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Current trends in school finance

Massachusetts school districts are at a fiscal crossroads

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Funding public education represents a massive state and local effort. Spending on education is second only to Medicaid in terms of the overall state budget and it consumes the largest share of local tax revenues. Between state and local taxes, Massachusetts taxpayers spent nearly $11 billion to operate the Commonwealth's PK-12 education system in fiscal year 2006.

School districts across the Commonwealth have faced significant fiscal pressures in recent years. Rapidly increasing health insurance premiums, higher tuition charges for special education students, and slow-growing and declining state aid during the last economic downturn are all contributing to these budgetary challenges.

Recent changes have brought some relief, most notably in funding for special education students, reforms to the Chapter 70 formula and increases in state aid, and restructuring of the School Building Assistance program. Yet, Massachusetts school districts still sit at an important fiscal crossroads.

Balancing rapidly increasing costs with the needs of students is challenging our education system. Examining the recent trends in school district expenditures and revenues during the past five years can shed light on these and other challenges that districts will continue to face in the future.

Where does the money go?

School districts spend most of their money on providing instructional services for students (see Table 1). Instructional spending amounts to $6.4 billion statewide and comprises 57 percent of total operating expenditures. Most of the cost of educating students is teacher salaries, comprising $4.1 billion or 37 percent of total spending. Other instructional services include salaries for principals, curriculum directors, paraprofessionals, librarians, medical and therapeutic staff, and guidance counselors and psychologists. Districts also need to purchase instructional materials and technology and provide professional development programs for their staff. Collectively these and other associated items amount to $2.2 billion, or 20 percent, of total district spending.

While not considered part of instructional spending, districts spend a significant amount of money on tuitions to send students to schools or programs outside of their home districts.

These include students who attend charter schools or other public school districts through the school choice program. It also includes special education students who attend collaboratives or private day or residential schools. Close to $940 million, or 8 percent, of district spending goes to cover these tuition costs.

The infrastructure that supports teachers and students in the classroom is also extensive. School districts provide transportation and food services for their students. They also cover a significant percentage of the health insurance costs for teachers and other district staff. Furthermore districts oversee the general maintenance and upkeep of their buildings. These indirect services amount to $3.5 billion, or 32 percent, of total district operating costs. Administrative costs occupy a relatively small part of the overall spending picture at $356 million or 3 percent.

Table 1: School district operating expenditures, all funds ($ in millions)

Spending	FY02	FY03	FY04	FY05	FY06
Administration	320.3	327.0	324.6	345.4	356.5
Instructional leadership	620.8	659.4	644.3	672.0	694.2
Classroom and specialist teachers	3,796.1	3,869.8	3,908.7	3,988.0	4,126.0
Other teaching services	580.8	614.6	634.9	677.8	721.2
Professional development	205.9	212.0	201.5	184.7	182.6
Instructional materials and equipment	349.7	321.3	316.4	320.8	341.0
Guidance, counseling, and testing	257.4	269.4	267.6	281.4	296.6
Pupil services	843.5	870.4	873.6	892.2	970.5
Operations and maintenance	749.9	759.6	781.2	834.8	911.5
Insurance and retirement programs	1,046.2	1,183.5	1,384.0	1,515.9	1,659.7
Payments to out-of-district schools	645.6	717.6	802.5	891.8	938.7
Total operating expenditures	9,416.4	9,804.5	10,139.4	10,604.8	11,198.5

