INTEROFFICE CORRESPONDENCE
Los Angeles Unified School District
Independent Analysis Unit

INFORMATIVE

TO: Members, Board of Education
Austin Beutner, Superintendent

DATE: June 14, 2018

FROM: Glenn Daley, Director, Independent Analysis Unit
Analysts: John Diaz, Andrew Thomas, Ph.D.

SUBJECT: SUPERINTENDENT'S 2018-2019 FINAL BUDGET

This informative is a response by the Independent Analysis Unit (IAU) to the Superintendent's Budget for fiscal year 2018-2019. There is little new factual detail here that the budget documents the Board has received do not already contain, but the IAU believes that a brief discussion with historical context from an independent viewpoint may be useful to Board Members. Note that new developments are happening almost daily, particularly at the state level. Some details in this informative may be out of date by the time you see it, but we have attempted to discuss the potential changes that we are aware of.

SUMMARY

- **Revenue outlook is relatively good for this year**. The L.A. Unified 2018-2019 budget reflects the expectation that LCFF sources will provide $5.6 billion in revenue in 2018-2019. Though this amount is the highest in the history of the Local Control Funding Formula (LCFF), it may be an underestimation: the legislature, which votes on the budget June 14, plans to give up to an additional $34 million dollars to the District for this appropriation.

- **Though revenue is at an all-time high, 2018-2019 will be the peak of L.A. Unified's revenue for the next five years**, barring unexpected surpluses in state revenue, district enrollment, or legislative change.

- **The Title I budgeted allocation is higher than what was budgeted in last year's budget, but the actual amount will probably be lower.** The District expects $399 million this year, which is higher than the $343 million it expected during budget development last year. However, the District actually received $403 million last year, which means its expected allocation this year is down slightly, reflecting a loss of enrollment.

- **The District projects discretionary non-recurring funds to be higher than last year but may need to revise this amount downward**. After the governor's May revision to the state budget, the District estimated that L.A. Unified would receive $344 per pupil, or about $164.4 million in discretionary non-recurring funds (accounted for as mandated cost reimbursements). However, the 2018-19 State Budget agreement between the Administration, the Senate, and the Assembly, decreased this amount to $80 million for L.A. Unified, which is half of the anticipated amount.

- **Proportionality calculations are simpler and more transparent**. Since LCFF is fully funded, any stakeholder will be able to see how much L.A. Unified receives for base, supplemental and concentration grants and calculate the proportion by which the District must increase or improve services for high-needs students: no more complicated “gap percentage” calculations.

- **The Governor’s budget and the May revision propose a statute requiring the District to create a document called *LCFF Budget Overview for Parents,*** which will affect how the District manages its budget reports, LCAP development and parent engagement efforts.

KEY TAKEAWAYS

Revenue

Table 1 shows key 2018-2019 expected revenues that substantially change from previous-year budget development cycles.

The LCFF-controlled part of the Principal Apportionment is the largest it has ever been, which the District anticipated and used for projections. Last year, LCFF sources provided $5.4 billion. This good news may actually improve: this year’s budget numbers reflect the proposed funding amount in the Governor’s May Revision, but the legislature, which votes on the budget June 14, plans to provide $34 million dollars more for this appropriation.[1]

Federal IDEA-based special education funding has seen relative stability through the past four budgets because it is based on formulae keyed closely to special education enrollment. The slight decrease in expected 2018-2019 special education revenue indicates a lower projected special education population.

Title I revenue expectations have increased compared to last year’s budget because at this stage last year, the District anticipated a large cut in Federal funds in response to President Trump’s election. This cut did not occur. The District received an allocation of approximately $403 million in 2017-2018. This year, the District anticipates a lower amount based on losing 16,000 students.

