93,241,503	9.1%
Total Federal	$842,702,511	$842,702,511	$0	0.0%
Major Revenues	$24,604,389,797	$28,089,219,762	$3,484,829,965	14.2%
Expenditures				
Salaries	$11,412,375,048	$12,662,071,046	$1,249,695,998	11.0%
Net PSERS	$1,470,375,483	$2,029,279,155	$558,903,673	38.0%
Health Care and Other	$2,842,113,083	$3,294,788,013	$452,674,930	15.9%
Charter Tuition	$1,654,992,813	$2,321,213,034	$666,220,221	40.3%
Net Other Expenditures	$5,788,526,972	$6,391,752,506	$603,225,534	10.4%
Major Expenditures	$23,168,383,399	$26,699,103,755	$3,530,720,356	15.2%
Surplus/Deficit	$1,436,006,399	$1,390,116,008	($45,890,391)	-3.2%

This is a major surge compared to a total increase of $350 million in the five previous years combined, which included several years of overall salary decreases due to reductions in staffing. In the prior period these personnel losses had direct impacts not only on salaries but on salary-related expenditure categories. With fewer district staff, there were lower than otherwise expenditures for PSERS and Health Care.

Charter School Tuition payments make up the next largest category in dollar growth ($666 million) and have the largest projected growth rate (40%) of all expenditure categories, slightly higher than PSERS. Net Other Expenditures, a grouping of non-personnel expenditures, is the second largest expenditure category and third largest dollar growth, slightly less than Charter Tuition.

Health Care and Other has the lowest projected five-year dollar gain as health costs are estimated to be held to relatively small annual increases due to implementation of district cost containment strategies that involve plan design changes for medical and pharmacy coverages. These include: increased premium shares for employees; modified spousal rule surcharge rules; raised co-pays; co-insurance; altered or removed premium assistance programs for retirees; introduction of high-deductible plans with fixed cost payments to Health Savings Accounts. Other factors include the overall reduction of district positions and use of outside contracting. The projected five years, 2017-18 through 2021-22, are close to being balanced between projected revenues and projected expenditures with only a small shortfall of $45 million (-3.2%) for the state.

Figure 8 illustrates the changes in percentage support from the major revenue sources over the total five-year amounts for each time period. The two largest projected changes in percentage share are in: 1) Total Local Revenues where the share of support is projected to decline from 85% to 81%; and 2) BEF where the state share is projected to decline from 20% to 16%. SEF and Total Federal show minor share changes. However, the projected reduction in percentage support share for Total Local Revenues and corresponding increase for BEF could be misleading. The very high Total Local Revenue share from 2012-13 through 2016-17 was due to the relatively low funding increases from BEF during this time period; as shown previously in Table 5, two of the years in the five-year period had reductions in the BEF subsidy and another had a zero dollar increase. For a different and more balanced perspective, Table 8 shows the impact in dollars, not just percentage change, where the amount of funding from Total Local Revenues is projected to increase by approximately $2.8 billion

Figure 8

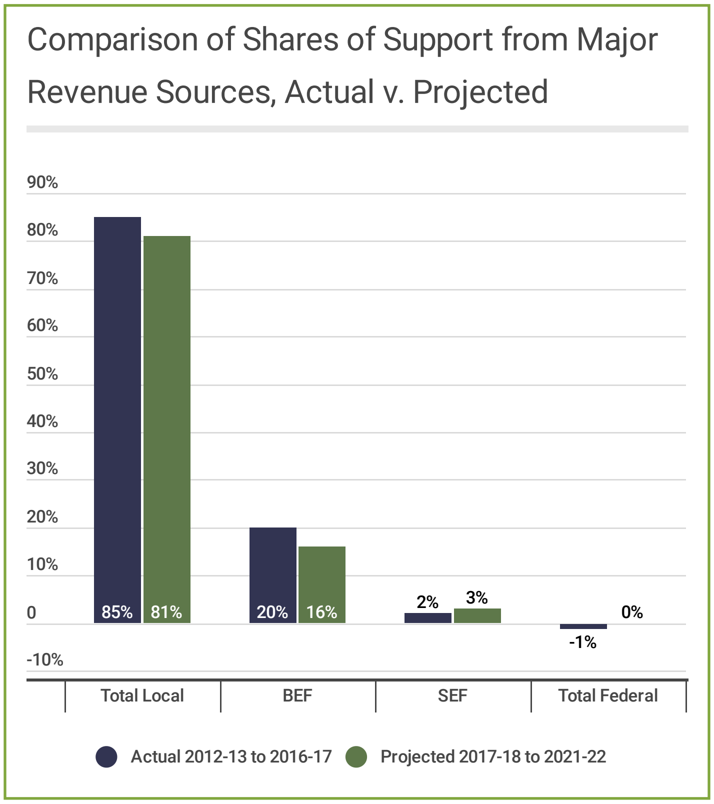
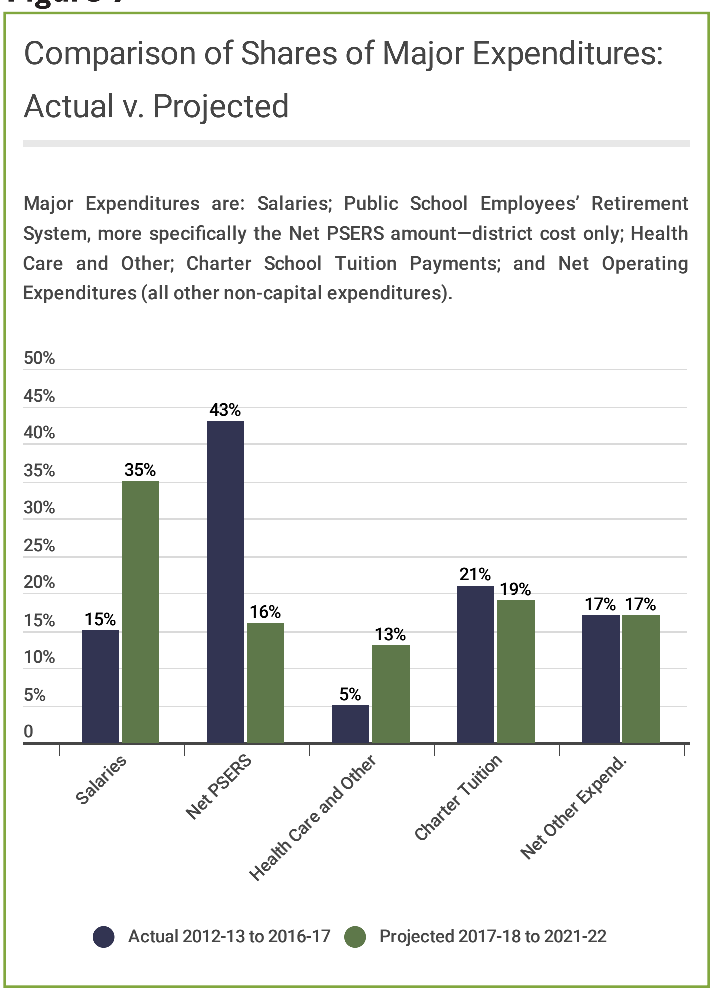