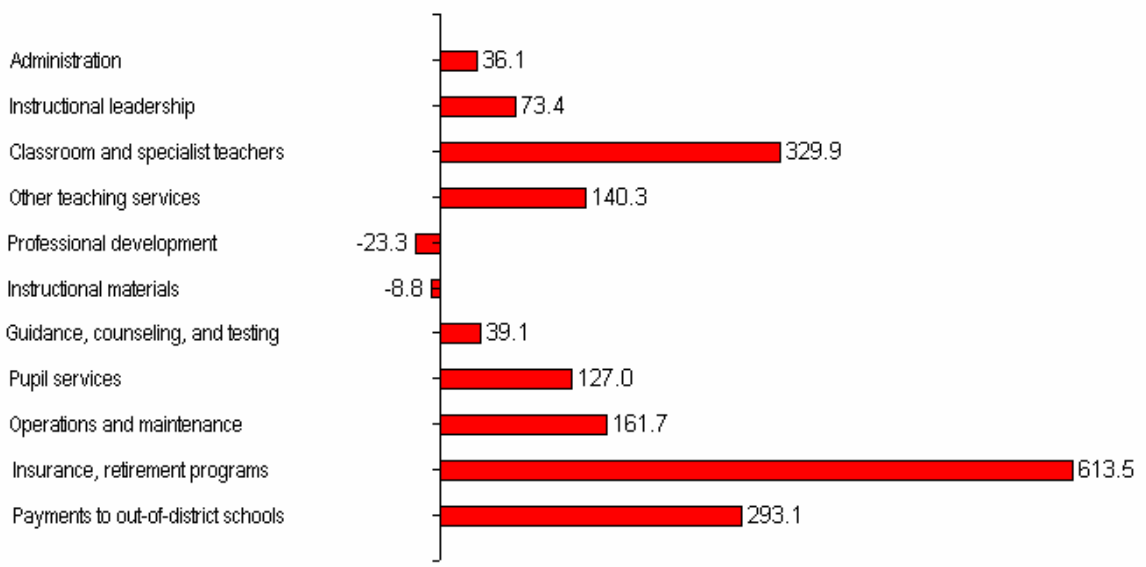
Note: Retirement programs do not include payroll contributions to the Massachusetts Teacher Retirement System.
Source: Massachusetts Department of Education End of Year Pupil and Financial Reports

Between fiscal years 2002 and 2006, district operating expenditures increased by 19 percent, or $1.8 billion (see Figures 1 and 2).[1] One-third of this increase, or $614 million, was driven by rapid growth in health insurance costs. This reflects a national trend of rapidly increasing health insurance costs for all employers. School districts are obligated through their collective bargaining agreements to provide a specific level of coverage to their active and retired employees even if the cost of insurance increases. As a result, health insurance as a share of total operating expenditures grew from 11 percent to 15 percent between fiscal years 2002 and 2006 and will likely increase further if current trends continue.

[1] Unless otherwise indicated, all dollars are expressed in nominal terms.

Figure 1: Change in district operating expenditures, FY02 to FY06

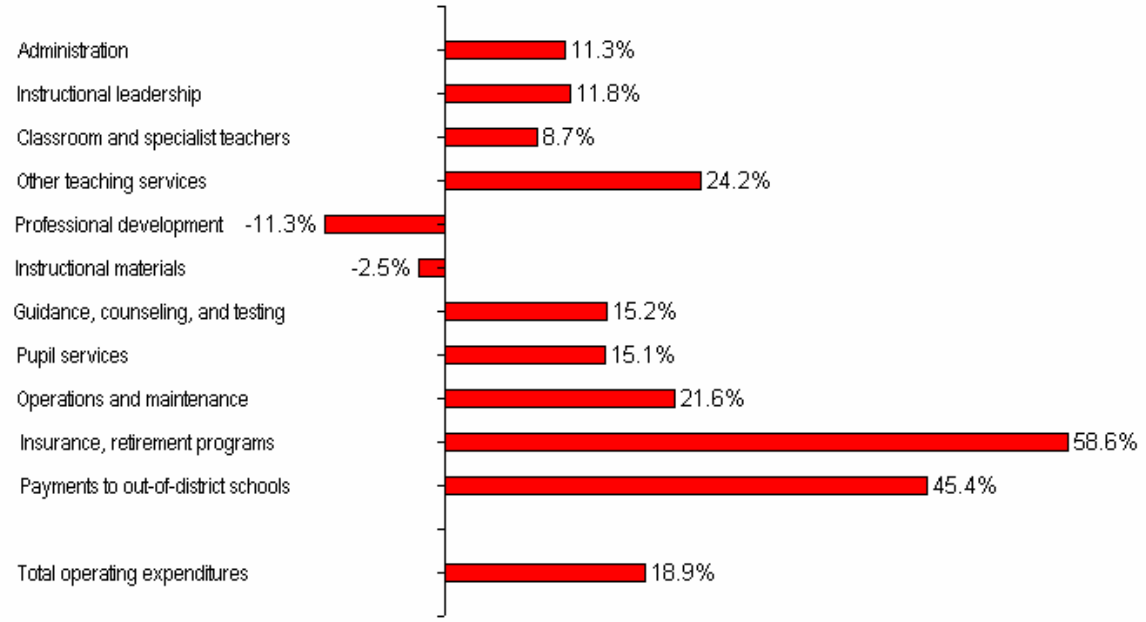
State totals by functional category ($ in millions)



