

INTER-OFFICE CORRESPONDENCE
Los Angeles Unified School District

INFORMATIVE

TO: Members, Board of Education Date: October 10, 2008

FROM: Randy Ross
Director of Educational Policy

SUBJECT: **Impact of Charters on the Functioning of LAUSD**

COPIES: D. Brewer, R. Cortines, J. Morris, R. Fesler, M. Reilly, R. Rasmussen, D. Holmquist, G. Kildare, J. Cole-Gutierrez, J. Crain, J. Thornton

At the request of Board member Vladovic, this informative examines the impact of charter enrollment on the District’s ability to function.

Dr. Vladovic posed the following question: At what level (50,000, 100,000, 200,000 ...) does overall charter school enrollment become so large that it severely hampers the ability of LAUSD to function as a district? This is a complex question whose precise answer could benefit from careful analysis in multiple areas. Given Dr. Vladovic’s need for a ballpark estimate, we have used readily available data and made key assumptions.

Because the “charter” question fuses several critical policy parameters (specifically, enrollment shifts, fixed costs [e.g., retiree benefits], and funding equity), our analysis unfolds as follows:

1. The impact of declining enrollment
 - a. Normal fixed (or lumpy) costs
 - b. Extraordinary fixed (or lumpy) costs
2. The impact of increasing charter enrollment
 - a. Implications of extraordinary fixed costs
 - b. Implications of differences in per pupil funding

Impact of declining enrollment under normal conditions

Increases in charter school enrollment in effect reduce LAUSD’s enrollment. The District cyclically experiences fluctuations in enrollment. Overall enrollment – currently at less than 650,000 K-12 students (not including independent charters) – has been declining since about 2003. Before the current period of declining enrollment, District enrollment had risen annually for over twenty years, from nearly 550,000 students in 1981 to about 738,000 in 2002-03.

Primary causes of shifts in enrollment include changes in: (1) birthrates; (2) migration patterns; and (3) school choice patterns (e.g., private school, home schooling, LAUSD residents enrolling in districts outside of LAUSD, and charter school). The District's enrollment (excluding independent charters) is projected to fall by about 43,000 students over the next two years, while enrollment in independent charter schools is expected to climb by about 11,000 over this same period. Thus, at most, charters would explain about one-fourth of the overall drop in District enrollment during this period.

Ordinary drops in enrollment result in reductions in District student-generated revenue. These reductions necessarily are (or should be) accompanied by commensurate reductions in district expenditures – primarily staff in schools (e.g., teachers, custodians) and in nonschool functions.

If the District's ordinary "fixed" costs could be varied over time, then the District could function satisfactorily at relatively low levels of enrollment (e.g., less than 200,000 students). The logic here is that, aside from LAUSD, no other California district enrolls more than 150,000 students. The vast majority of these districts operate satisfactorily. Thus, we are confident that under ordinary conditions (planned expenditure reductions and normal fixed costs), LAUSD could function satisfactorily if its enrollment fell as low as 300,000 students.

Impact of declining enrollment given extraordinary fixed costs: the case of retiree benefits

The existence of extraordinary fixed costs complicates the analysis. To illustrate, we will consider the implications of the District's expense on retiree benefits.

Employees who meet certain conditions continue to receive full health benefits upon retirement (see Table 1). "Coverage provided in the District-sponsored hospital-medical plans, dental plans and vision plans is the same as that received by active employees, with the exception that Medicare enrollment is required when eligible, usually upon reaching age 65. Premiums for District coverage are paid in full by the Board of Education for eligible retirees and their eligible dependents."¹

¹ See LAUSD, "Retiree Health Benefits."

Table 1
Shifting stringency of eligibility for LAUSD retiree benefits

Hire Date	Eligibility for Retiree Benefits ²
Before March 11, 1984	You must have been eligible for coverage for 5 consecutive years immediately prior to your retirement effective date
After March 11, 1984, but before July 1, 1987	You must have been eligible for coverage for at least 10 consecutive years immediately prior to your retirement effective date
On or after July 1, 1987 but before June 1, 1992	You must have been eligible for coverage for at least 15 consecutive years immediately prior to your retirement effective date <i>or</i> have been eligible for coverage for 10 consecutive years before your retirement effective date plus an additional 10 years which need not to be consecutive.
Hired on or after June 1, 1992	The employee's age plus the number of consecutive years of service, when added together, must equal 80.