This year’s estimates for mandated cost reimbursement revenue reflect high confidence that the state will apportion $160 million in discretionary non-recurring funds in addition to the mandated cost block grant. However, the District may be overestimating the discretionary non-recurring funds it will receive. Rather than providing $160 million, the state budget agreement as of June 12 provides only $80 million in discretionary non-recurring funds accounted for as mandated cost reimbursement. So, rather than $180 million, the District can expect a total of only $100 million in revenue for this line item.

Expected All Other Local Revenue continues a year-over-year gradual decrease; however, estimates of this local revenue have been volatile, with *actual* amounts far exceeding *budgeted* amounts. For example, last year, though the District expected $59 million in All Other Local Revenue, it received about $139 million. This year, the number may go down 20% or it may not.

[1] The statutory cost-of-living (COLA) increase for LCFF sources is 3.7% as of June 12, as set by the California legislature’s budget trailer bill, AB 1808. This amount results in an increase in LCFF funds for non-charter and locally funded charter schools from $5,631,979,528 to $5,665,979,528.

Table 1. Expected Revenues from Major Sources, 2018-2019 L.A. Unified Budget

Object	FY16	FY17	FY18	FY19	% change since FY 16	% 1-Year change
Total LCFF Sources	5,250,007,182	5,416,517,706	5,473,490,496	5,631,979,528	7%	3%
IDEA	115,676,911	127,564,688	115,900,896	113,850,111	-2%	-2%
Title I, Part A, Basic	372,592,188	380,929,595	342,855,568	398,678,224	7%	16%
Mandated Cost Reimbursements	328,669,466	136,652,823	16,963,982	182,350,459	-45%	975%
All Other Local Revenue	87,264,089	64,041,681	59,096,819	49,318,568	-43%	-17%

Sources: Superintendent's Final Budgets 2015-2019

Expenditures

Table 2 shows changes in planned expenditures for the major expenditure objects in the budget over the last four fiscal years. Certificated salary costs have declined over time and the budget shows them falling again in 2018-2019 due to a decrease in enrollment and teacher attrition. Classified salary costs, however, have climbed by close to 10%, due in part to the new SEIU Local 99 collective bargaining agreement, which this year's budget includes.

Table 2. Planned Major Expenditures, 2018-2019 L.A. Unified Budget

Object	FY16	FY17	FY18	FY19	% change since FY 16	% 1-Year change
Certificated Salaries	2,356,291,293	2,180,648,887	2,168,300,859	2,080,295,198	-12%	-4%
Classified Instructional Salaries	209,329,850	242,990,689	229,639,861	250,313,730	20%	9%
Classified Support Salaries	292,969,188	337,707,339	333,017,450	358,765,586	22%	8%
STRS	322,764,795	566,759,872	620,345,660	656,089,372	103%	6%
PERS	100,669,441	139,436,960	143,179,107	186,538,768	85%	30%
Health and Welfare Benefits	595,609,646	663,862,163	726,840,321	725,206,188	22%	0%
Assigned	308,234,576	702,731,946	588,611,885	892,266,404	189%	52%
Reserve	113,650,248	156,334,368	350,665,482	782,600,825	589%	123%

Pension costs for current or former teachers (CalSTRS participants) have climbed since 2013-2014, which was the last of many years in a row during which pension employer contributions to CalSTRS remained steady at 8.25%. After 2013-2014, the employer contribution rate per-employee began to climb, first by 1% a year, then by 2% a year. This rate increase has resulted in an overall doubling of these pension costs over the last 4 years, though the increase from last year was only 6%. This cost increase will taper off as rates hit their maximum allowable by law of 20.25% in 2022-2023.

Classified pension costs (CalPERS) have also increased over the last 4 years, at a more gradual rate overall, but at a higher rate (2.57%) this year. These costs will to continue to grow as a proportion of total spending, as employer contributions climb from the current 18.10% to 27.30% in 2024-2025 and higher in subsequent years. However, note that classified pension costs are much smaller than certificated pension costs.

Health and Welfare expenditure projections, however, show no growth this year or the next, due to the recently approved 2018-2020 Health and Welfare agreement.