Note: Retirement programs do not include payroll contributions to the Massachusetts Teachers Retirement System.
Source: Massachusetts Department of Education End of Year Pupil and Financial Reports

Figure 2: Percent change in district operating expenditures, FY02 to FY06

State totals by functional category



Note: Retirement programs do not include payroll contributions to the Massachusetts Teachers Retirement System.
Source: Massachusetts Department of Education End of Year Pupil and Financial Reports

Payments to out-of-district schools also increased substantially: by $293 million or 45 percent. An increase in tuition payments to private special education schools accounted for the largest share of growth in this category. Some of these cost increases were borne by the state through the Circuit Breaker program, which reimburses districts for the expense of educating high-cost special education students, both in-district and out-of-district.

Other teaching services, which includes paraprofessionals, medical and therapeutic services, substitutes, and librarians, also increased by 24 percent. The largest increases in this category were in salaries for paraprofessional and medical and therapeutic staff.

Salaries for classroom and specialist teachers occupy the largest slice of the spending pie, and during this period they grew by $330 million or 9 percent. Relative to other increasing expenditure categories, teacher salaries grew at the slowest rate. As a result, the share of district operating budgets going towards teacher salaries fell from 40 percent to 37 percent.

The two areas where spending declined were professional development and instructional materials. Professional development spending fell by $23 million, or a little more than 10 percent. School districts spent less on professional development in response to fiscal pressures and because the state relaxed its $125 per pupil spending requirement for professional development in fiscal year 2004. The fiscal downturn also affected spending on instructional materials, which declined by $9 million or 2.5 percent over the same period.

Where does the money come from?

School districts rely on a variety of funding sources to support their operating budgets, including local property taxes, Chapter 70 (state) aid, state reimbursement programs, federal and state grants, and user fees. On average districts receive the majority of their funding from local property taxes, but in fiscal year 2006 there were 64 districts that relied on Chapter 70 aid to fund more than 50 percent of their operating budgets. Reimbursement programs and federal and state grants make up smaller shares of the revenue picture, but these funds play important roles in supporting programs and helping districts deliver needed services.

Property taxes

Unlike school districts in many other states, districts in Massachusetts lack the independent authority to raise property taxes, relying instead on the tax revenues generated by the cities and towns that they serve. As a result, slow growth or constraints on local tax revenues also mean fewer resources available for local schools.