The projected cost of retiree benefits for 2008 is \$269 million, or an average of \$8,165 for each of about 33,000 retirees and their eligible dependents (see Table 2).³ The number of benefited retirees is expected to more than double to over 75,000 by 2020. If the 75,000 LAUSD retirees were receiving full benefits today, the cost would be \$342 million higher (i.e., \$611 million). In effect, to balance its budget the District would have to reduce by that amount what it spends on school and nonschool functions.

Table 2
Estimated cost of retiree benefits

Number of Retirees Receiving Benefits		Est. Cost of Retiree Benefits (millions of 2007-08 \$)
Hypothetical	0	\$ 0
Current	33,000	\$ 269
Projected for 2020	75,000	\$ 611

Table 3 shows how enrollment affects the impact of this fixed cost. Currently, about 33,000 retirees receive full benefits at a cost of about \$420 per student. If enrollment falls by 40,000 students, the per-student cost goes up to \$450, an increase of \$30. If

² See LAUSD, "Retiree Health Benefits" for list of all eligibility conditions.

³ See Holmquist and Kildare.

enrollment falls to 500,000 students (which is close to the projection for 2018), the per-student cost rises to \$540.

As the number of retirees moves toward 75,000, the cost of retiree benefits per student rises proportionally. If the District’s enrollment were to fall to 500,000, the cost of retiree benefits per student would be about \$1,220 (in 2007-08 \$), which is \$800 per student more than the District’s current outlay.

Table 3
Estimated cost of retiree benefits per student

Enrollment (excl charters)	Number of Retirees receiving benefits		
	Zero	33,000	75,000
640,000	\$0	\$ 420	\$ 960
600,000	\$0	\$ 450	\$ 1,020
500,000	\$0	\$ 540	\$ 1,220
400,000	\$0	\$ 670	\$ 1,530
300,000	\$0	\$ 900	\$ 2,040
200,000	\$0	\$ 1,350	\$ 3,060

Note: In 2007-08 \$; rounded to nearest \$10

The District’s primary source of general purpose (unrestricted) funding is the revenue limit. The revenue limit per student is currently about \$5,800. Before these dollars are allocated to District current operations – school and nonschool – about \$420 per student must be deducted to pay for retiree benefits. Thus, retiree benefits currently consume about 7 percent of revenue limit per ADA (see Table 4). Other things remaining the same, the rising number of retirees would result in this share more than doubling. Coupled with a fall in enrollment to 500,000, retiree benefits would consume over one-fifth of revenue-limit funding. Further reductions in enrollment could result in even larger shares of revenue-limit funding being allocated to retiree benefits.

Table 4
 Cost of retiree benefits as percent of revenue limit per ADA

Enrollment (excl charters)	Number of retirees receiving benefits		
	Zero	33,000	75,000
640,000	0%	7%	16%
600,000	0%	8%	18%
500,000	0%	9%	21%
400,000	0%	12%	26%
300,000	0%	15%	35%
200,000	0%	23%	53%

Because few California school districts provide their retirees with the level of benefits provided by LAUSD, every one percent increase in the share of revenue-limit income that goes for retiree benefits weakens the District’s competitive position. That’s because the greater the share of revenue-limit income devoted to retiree benefits, the weaker the District’s ability to compete with other districts for employees on the basis of salary and working conditions (e.g., class size). Consequently, as the share of revenue-limit income going to retirees rises, gradually the quality of District staffing would probably diminish. We would expect this to lead eventually to lower student outcomes.

Impact of increasing charter enrollment:

Given this background, how do changes in charter enrollment affect District finances?

A 2001 survey of a sample of leaders in 49 school districts conducted by RPP International found that “nearly half ... perceived that charter schools had negatively affected their budget and explained this impact by pointing to the reduced revenue from students who had transferred from districts schools to charter schools.” The report further noted that California districts, which have sole charter granting authority, “were more likely to report that charter schools had no impact on their budget, and that charter schools had little or no effect on their central office operations.”