Figure 9



over the next five years, while over the same time, state BEF funding is projected to increase at $730 million (assuming an annual growth of 2.0%). BEF thus raises its share of support, although it would continue to contribute a much lower amount than Total Local Revenues.

Figure 9 shows the same comparisons for expenditures. It reflects the projected changing composition of district expenditures. Salaries and PSERS trade places in their share of the increases in total district expenditures with Salaries rising from a low of 15% to a dominant 35%, while PSERS drops from 43% to 16%. Health Care would also increase its share from 5% to 13%. The result would be a more equal distribution of expenditure categories, with four of the five categories in the 13% to 21% range of total expenditures. Salaries, with substantially greater growth, will have the greatest impact on district budgets during the projection period. During the previous five years the distribution was more distorted with PSERS and Charter Tuition being the primary expenditure drivers.

SENSITIVITY ANALYSES OF MAJOR REVENUES AND EXPENDITURES[11]

Several analyses were conducted to test the sensitivity of the projection results to changes or potential changes in the assumptions. These are important analyses since many of the assumptions are estimates based on past conditions, policy decisions yet to be made by the legislature and school districts, and future economic conditions. The results given in **Table 9** provide a policymaker's guide to gauge the impacts of decisions that result in changes in revenues and expenditures. It shows the effects of a 1% change in the value of each of the variables in terms of the 2019-20 dollar impact, the five-year cumulative dollar impact, the additional number of districts put into or out of a shortfall condition in 2019-20 (the first year a change could me made), and the total number of districts in shortfall at the end of five years in 2021-22. Note that the dollar impact could be either positive or negative depending on the direction of the change, although the revenue categories are illustrated as having positive fiscal impact on districts, while the expenditure categories are shown as having negative fiscal impacts. Increased percent changes in revenue items would raise projected revenues and reduce the projected statewide shortfall results but decreases in revenues would lower the revenues and increase the number of shortfall districts. For expenditures the reverse is true; an increase in the percentage change would increase

11. For a description of all the initial assumptions, see Assumptions for Projections: Baseline Case in the Appendix.

Table 9

SENSITIVITY ANALYSES FOR REVENUE AND EXPENDITURE CATEGORIES						
	Baseline %	Test % with +1% Change	2019-20 $ Change with +1% from Base	5-Year $ Impact with +1%	Change in 2019-20 Shortfall Districts	# of Shortfall Districts in 2021-22
Revenues						
Total Local	3.14%	4.14%	$52,337,170	$262,726,265	-5	285
BEF +1%	2.00%	3.00%	$60,950,790	$192,110,795	-36	259
BEF -1%	2.00%	1.00%	($60,951,490)	($188,380,606)	+23	327
SEF +1%	2.00%	3.00%	$10,881,789	$44,642,953	-14	291
SEF -1%	2.00%	1.00%	($10,674,517)	($43,349,056)	+25	303
Expenditures						
Salary	2.10%	3.10%	$126,226,916	$632,347,944	+54	361
PSERS			$21,155,627	$101,342,860		
Health Care	3.00%	4.00%	$32,325,247	$163,077,118	+18	315
Charter Tuition	7.00%	8.00%	$21,794,600	$110,514,373	+6	304
Net Other Expenditures	2.08%	3.08%	$32,153,487	$161,161,616	+18	321

the expenditures, but raise the overall number of districts in shortfall conditions, while the opposite would be the case if the expenditure change were negative. The results for 1% decreases from the baseline assumptions for BEF and SEF are also shown in Table 9.