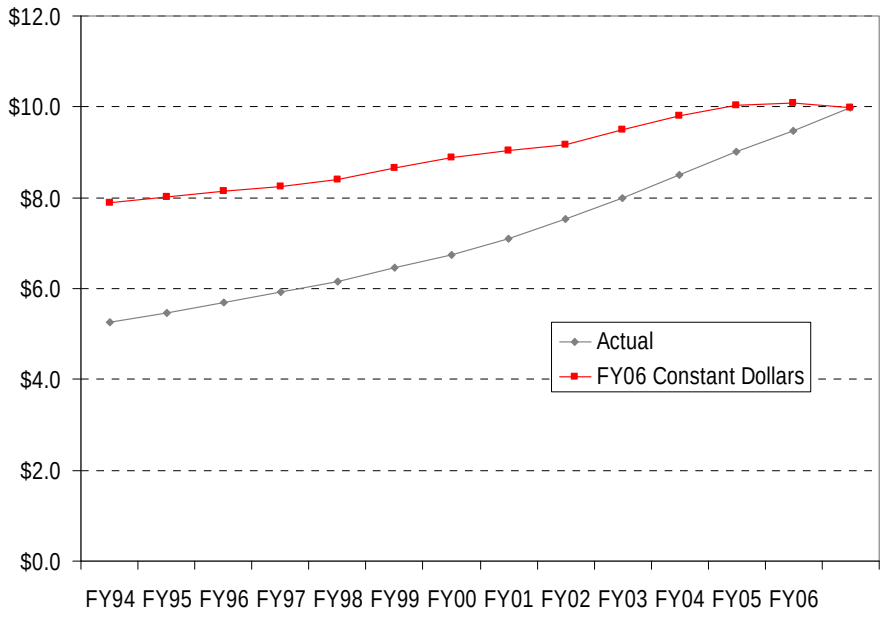
Annual growth in a city or town's tax levy is governed by Proposition 2 ½. Proposition 2 ½ limits annual growth in the amount of property taxes that a municipality can raise to 2.5 percent over the previous year plus receipts from newly taxable property. The law also creates a levy ceiling, limiting the revenue cities and towns can generate from property taxes to 2.5 percent of the total assessed property value in the community.

The annual growth limit may only be exceeded if voters pass an override granting the city or town authority to raise a specific amount of additional revenues to support operating

expenditures. Overrides are always controversial, but recently voters have been rejecting them at higher rates than they have in previous years.

In nominal terms, property tax receipts grew from $5.4 billion to $9.9 billion between fiscal years 1994 and 2006: a $4.5 billion or 83 percent increase (see Figure 3). The growth rate appears much flatter, however, after comparing total statewide property tax receipts in fiscal year 2006 dollars.[2] Looking at revenue growth in real terms shows that tax receipts grew by $2.0 billion or 25 percent over this period.

Figure 3: Annual property tax levy
Actual versus inflation-adjusted (billions of FY06 dollars)



Source: Massachusetts Department of Revenue Municipal Data Bank

State aid: Chapter 70

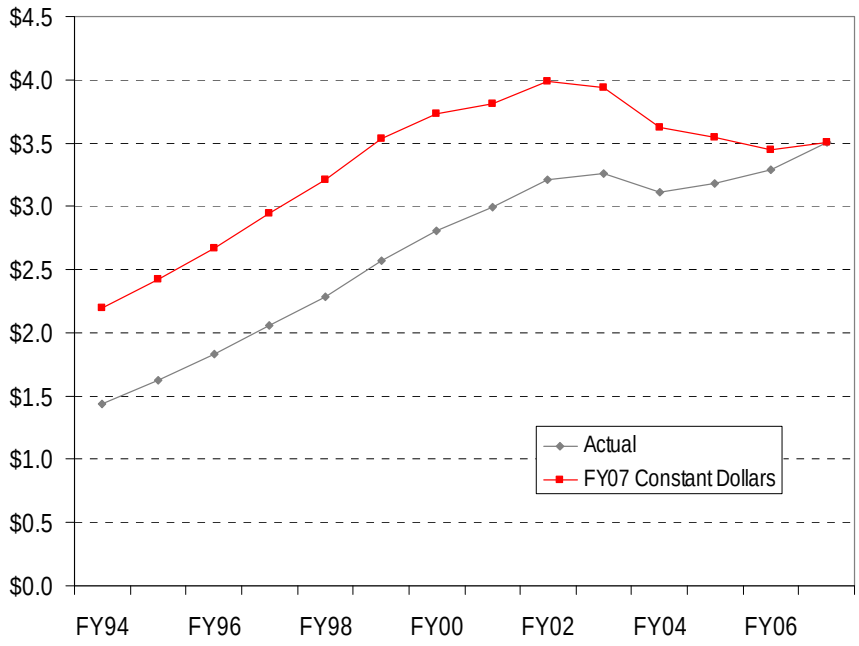
The second major source of operating revenue for schools is state aid, generally referred to as Chapter 70 aid. Chapter 70 aid is distributed through a formula that establishes an adequate spending level for each school district. The goal of the formula is to ensure that every district reaches this spending goal each year through a combination of state aid and local resources.