The RPP International report also noted that respondents’ perceptions varied depending on whether overall enrollment in their districts was rising or falling. “Every district with declining enrollment ... reported that charter schools had a negative impact on their budget,” while “...in districts with increasing enrollment trends, administrators were more likely to report no fiscal impact and made few changes in district operations or in the educational system.”

Over the 20-year period beginning the early 1980s, LAUSD experienced perennial growth in enrollment of over 8,500 students per year. This rate of growth placed enormous pressure on the District’s facilities and infrastructure. Because of seat shortages, the District adopted emergency measures to ensure all students could attend school. For example, thousands of students were bussed from their neighborhoods to schools in other neighborhoods where space was available. Many schools were

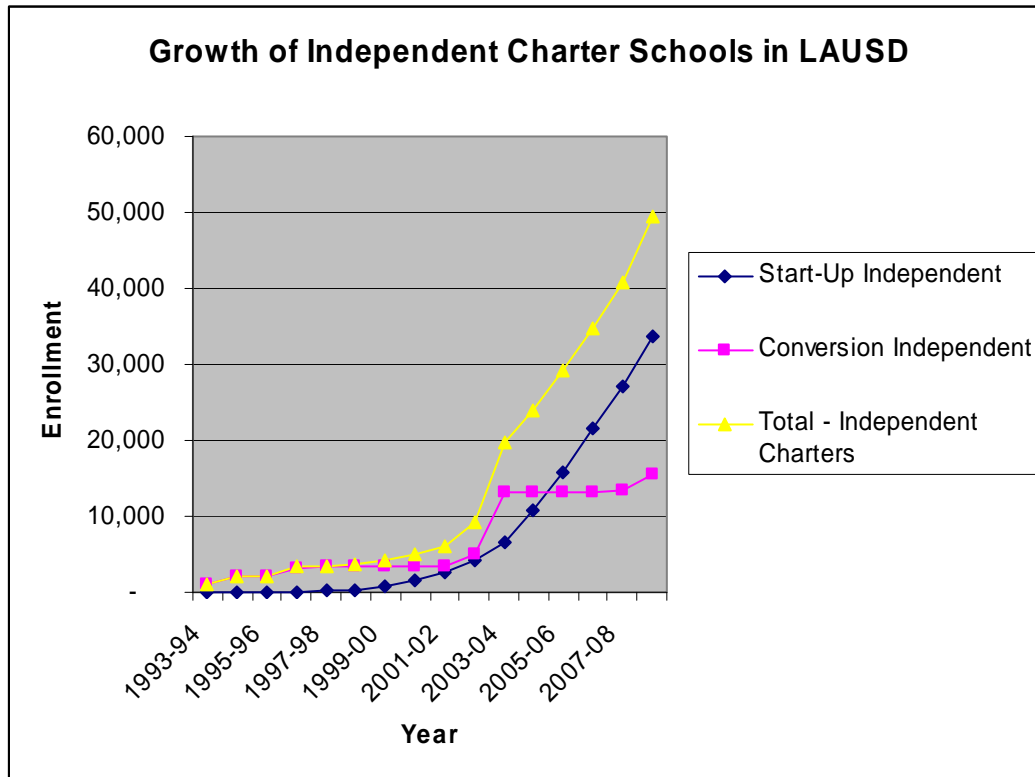
reconfigured as multi-track year-round in order to increase a school's annual enrollment by as much as 50 percent. During this period, charter school enrollment probably would have been viewed as having little negative impact on the District, and possibly a positive impact.

However, around 2003, LAUSD's overall enrollment peaked and has fallen annually. Since that time, concerns have been expressed within LAUSD about the potential negative effects of increasing charter enrollment on the District's functioning.

As Figure 1 shows, enrollment in independent charter schools snailed along beginning 1993-94. But in 2001-02 independent charter enrollment began climbing precipitously. Currently nearly 50,000 students are enrolled in independent charters operating in LAUSD. The Charter Schools Division projects that that number will increase by about 10,000 students by 2010-11 to a total of about 60,000 students. External proposals/initiatives to greatly expand enrollment in independent charters could potentially play havoc with the current projection.⁴ However, based on our review of actual and maximum enrollments for existing charters and those planning to begin operating in 2009-10, we do not believe that total enrollment in independent charters will exceed 100,000 students (which would represent a doubling of current enrollment) over the next several years.