Assigned balances are expected to jump in this year's planned expenditures primarily due to funds placed in reserve and assigned for potential salary increases, as well as proportionality carryover, which reflects the re-alignment of District resources over the last 4 years to increase and improve education for high-needs students.

Update to Discretionary Non-Recurring Funds

As described above, the budget document assumes that L.A. Unified stands to receive $344 per pupil, or about $164.4 million in discretionary non-recurring funds, but the current State Budget agreement between the Administration, the Senate, and the Assembly, proposes only $168 per pupil in discretionary funding. The District proposes to use these funds for ongoing salary and benefits increases and to offset instructional operating costs throughout the year. The District does not propose to use these funds to add to the OPEB trust. Thus, the planned use of discretionary non-recurring funds does not fulfill District policies and recommended practices.

The IAU analyzed a series of strategies for uses of discretionary non-recurring funds, as shown in Table 3. Of these options, the 2018-2019 budget proposes to use these funds for savings and spending, including for spending on recurring expenses, which is not recommended except where the expenses represent an investment that will return greater value. Currently, the District does not propose to invest these funds on programs that could recover revenue, transform instruction, or meet other strategic goals.

Table 3. Use of Discretionary Non-Recurring Funds

Pay down debt- Use funds to pay for accrued liabilities
Save- Place funds into the District's Unassigned ending balance to boost reserves
Spend- Use money for goods or activities that contribute to specific District goals
Invest- Fund attendance/enrollment or Employee initiatives that can recover revenue, or develop property to create new revenue
Invest-to-transform- Invest for financial return, then spend over time on school improvement in selected high-need schools

The IAU informative that goes into detail regarding the potential use of discretionary non-recurring funds is available on the IAU website.[2]

Appropriation Changes

The governor has proposed, and the legislature approved fully funding the LCFF. Additionally, a new bill, AB2808, introduced in February of this year, proposes to increase the LCFF base rates in 2018-2019. According to the Assembly Appropriations Committee, meeting these new rates would increase annual Proposition 98 spending by about $35 billion statewide, assuming continued demographic and cost-of-

[2] Los Angeles Unified School District Independent Analysis Unit. (2018). Uses of Discretionary Irregularly Occurring One-time Funds. Retrieved from http://laschoolboard.org/sites/default/files/02-28-18IAUDiscretionaryFundsReport.pdf.

living trends. However, for this increase to occur, new state revenues would be needed and these are not on the immediate horizon. The bill has passed the assembly and is now under consideration in the senate.[3]

Special Education

AB602 funding will not receive any ongoing increase in per-student base rates in the next year. In the new budget, state support for special education only increased by about $1 million over last year. However, a new bill, AB 3136, supported by various LEAs would give $1.3 billion over five years to increase special education support throughout the state, including increases to base special education student funding rates.[4]

Long-Term Considerations: OPEB and Pensions

The 2018-2019 budget contains no contribution to the Other Postemployment Benefit Plans (OPEB) Trust. Without this contribution or further cost savings, the District will not have a policy in place to decrease its long-term unfunded OPEB liability.

Accountability

The Governor's budget in January called for increased transparency for district budget expenditures and the May revision added details to this proposal. The intent of the legislation under current consideration is that parents should have access to information that links the LCAP and spending on high-needs students to actual districtwide and school-site budgets. Specifically, the legislation proposes a new report, called the *LCFF Budget Overview for Parents*, which should make a clearer connection between LCAP explanations of planned expenditures and documentation of those expenditures in District budget documents. The LCFF Budget Overview for Parents would be considered part of the adoption of the LCAP and need to be included as part of the 2019-2020 L.A. Unified budget.

Additional state resources, in the form of the Community Engagement Initiative, will be directed towards increased transparency. The IAU recommends taking this new legal requirement as an opportunity to improve budget reporting so that parents and community members can track how the Principal Apportionment affects students at school sites.