The amount that each school district must spend to provide an adequate education to its students is known as the foundation budget. The foundation budget is calculated using a set of assumptions about how much districts should spend per pupil in a number of expenditure categories and for a variety of student groups, assigning higher rates to

[2] The inflation adjustment was made using the Implicit Price Deflator for State and Local Government services published by the Bureau of Economic Analysis. This is the same index that is used to adjust the foundation budget assumptions in the Chapter 70 formula each year.

students whose resource needs are assumed to be greater, such as vocational students, English language learners, and low-income students. These rates are adjusted each year for inflation.

Figure 4: Chapter 70 aid
Actual versus inflation-adjusted (billions of FY07 dollars)



Source: Massachusetts Department of Education

When the Education Reform Act was enacted in 1993, the Commonwealth committed to bring all districts up to their foundation budget spending level within seven years. The economic growth that occurred in the middle and late 1990s meant that the state was able to meet this commitment on time, an achievement that few thought was possible seven years before. New aid was also distributed to districts who were already being funded at or above foundation. Chapter 70 funding increased by $1.5 billion during this period, with annual rates of growth consistently over 10 percent (see Figure 4). This strong growth continued through fiscal year 2002.

This influx of state aid increased spending overall and directed more resources to less advantaged school districts. Between fiscal years 1994 and 2005 the state's average per pupil spending went from $5,235 to $9,096, an increase of 74 percent. In fiscal year 2005 dollars this equaled a 25 percent increase. The push to bring all districts up to foundation benefited low-income districts in particular. In fiscal year 1993, districts with per capita income from the lowest quartile spent about $1,400 less per pupil than high-income districts. By fiscal year 2000, this gap had narrowed to $370.[3]

[3] Kenneth Ardon and Robert Costrell (2001). "Fairness in school funding: Reformulating local aid for phase two of education reform." The Commonwealth of Massachusetts Executive Office for Administration and Finance.

When the stock market bubble burst in 2002 state revenues fell dramatically. For three successive fiscal years starting in 2003, new Chapter 70 funds were only provided to districts that needed additional support to guarantee that they would reach foundation. Districts who were already being funded at or above foundation were level-funded in fiscal year 2003 and actually saw their state aid reduced by as much as 20 percent in fiscal year 2004 when the revenue picture worsened. Statewide, Chapter 70 aid fell by 4.5 percent or $150 million that year. Most districts were level-funded once again in fiscal year 2005.

Chapter 70 aid grew by 3.3 percent in fiscal year 2006, which was enough to ensure that all districts received some increase in funding, not just those eligible for foundation aid. Funding increased further in fiscal year 2007 as the state began to phase-in a sweeping set of changes to the funding formula that increased state aid by 6.6 percent overall, bringing the total appropriation to $3.5 billion. Starting in fiscal year 2007 the formula began using communities' property values and residential income to determine the "ideal" mix of state and local funding for schools and is moving rapidly to reach that goal over a five-year period.

Currently, however, in inflation-adjusted terms the amount of Chapter 70 aid that was distributed in fiscal year 2007 was equivalent to the amount allocated in fiscal year 1999, short of the peaks reached in the early 2000s. Moreover, of the 252 districts that saw their state aid reduced in fiscal year 2004, 78 are still scheduled to receive less aid, in nominal terms, in fiscal year 2008 than they did before the fiscal downturn.