A +1% change in the projected annual Total Local Revenue increases would raise the revenue estimates about $262 million over the baseline assumption for the five-year projection period. A separate rate for each district is applied, which is a modified three-year average rate, bounded by an overall range to keep the district rate between 1% and 5% in order to keep individual districts' rates reasonable for projections; the statewide average was 3.14%. An increase of 1% to that range of projection rates would boost the annual Total Local Revenue growth approximately $52 million in 2019-20. Concomitantly, an additional five districts would be projected to move out of shortfall in 2019-20 reaching a total of 285 districts by 2021-22. The reason for the relatively small impact is that most of the districts are inside the growth range rate limits and would not be affected by the change.

The baseline assumptions for BEF and SEF in the model are both a 2.0% annual increase. Each 1% increase in the BEF from this base would result in approximately $60 million of additional revenues for districts in 2019-20 and 36 fewer districts having shortfalls in that year. For the longer term, a 1% increase in BEF to a 3% annual increase would raise the five-year total revenue estimates by approximately $190 million and reduce shortfall districts by 39 to leave 259 shortfall districts. The pattern is similar for SEF. A 1% increase in the SEF assumption to a 3% annual increase would result in an increase for the SEF subsidy in 2019-20 of about $10 million and leave 14 fewer districts in shortfall condition. The total five-year revenues would increase approximately $45 million with 291 districts remaining in shortfall conditions by 2021-22.

A 1% change in projected annual increase for Salaries would result in a gain in 2019-20 of $126 million and a related change of $21 million for PSERS. An additional 54 districts would be in a shortfall condition with the higher costs. For the longer perspective, there would be a five-year cost increase of about $632 million for salaries alone and $101 million in PSERS (since PSERS expenditures are based on the level of Salaries) for a total five-year cost increase of $733 million. The result would be an estimated 361 districts in shortfall by 2021-22.

For Health Care, a 1% increase in the estimated annual growth would yield an increase in the projected expenditures in 2019-20 of $32 million and have 18 more districts in shortfall. For the five-year results there would be an estimated additional cost of $163 million in five-year total expenditures and 315 districts remaining in shortfalls by 2021-22. The model has a 3% increase as the base case.

Each 1% change in the rate of Charter School Tuition Payments would cause a $110 million change in five-year total expenditures and have 304 districts in shortfall conditions in 2021-22. The base case for the model is a 7.0% increase, a conservative extrapolation of the prior three year's statewide averages and much lower than double digit increases in prior years. For the short term, if the tuition payments were increased by 1%, the additional costs to the districts in 2019-20 would be higher by $21 million and an additional six districts would go into shortfall.

For Net Other Expenditures, the grouping of non-personnel, non-capital expenditures, an increase of 1% in the projected change would mean a five-year change of $161 million with 321 districts remaining in shortfall conditions. For 2019-20, the annual increase would be approximately $32 million that year and cause an additional 18 districts to go into shortfall.

CONCLUSIONS

A. In sum, the upcoming five years in the projections are likely to continue to be difficult for many school districts through 2021-22.
• "Fiscal stress" will remain, although to a lessening degree as the number of shortfall districts decline from 378 to 298 by the end of the period
• 60% of districts will remain in shortfall conditions by 2021-22

B. Local revenue, primarily property tax, will continue to carry the largest burden for education
• There will be a $2.8 billion increase over five years, an 81% of total revenue increase
• This fact remains unless state funding increases and/or supplants the local share significantly

C. Conditions for districts are projected to be in a less volatile period than the prior 10 years
• The condition is not static, however, as key fiscal components will change
• This will lead to tension with increasing mandates exceeding state funding

D. Shortfall districts may be becoming locked into permanently negative financial positions
• Fiscally stressed districts appear to be moving toward a steady-state negative condition
o At the projected funding levels in the study, neither local resources nor state sources can lift them sufficiently to avoid ongoing fiscal stress
• Reaching the required balanced budget would likely require program cuts to reduce expenditures
o Districts cannot reduce mandated expenditures: PSERS, and Charter School Tuition

E. There is the possibility of the state being divided into two groups of districts—Haves and Have-Nots
• Have-Nots:
o Lower expenditures, fewer educational resources, lower levels of staffing, and other limited opportunities for students
• Haves:
o With sufficient resources to maintain or improve their fiscal condition

F. Growing Charter School costs will place an increasing burden on school district taxpayers
• $1.65 billion in 2016-17, projected to grow to $2.32 billion in 2021-22
• Increases in charter school costs are projected to exceed the amounts for BEF for each year
• No state support for state mandated costs; full burden falls on local taxpayers
• The BEF and SEF act more like pass-through funds from the state to charter schools
o No state support left for instruction, operations, PSERS
• Modifying the Charter School funding formula would require legislative action

G. PSERS, the other state mandated cost, will add further to district budget shortfalls
• Impact will lessen over time
o High in early years and dropping off in later years as increases in ECR are smaller

H. Fiscal policy for education has produced a funding structure leading to inequity and more fiscal stress
• There is an imbalance between limited revenue increases and growing mandated expenditures
• Many districts have been placed in permanent structural deficits
• This can only be corrected by legislative policy changes

The phenomenon of shortfalls for a substantial majority of districts in the state is not a one-year or even a short-term condition. It is a persistent, ongoing, and systemic crisis that will continue and worsen unless structural changes are made in the Pennsylvania school funding system.