Also, the District's obligation to increase or improve services to high-needs students will come under new scrutiny. Since LCFF will be funded at 100% of the legal targets this year, the *proportionality* requirement for the District will change. Proportionality refers to increasing and improving services to historically underserved students *in proportion to* the increase in funds apportioned for the supplemental and concentration grants. In the past, determining the amount by which the District should increase or improve services entailed calculating how much was spent in the prior year and increasing that amount by the percentage increase in supplemental and concentration funding.

Since supplemental and concentration grants will reach their full amounts—statutory *targets*—this year, there will not be a percentage increase. Instead, the percent by which the District needs to increase or improve services will be simply the total of the target LCFF supplemental and concentration grants (as

---

[3] Pratt, R. (2018) Assembly Bill Third Reading: AB2808. Retrieved from file:///C:/Users/john.diaz/Downloads/201720180AB2808_Assembly%20Floor%20Analysis_.pdf.

[4] O'Donnell, Frazier, Thurmond, Reyes. (2018). ASSEMBLY BILL No. 3136. Retrieved from https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB3136.

defined by statute) divided by the total of the target base grant. This simpler calculation will not only ease administrative burden, but also make support for underserved youth more transparent to stakeholders.

For years in which the LCFF grows only by the statutory cost-of-living adjustment, the proportionality requirement will stay relatively flat from the prior year. However, if future state budgets give large infusions into the LCFF, its impact on the District's proportionality requirement could be significant. Since the District is on record as advocating for more funding, policymakers should be aware that higher grant amounts will mean proportionately increased or improved spending for underserved students above and beyond what is provided for all students.

DISCUSSION

Overall, L.A. Unified's budget is positive in the short term, but not exuberant. It modestly adjusts revenue upward from the second interim projections and from last year's budget development. Despite another year of fiscal growth at the state level and increasing per-ADA LCFF grant amounts, L.A. Unified's revenue growth is flattening due to year-over-year decreases in average daily attendance, which reflects declining enrollment. In the past year alone, L.A. Unified lost 16,000 students.

The District faces two distinct long-term financial pressures: retirement healthcare costs and pensions. Healthcare costs will not grow this year due to a new health and welfare agreement, which is good news. However, the OPEB liability will remain substantially unfunded due to the District's plan to discontinue paying into the OPEB Trust. District expenditures for certificated pensions (CalSTRS) are large and will continue to grow into the foreseeable future, but this expenditure also means that these obligations are more secure. Classified pension expenses are nearing their peak as a proportion of administrator costs.

Moving forward, even if the enrollment decline slows, projections show that 2018-2019 will be the peak year for L.A. Unified's state revenue, at least for the next five years, barring major changes in state funding. So, it is important to consider how the District can continue to work towards increased attendance and enrollment stabilization, as well as cost containment.[5] Even with revenue growth uncertainty, the Governor's proposal of continued appropriation of LCFF funds and increased accountability offers greater stability and transparency for the District's fiscal picture.

The structural deficit is a major theme in the Budget Board Informative. The IAU is conducting an in-depth analysis of the District's fiscal deficit, with a report pending. In a nutshell, this analysis finds that the threat to the District's fiscal soundness is long-term in nature, and therefore its solutions must be long-term. The present budget projects a declining reserve balance in the short term, and the District is taking several steps to address this gap in the short term. The solutions identified by the IAU, though, are not about year-to-year budgeting. They include the need for more integration of strategic planning and budget planning, carefully analyzed changes to make the District structure more effective and efficient, and the transformation of instruction to achieve greater success with higher productivity.[6] It is too late to take on these challenges in the 2018-19 budget, but it is not too early to begin the work required to move the 2019-20 budget in the right direction.

[5] The IAU is currently conducting research on the trends and causes of enrollment decline within the district.
[6] Note that `productivity' is *not* used here to mean people working harder, but it is used in the economist's sense of increasing results at a lower overall ongoing cost by making the right investments in techological, organizational, and human capital.