Chapter 70 aid is scheduled to increase by another 6.2 percent, or $220 million, in fiscal year 2008 as the changes to the formula continue to be implemented. At this rate of increase, Chapter 70 is expected to outpace overall state budget growth by 2 percent. Assuming the legislature continues to phase in the changes to the formula at or near the current pace, many districts will see funding increases in the next few years.[4]

State reimbursement programs: Circuit Breaker, charter school tuition, transportation, and School Building Assistance

In addition to Chapter 70, the state funds a number of other line items that provide support for school districts.

The Circuit Breaker program reimburses districts for costs that they incur to educate both in-district and out-of-district special education students. If the cost of educating these students exceeds a certain threshold, $31,616 in fiscal year 2006, districts can be reimbursed for up to 75 percent of the cost above this amount, depending on the availability of funds. Since its inception in fiscal year 2004, the Circuit Breaker program has grown from $94 million to close to $200 million in fiscal year 2007.

The state also reimburses districts for part of the tuition costs that they pay to send their students to charter schools. After it was not funded in fiscal year 2003, this program grew from $13 million in fiscal year 2004 to $68 million in fiscal year 2007.

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[4] For more information on how the foundation budget and Chapter 70 aid are calculated, go to http://finance1.doe.mass.edu/chapter70/chapter_08.html.

Regional school districts are also reimbursed for a portion of the transportation costs that they incur. Funded at $40 million in fiscal year 2002, the program reached a low of $26 million in fiscal year 2004 before growing to $55 million in fiscal year 2007, which covered 90 percent of eligible costs. Municipal districts were eligible for transportation reimbursements up until fiscal year 2004 when funding was eliminated in response to the fiscal downturn. In prior years, municipal districts were receiving around $50 million in transportation reimbursements, or a quarter of eligible costs.

Finally, significant changes have been made to the School Building Assistance (SBA) program in recent years. In order to deal with a mounting backlog of projects eligible for reimbursement, the state issued bonds to reimburse cities, towns, and regional school districts for the state's share of the building costs within 3 to 4 years instead of the 30-year pay-off that was typical in the past. Going forward, a portion of the state sales tax will be dedicated to school building reimbursements. With this dedicated funding source and a much faster payment schedule the state will save millions of dollars in interest costs.

Federal and state grants

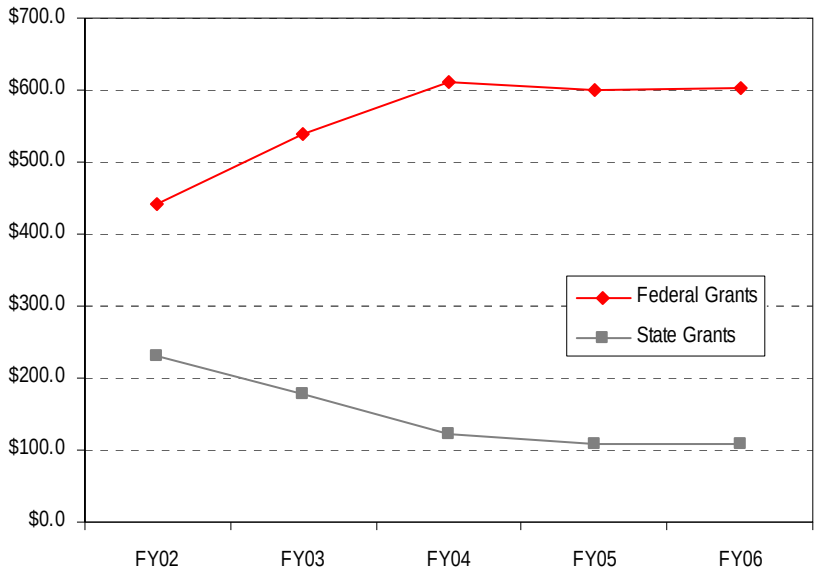
Federal and state grants provide important supplemental resources for school districts, giving them the ability to provide services and programs that they might not otherwise be able to afford. Grants are given out in the form of entitlements to support districts that meet certain eligibility requirements or awarded through competitive processes to districts that are best able to fulfill the funding requirements.