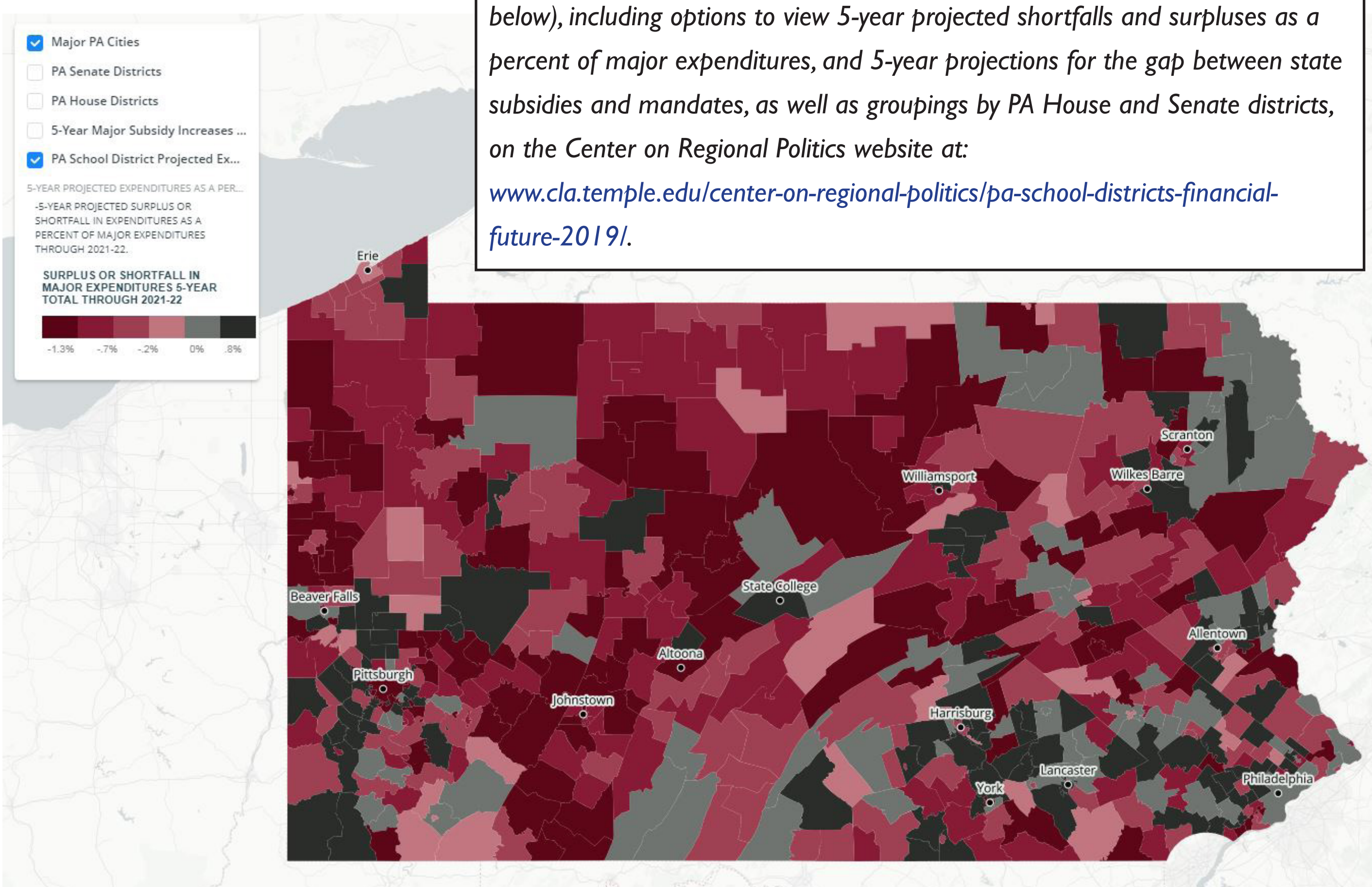
Without such comprehensive improvements, the probability of a state permanently divided into two school groups of districts is a distinct possibility: the Have-Nots that are continually undergoing fiscal stress leading to reduced and limited resources for students, versus the Haves with adequate funding and the ability to continually improve programs for their students.

About the Authors

William T. Hartman is a professor emeritus at the Pennsylvania State University's College of Education. His areas of research include public school finance, financial management of schools, school district budgeting practices, and data analysis for student performance improvement and decision making. His recent research focuses on the fiscal impacts on school districts of the current economic crisis. Other areas of interest include school district budgeting models and forecasts, special education finance, charter school funding, resource allocation at school and district levels, and decision making models in educational finance. Dr. Hartman has served as a consultant or advisor to state school funding projects in California, Florida, Maryland, North Carolina, Ohio, Pennsylvania, Idaho, and Vermont. He obtained a bachelor's degree in mechanical engineering at the University of Florida, a master's degree in business administration in management control and marketing at Harvard University, and a doctorate in educational finance and administration at Stanford University.