⁴ See Maxwell.

Figure 1



Broadly, charter enrollment affects the District’s functioning through two broad pathways: (1) reduced District enrollment; and (2) District subsidization of independent charters. We examine the impact of each of these factors below separately. Then we examine their combined effects.

First, as the enrollment in independent charters rises, the enrollment in LAUSD falls by up to the same amount.⁵ Given that independent charter schools do not contribute to District outlay for retiree benefits, as described above, when enrollment falls the share of per-pupil revenue-limit income needed to pay for retiree benefits rises. If enrollment in independent charters rose by 40,000 students, at the current level of benefited retirees (33,000), the share would increase from \$420 to \$450 (an increase of \$30 per student). At the anticipated future level of benefited retirees (roughly 75,000), the revenue limit share would increase from \$960 to \$1,020, an increase of \$60 per student.

Second, the average general purpose income per student received by independent charter schools exceeds the District revenue limit per student. In effect, this means that in cases where a student leaves LAUSD to attend a charter school, not only does the District’s enrollment fall by one student, the District may also have to subsidize the charter in the amount of the difference between the charter allocation and the revenue generated by the

⁵ Some charter school students would not have opted to attend a noncharter LAUSD school if the charter were not available. Anecdotally, enrollment data for one independent charter showed that 25 percent of the students possibly lived outside the boundaries of LAUSD.

student (revenue limit per ADA). For example, pursuant to SB319 Locke's General Purpose Block Grant equals about \$7,315 per ADA. SB319 stipulates that conversion charters approved after June 30, 2006, would be funded based on their actual expenses in the year preceding conversion. However, the District only receives about \$6,000 in revenue-limit funding for each of Locke's students. In effect, therefore, the District must subsidize this school to the tune of about \$1,300 per student. This compounds the challenge posed by extraordinary fixed costs.

Key Preliminary Findings

1. Absent extraordinary expenses on fixed costs, falls in enrollment have historically been effectively addressed through commensurate reductions in District operations at both the school and nonschool levels.
2. Unfortunately, the District does incur an extraordinary fixed cost – retiree benefits. The District's liability for retiree benefits, if it goes unabated, will severely hamper the ability of LAUSD to function as a viable, competitive school district, resulting ultimately in a diminution in the quality of our workforce.
3. While the retiree-benefits challenge, if unattended, would hamper the District's functioning, falling enrollment will/would accelerate the District's slide toward fiscal incapacitation. Because of the interdependent connection between retiree benefits and enrollment, it is difficult to pin down the level of enrollment at which the District would no longer be able to operate in its current manner.
4. About one-fourth of the projected 43,000 student drop in LAUSD's enrollment over the next two years will be attributable to increased enrollment in independent charters. Rising enrollment in independent charter schools negatively affects the District's financial condition for two reasons: (1) charter schools do not contribute to the payment of LAUSD's retiree benefits; and (2) current funding formulas for independent charters may result in LAUSD further subsidizing these charters. Given that enrollment in independent charters will probably not increase by more than 50,000 students over the next several years, this level of growth would have a negative effect on the District's financial condition but would not, in and of itself, incapacitate the District financially.

Key Preliminary Recommendations

1. The District needs to secure a strategy for addressing the problem of retiree benefits – both for current retirees and future retirees. Increased longevity and the transition of the baby-boomers to retirement fuel the projection that the number of benefited retirees will increase from 33,000 to over 75,000 over the next 10 years. To add to the impact of mushrooming retirees, anticipated revenue COLAs could be overwhelmed by projected rates of increase in the cost of medical premiums.
2. The District should take steps immediately to insure that funding provided to students in traditional schools is fair and equitable relative to funding provided charters and partnership schools. For example, absent some revision of current policy, the District's traditional public school students could on the average receive at least \$1,000 per student less than students attending independent charters.

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