Since fiscal year 2002, the gap between federal and state grant funding has increased substantially (see Figure 5). Federal funding increased as a result of the No Child Left Behind Act (NCLB), while state grants fell in response to weakening fiscal conditions at the state level. In fiscal year 2006, federal grant funds supported $603 million in district spending and state grant funds supported $110 million.

Districts saw their federal funding increase by $163 million, or 37 percent, between fiscal years 2002 and 2006. This change was driven largely by increases in NCLB funds for Title I and Title IIA programs as well as an increase in funding through the Individuals with Disabilities Education Act (IDEA). Meanwhile, state grant funds fell by $119 million, or 52 percent.[5] State funding fell because class size reduction grants, academic support grants, and smoking cessation grants were eliminated and because funding for community partnership grants for pre-school programs was reduced by $22 million.

[5] This figure assumes that grant accounts that were shifted from the Department of Education to the Department of Early Education and Care were level-funded in fiscal year 2006.

Figure 5: Trends in federal and state grants
(millions of dollars)



Source: Massachusetts Department of Education

User fees

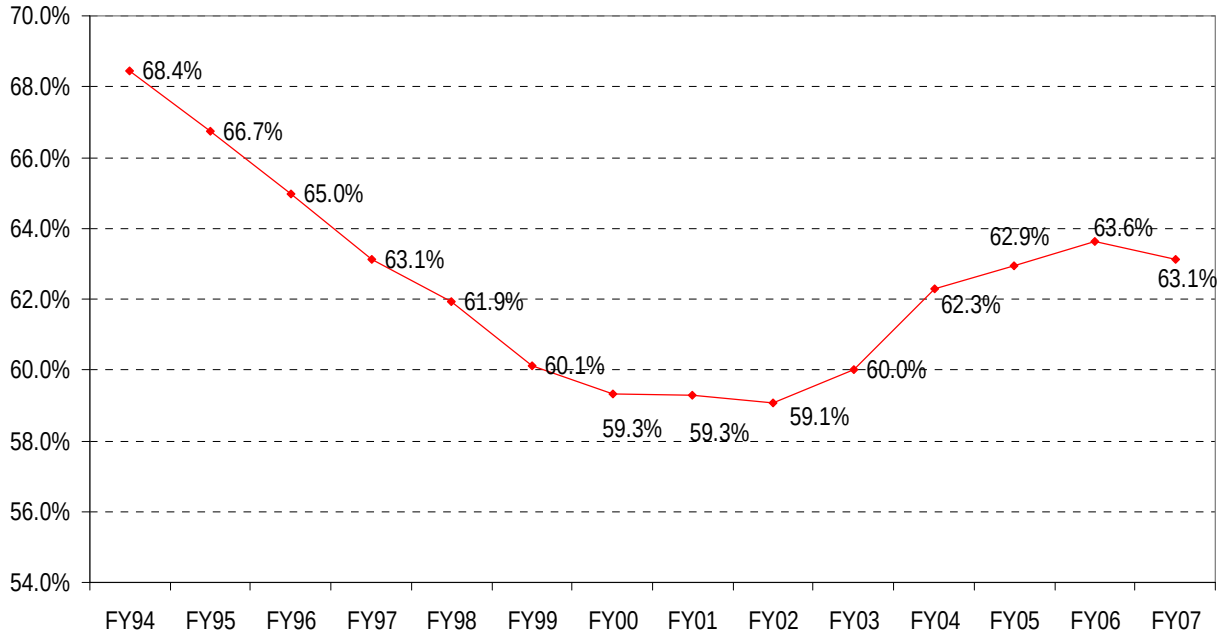
User fees support non-mandated programs such as athletics and transportation services for students who are not eligible for free busing. When the fiscal downturn hit, many districts instituted or increased their fees in order to preserve other programs and services. Between fiscal years 2002 and 2006, district spending on transportation from user fees increased from $3.2 million to $11.2 million, while spending from athletic revolving funds, which is largely supported by user fees, increased from $12 million to $22.6 million.