Timothy J. Shrom served 36 years as the business manager/CFO for the Solanco School District in Quarryville, Pennsylvania. Prior to his work at Solanco, he served in the Lancaster County banking sector. Presently, he serves as the director of research for the Pennsylvania Association of School Business Officials (PASBO). He has served as president of PASBO and represented the Association of School Business Officials International as a member of the National Center for Education Statistics (NCES) School Facilities Task Force. For PASBO, he served as chair of its Statewide Health Care Task Force, and as a trustee and Operating Committee chair for the PA School District Liquid Asset Fund (PSDLAF). Dr. Shrom holds a B.S. degree in business from Elizabethtown College, and a master's and PhD in educational leadership from Pennsylvania State University. His academic areas of concentration are school finance policy and school health care delivery structures. He has served as a board member of the Lancaster County Chamber of Commerce, as the chair of the Central Penn Business Group on Health, and as an executive committee member for the Lancaster-Lebanon EHCC health care consortium.

Find the full report, interactive graphics and PA school district maps (example below), including options to view 5-year projected shortfalls and surpluses as a percent of major expenditures, and 5-year projections for the gap between state subsidies and mandates, as well as groupings by PA House and Senate districts, on the Center on Regional Politics website at: www.cla.temple.edu/center-on-regional-politics/pa-school-districts-financial-future-2019/.



APPENDIX

Definitions Used in the Study[12]

Major Revenues used in the study are:
- Total Local Revenue. Includes property tax, earned income tax, all other local taxes collected, and all local non-tax revenue. (6000 revenue code)
- Basic Education Funding (BEF) from the state (7110 revenue code)
- Special Education Funding (SEF) from the state (7270 revenue code)
- Total Federal Revenue (8000 revenue code)

Major Expenditures used in the study are based on the Object dimension:
- Salaries. Total salary amounts (100 expenditure code)
- Public School Employees' Retirement System (PSERS). Net PSERS amount—district cost only. State subsidy for PSERS is deducted from total PSERS expenditures (230 expenditure code less State Subsidy 7820 revenue code)
- Health Care and Other. District total benefit costs (200 object code) less Pension (230) and Social Security (220) expenditure codes
- Charter School Tuition Payments (562 expenditure code). Includes tuition payments for both special and non-special students
- Net Other Expenditures (Non-Capital)
  - o Benefits—All remaining accounts except PSERS and Health Care.
    - Social Security - district cost only (220 expenditure code less State Subsidy revenue code 7810)
    - Tuition Reimbursement (240 expenditure code)
    - Unemployment Compensation (250 expenditure code)
    - Workers' Compensation (260 expenditure code)
    - Other Postemployment Benefits (OPEB) (280 expenditure code)
    - Other Current Employee Benefits (290 expenditure code)
  - o Purchased Professional and Technical Services (300 expenditure code)
  - o Purchased Property Services (400 expenditure code)
  - o Other Purchased Services except Charter Schools (500 expenditure code less 562 expenditure code)
  - o Supplies (600 expenditure code)
  - o Property (700 expenditure code)

Other Objects (800 expenditure code) which includes interest payments and Other Uses of Funds (900 expenditure code), which includes redemption of debt and fund transfers are excluded from the analysis.

Assumptions for Projections: Baseline Case

• Total Local Revenue

Used actual latest three-year average change for each district modified with any negative average set to 0% and maximum rate capped at 5%. The three-year average growth across all districts was 2.74%. The growth of Total Local Revenue (primarily property taxes) parallels the IFO projections of property tax growth[13] through this time period, although there are some year-to-year variations.

• BEF

Used 2% annual increase as a most likely estimate. Only the last three years, 2019-20 through 2021-22, were projected since the 2017-18 and 2018-19 actual amounts were known. Distribution to districts was based on a proxy of the new BEF formula using the 2018-19 allocation shares. Although district share trends will change over the three-year projection period, using each districts' "revised" share of new funding from the 2018-19 year four of the formula, will be the most accurate estimates at this time.

• SEF

Used 2% annual increase.

• Total Federal

Total federal funding was included. Used 0% annual increase for the projection period. No repeat of ARRA funding is anticipated. Most federal programs require LEAs to spend all funds provided within a narrow range of carry-over, so any significant federal increases will have little impact on the surplus/shortfall positions in this study.

• PSERS

Used NET district costs after deducting state subsidy. Incorporated the latest official PSERS Employer Contribution Rates, which are increasing, but at a declining rate from 32.57% in 2017-18 to 35.68% in 2021-22.

12. Based on accounting codes from *Manual of Accounting and Financial Reporting for PA Public Schools*. Revised July 2018.
13. Independent Fiscal Office. 2017 . Letter to Pennsylvania Representative Jim Cox regarding forecasts for school property taxes. January 4. Harrisburg, PA.

- **Salaries**

Used 2.1% annual increases for all districts. This was the statewide increase in 2016-17. It is consistent with the range estimated in the PSERS 2017 Actuary report, (1.49% to 2.42%).[14]

- **Health Care and Other**

Used 3% annual increases for all districts.

- **Charter School Tuition Payments**

Used 7% annual increases for all districts (2016-17 Statewide Average). This represents an extrapolation of the last three years' growth rates of 3.5%, 4.2%, and 6.8% respectively. This is a conservative estimate since the statistical forecast growth rate for 2017-18 is 8.1% and would rise in later years. The annual increase used in the study is also well below the double-digit growth rates experienced prior to 2014-15.

- **Net Other Expenditures (Non-Capital)**

Used actual latest three-year average change for each district modified with any negative average set to 0% and maximum increases capped at 5%. The three-year modified average growth across all districts was 2.04%. Included in this area are major instructional and support expenses not already included in Salaries, Benefits or Charter School Tuition. These expenditures are primarily categorized as: the remaining 200 Benefits; 300 Purchased Professional and Technical Services, 400 Purchased Property Services; 500 Other Purchased Services; 600 Supplies; and 700 Property.

Detailed Description of Analytical Approach

A simulation model was created to project the results for each selected fiscal category. The model contained the five past years of actual data (2012-13 through 2016-17) for each district for each of the fiscal categories. From the base data, the annual dollar and percentage changes were determined for each district. Since for some fiscal elements there were substantial differences among districts in the annual changes for a given year and within each district on a year-to-year basis, several statistics were calculated for each year to examine the summary results; these included the average for the total state change, the average of the individual district changes, and the median of the individual district changes. To provide more insight to the overall results, the number of districts that had positive and negative annual changes and the total dollar amounts involved across the state were also calculated each year.

Using the model, projections for the revenues by category and for the major expenditures for each district were calculated annually for the next five years, 2017-18 through 2021-22. The projections were based on the most likely assumptions established previously. If the projected revenues exceeded the expenditures, the district would have a surplus, but if projected expenditures were greater than revenues, the district would experience a shortfall. The shortfall indicates the magnitude of fiscal stress the district would be facing in the future and the additional revenues or size of the budget cuts necessary to reach a balanced budget as required by law. To examine the varying impacts on districts, the number of districts with shortfalls or with surpluses annually for the five years was determined.

The results were summarized to the state level to determine the projected fiscal conditions for Pennsylvania's school districts over the next five years. Analyses were conducted to examine whether there were expected to be surpluses or shortfalls each year both for the state as a whole and for individual districts along with the number of districts that had surpluses and shortfalls each year and the dollar magnitudes involved. The trends over the five years were also examined along with the impacts of each of the fiscal categories on the outcomes.

Fund Balance Analysis[15]

Pennsylvania school districts can utilize five separate types of fund balances that serve different purposes as specified in the *Manual of Accounting and Financial Reporting for PA Local Education Agencies*.[16]

0810 Nonspendable Fund Balance

Amounts that cannot be spent because they are either in a non-spendable form, or legally or contractually required to be maintained intact such as inventory, or principal of a permanent fund.

0820 Restricted Fund Balance

Amounts constrained to be used for a specific purpose per external parties or legislation.

14. From June 30, 2017 PSERS (Conduent) Actuarial Report presented to the PSERS board, May 2018.
15. For a recent analysis of Pennsylvania Fund Balances, including their distribution among school districts, see David W. Davare. 2018. *Explaining School Fund Balances: Are PA Local Education Agencies with a $4.9 Billion Fund Balance, Holding Too Much in Reserve? An Update for FY 2016-17.* A Policy Brief from the Center on Regional Politics, Temple University.
16. Chart of Accounts for PA Local Educational Agencies, 2018-19. 2018. Harrisburg, PA: PA Office of the Budget.

0830 Committed Fund Balance
Amounts constrained to be used for a specific purpose as per government's highest level of decision making authority such as the school board, board of directors, board of trustees, etc. Note: board resolution required. Constraint can also be removed or changed by an equal level action.

0840 Assigned Fund Balance
Amounts intended to be used for a specific purpose as per a committee or individual authorized by the governing body. These amounts are not restricted or committed.

0850 Unassigned Fund Balance
Amounts available for any purpose within the general fund only. Other governmental funds, by their nature would automatically require that funds be classified as nonspendable, restricted, committed or assigned. In the event that a fund, other than the general fund, has expenditures that exceed revenues, the unassigned fund balance category may be used to report a negative ending fund balance only.

Of these different types, the three main fund balance accounts used by school districts are the Committed, Assigned, and Unassigned. The committed and assigned fund balances are used to set aside funds to be used for specific purposes, while the unassigned fund balance serves more as a contingency reserve and can be used for any purpose to support the district. However, by statute, unassigned fund balances for Pennsylvania school districts with total expenditures cannot exceed 8% of total expenditures if they wish to raise property taxes; higher maximum percentages are established for districts with lower total expenditures.[17]

Table 10

TOTAL AND RELATIVE SIZE OF FUND BALANCE AMOUNTS							
	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**5-Year $ Change**	**5-Year % Change**
C + A FB	$2,259,820,649	$2,446,469,980	$2,550,103,224	$2,576,462,144	$2,644,949,946	$385,129,297	17.0%
Unassigned FB	$1,723,587,607	$1,643,400,402	$1,730,292,610	$1,830,200,202	$1,900,540,457	$176,952,850	10.3%
Total FB	$3,983,408,256	$4,089,870,382	$4,280,395,834	$4,406,662,346	$4,545,490,403	$562,082,147	14.1%
Total Expenditures*	$25,564,247,877	$26,128,265,208	$27,386,591,259	$28,308,905,232	$30,495,435,507	$4,931,187,630	19.3%
Fund Balance % of Total Expenditures							
C + A FB	8.8%	9.4%	9.3%	9.1%	8.7%		
Unassigned FB	6.7%	6.3%	6.3%	6.5%	6.2%		
Total FB	15.6%	15.7%	15.6%	15.6%	14.9%		
Days of FB							
C + A FB	32	34	34	33	31		
Unassigned FB	24	23	23	23	22		
Total FB	56	56	56	56	54		
Total Days	360	360	360	360	360		
Uncovered Days	336	337	337	337	338		
Covered by Unassigned FB	24	23	23	23	22		