How revenue trends are affecting district spending patterns

At least up until fiscal year 2006, years of slow-growing and declining state revenues have meant that school districts and the cities and towns that they serve have shouldered a higher share of the cost of educating their students. When Chapter 70 funds were increasing throughout the 1990s, the percentage of spending coming from local contributions declined (see figure 6). When statewide Chapter 70 funding was growing more slowly or declining between fiscal years 2002 and 2006, the share of local spending increased.

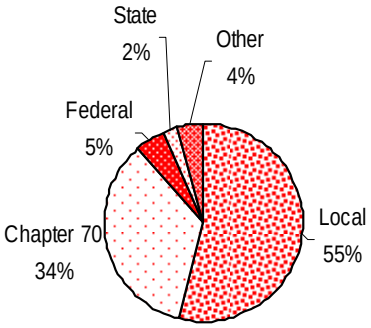
This trend was also apparent in the distribution of funds that support district spending activities. Looking at how the share of spending among district funding sources has changed, the local share of total spending increased by 3 percent between fiscal year 2002 and 2006, while the share of Chapter 70 aid fell from 34 percent to 30 percent (see Figure 7). The share of federal funding held steady, while state grant support fell by 1 percentage point. Funding from other sources consumed a larger share of the overall pie, due to increases in Circuit Breaker funding for special education students and a greater reliance on user fees to support services like transportation and athletics.

Figure 6: Local spending as a share of district operating costs

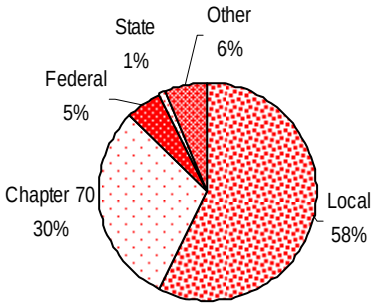


Source: Massachusetts Department of Education

Figure 7: District operating expenditures, all funds by source



FY02



FY06

Source: Massachusetts Department of Education

Note: Figure 7 includes other state revenues in the share of local spending that cannot be distinguished from local source revenues. These are mostly Lottery and Additional Assistance funds, which cities and towns can use to offset some of their educational spending in addition to other municipal expenses. If it could be calculated, the percentage accounted for by these funds would be relatively small, and it probably declined between fiscal years 2002 and 2006 when funding for both line items was reduced.

Future trends

Coming years are likely to bring continuing challenges for districts on both the expenditure and revenue sides of their budgets.

Rising costs are making it difficult for school districts to come up with sufficient funds to maintain let alone expand existing programs. And while the state's fiscal situation has improved recently and state aid is expected to grow as changes to the funding formula are implemented, some experts predict that state revenue growth will slow in the future unless job growth improves.[6]

At the same time demand is growing to invest more in educational programs such as universal pre-school and expanded learning time in order to ensure that our students can compete in a global economy. If education spending cannot increase quickly enough to support these initiatives, districts and schools will need to find ways to use their existing resources more efficiently.

For instance, Governor Patrick recently signed a new law that will allow cities, towns, and regional school districts to purchase their health insurance from the Group Insurance Commission, which oversees health care plans for state employees. The estimated cost savings associated with this change are significant and could free up additional resources to support programs and services that directly benefit students.[7] Since local governments will need the approval of 70 percent of their collective bargaining units to take advantage of the new law, time will tell how many will pursue this option, what kinds of cost savings they will realize, and how these savings will be used to benefit schools.

This is one possible solution. Others will need to be considered so that districts achieve the fiscal capacity that they need to meet current and future challenges. ✱

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[6] "MTF Forecast: Sharp Slowdown in Growth of Tax Revenues." http://www.masstaxpayers.org/data/pdf/bulletins/sharps~1.pdf

[7] "Municipal Health Reform: Seizing the Moment." http://www.bmrb.org/content/upload/BMRBMTF.pdf