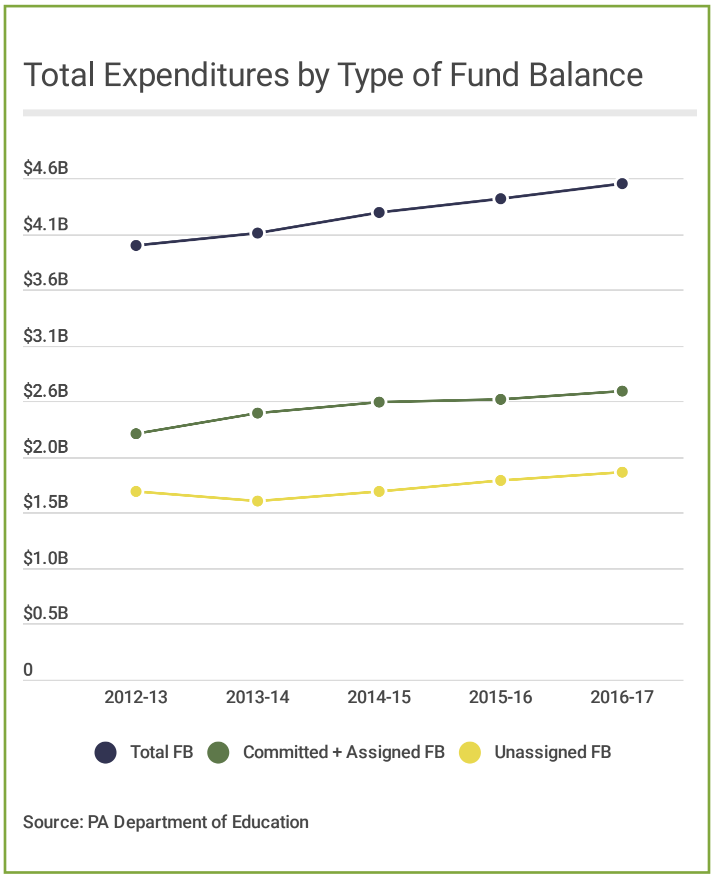
*Without increases in Charter School Tuition and Gross PSERS, the net five-year total expenditure gain was 10.9%.
Source: PA Department of Education webpage. Detailed AFR Data, General Fund Balance: 1996-97 to 2014-15 (Excel), accessed January 10, 2017. Available at http://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VZwC6mXD-Uk

17. See the Pennsylvania Code, 24 PS 6-688, Limitations on certain unreserved fund balances.

The fund balance analysis examined the magnitude and variations of these three major accounts over the time period 2012-13 through 2016-17. The standard measure of fund balances is the percent of total expenditures and was used as the metric since dollars alone are insufficient to evaluate the appropriateness of fund balances, which are relative to individual district spending levels and economic conditions. Another comparable indicator is the number of equivalent days of budget coverage of the fund balance; this puts the dollars and percent measures in an operating perspective for a district. For example, the 8% maximum established for unassigned fund balances, if the district plans to raise property taxes, will support only approximately 29 days for a district to operate.

The fiscal history of total annual school district fund balances in Pennsylvania is shown in **Table 10**. Here, the Committed and Assigned (C+A) fund balances are combined into a single account since they are both used to set aside monies for specific planned future uses in the district. The actual dollar amounts are also shown as a percent of total expenditures to measure their relative magnitude.

Figure 10



The patterns of the two types of fund balances have been similar over the past six years as illustrated in **Figure 10**. Unassigned fund balances have remained fairly steady in the range of $1.6 billion to $1.9 billion annually. Their percent of total expenditures has also remained more or less steady, fluctuating up and down small amounts annually ranging from 6.7% of total expenditures to 6.2%. At these levels, they have consistently remained, on average, well below the maximum permissible levels allowed by the state. The general pattern is one of stable fund balances that support district current operations.

In a similar fashion, Committed and Assigned fund balances have shown a pattern of small annual growth with total amounts ranging from $2.2 billion to $2.6 billion per year. Their percent of total expenditures rose in the first two years of the period and then declined in the latter three, starting at 8.8%, moving to 9.4% at the peak and declining back to 8.7% by the final year. The different purposes of these fund balances are reflected in their growth pattern in connection with economic and fiscal stress and uncertainty that districts faced over this time period.

The dollar growth in Committed and Assigned fund balances, as well as Unassigned fund balances, is intertwined with the past six years of state policy and actions and reflect districts acting to maintain and protect their fiscal ability to operate adequate educational programs in accordance with educational standards established by the state. The fiscal policies and mandates that have impacted districts include:

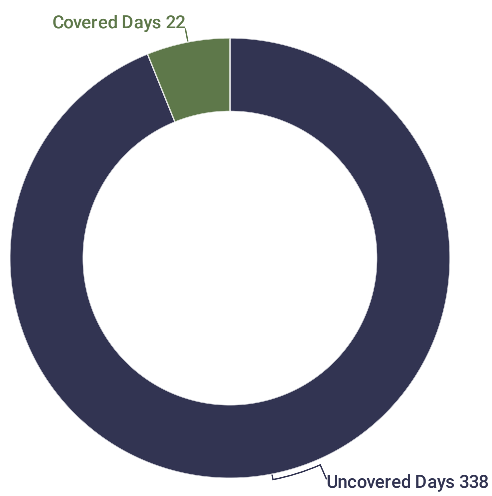
- unreliable and substantially delayed state budgets;
- state funding uncertainty and volatility in levels of state subsidies;
- state withdrawal from capital formation policy and support (PlanCon);
- rapidly rising pension expenditures;
- substantial increases in charter school tuition payments and elimination of the state support;
- increases in reserves for rising health care costs;
- no state subsidy increases for special education for multiple years; and
- nearly a decade of some extreme deferred maintenance in some districts and other LEAs.

District responses to the fiscal stresses from these state policies and mandates were strongly influenced by the restrictions of Act 1 on the ability to increase annual millage rates. Without the ability to raise property taxes beyond the level of inflation, prudent fiscal budgeting and planning led districts to build reserves ahead of time to support anticipated future expenditures. To achieve a balanced budget without significant educational program reductions in the face of unfunded state mandates and uncertain, and, in some cases, reduced state funding, meant establishing committed and assigned fund balances from which to support future needs.

To illustrate the relative magnitude of an unassigned fund balance in district fiscal planning, **Figure 11** shows the proportion of the budget year that the actual 2016-17 state total unassigned fund balance represented in relation to districts' total expenditures for the operating year. The total unassigned fund balance for all districts in 2016-17 was 6.2% of their total expenditures. This was equivalent to 22 days of operation for a 360 day year. Using their unassigned fund balances alone, districts could only operate for approximately three weeks—less than a month's payroll and vendor payments—if other planned revenues did not materialize or were late.

Figure 11

Equivalent Budget Expenditure Days of Unassigned Fund Balance 2016-17



Source: PA Department of Education

While fund balance analyses are important to understand fiscal activity, and to a degree the fiscal health of a district, for the most part fund balance is a critical tool for cash flow and hedging tax rate increases. When a district is deciding tax rates in May before state subsidies are known, a reasonable fund balance allows the district to mitigate any rate increase being considered. Without a sufficient fund balance, any estimated shortfalls in the projected year will have to be settled through reductions in expenditures and/or property tax rate increases.

Fund balance is the result of subtracting current assets from current liabilities on the district's balance sheet. While assets will include cash and investments, most district assets must also accrue funds "due" from governmental units and taxes yet to be collected from that fiscal year. Liabilities reflect estimated costs for unpaid items such as summer payrolls, benefits incurred but not yet paid, and final invoices for the fiscal year ending. On June 30, when the fiscal year ends and the fund balance is determined, it represents a one-day snap shot of how much districts are owed from the state, federal government, or other government bodies, and tax collection entities, and how much they owe to a variety of creditors. At this point, the fund balance represents a contingency to be able to operate while allowing for late payments from government agencies, changes in actual expenditures from those estimated in liabilities, and to deal with unexpected financial requirements.

In summary, unassigned fund balance activity appears to be consistent with prior findings as it remains around the equivalent of less than one month, or approximately 6.2% of total expenditures.

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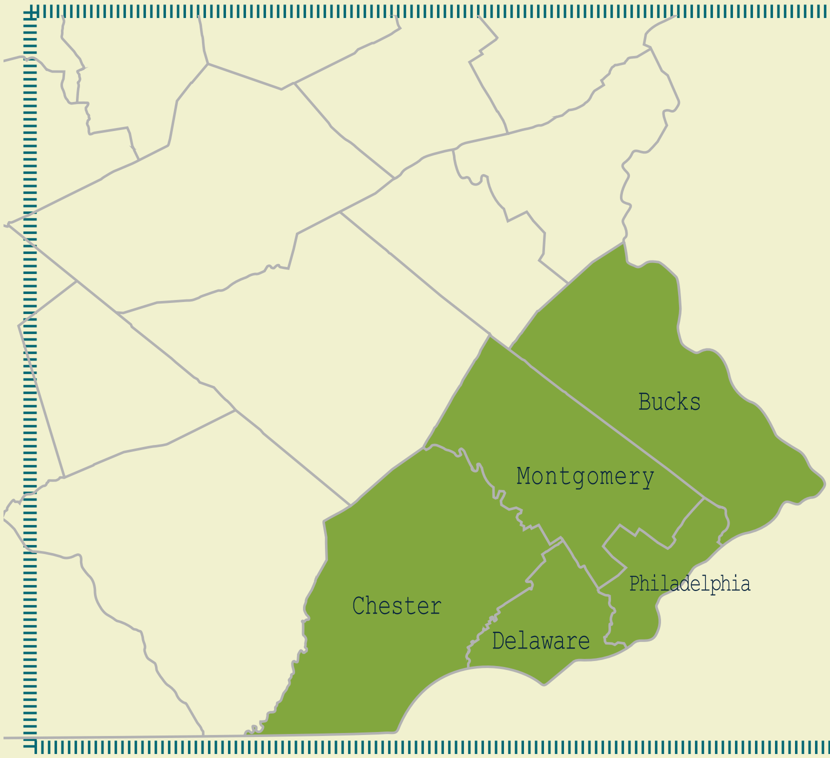

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POLICY BRIEF

A Tale of Haves and Have-Nots: The Financial Future of Pennsylvania School Districts

WILLIAM HARTMAN & TIMOTHY J. SHROM

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