

Schools' Budget: One-Shots Now, Cuts Later?

The \$12.4 billion fiscal year 2003 adopted budget for the city's education department is \$652 million higher than the budget for 2002. This 5.6 percent increase in funding from city, state, federal, and private sources—sufficient to cover higher salaries under the new teacher's contract and avoid significant reductions to the classroom—was primarily funded with nonrecurring ("one-shot") resources, including borrowing that will increase future costs. Because these sources can not be counted on in future years, the city will have difficulty sustaining the funding increases in 2004 and beyond.

The increases may be even more fleeting, as the Bloomberg Administration has already directed the school system to identify \$379 million of savings (7.5 percent of the city-funded appropriation) in its budget for the upcoming school year. This will pose an early challenge to the incoming Chancellor. The majority of spending in the school system directly supports instruction, and much of that spending is beyond the direct control of the city. Previous efforts to identify savings in the central bureaucracy have met with only limited success.

If the \$379 million cut is implemented, it would erase the \$289 million increase in city funds for the schools adopted in June and bring city funding in the education department budget to below last year's total. Because of the maintenance of effort (MOE) requirement incorporated in the recently enacted governance legislation, this cut has additional significance. The level of city-funded spending at the end of this fiscal year will set the initial level of spending that must be maintained in future years.

Teacher contract costs. The city faces a large new expense due to the new United Federation of Teachers (UFT) contract ratified in June. The agreement will require city-funded spending in 2003 of more than \$300 million above the cost of the previous contract, including pension contributions. The cost would have been even higher except for the use of nonrecurring revenues to hold down the cost this year. The cost to the city will more than double in 2004, when the one-shot revenues will no longer be available.

IBO estimates that the UFT settlement increases labor costs above the previous contract by roughly \$1.0 billion in 2003 and \$1.1 billion in 2004. But the city will not have to bear all of these costs. First, around \$177 million of the total 2003 cost (nearly 18 percent) will be reimbursed by federal and state categorical grants that cover salaries and benefits for positions financed by these grants. Second, the city allocates a significant portion of the unrestricted state education aid it receives towards labor costs. The schools' collective bargaining reserve (which held enough funds to cover the same sort of agreement as was reached with DC 37) includes \$238 million of state aid in 2003 and \$247 million in 2004. Third, the city has reduced the burden of the contract for 2003 only with \$275 million of nonrecurring

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revenues. The remaining cost funded by the city is \$313 million in 2003, and it more than doubles in 2004.

The \$275 million of one-shot financing to help cover the city's 2003 cost of the contract comes from three sources: the state's Municipal Bond Bank, an advance of state aid payments, and a funding swap.

Municipal Bond Bank financing. The largest of these one-shots, \$206 million, comes from the state's Municipal Bond Bank (MBB) financing payments of prior-year education aid. In past years, the state did not appropriate sufficient funds to pay all valid education aid claims. The state currently owes the city an estimated \$433 million in general support for the public schools from prior years. In essence, the state is loaning New York City funds, rather than paying the school system the aid owed from prior years. To pay off the "loan" the city must forego some of its future school aid.

The MBB will sell bonds with the proceeds used to satisfy these prior-year claims. Of the \$433 million, \$227 million will be used to close accrued receivables from 1993 through 1997. The budget allocates the balance—\$206 million—towards the teachers' contract.

The \$433 million in MBB debt will be paid back with interest over 10 years by intercepting future state aid payments to the city. The bond bank will intercept roughly \$55 million per year in education aid. Because education aid will not be intercepted during 2003, the education department will retain \$33 million the state has already appropriated for prior-year aid payments in the current school year. The city's 2003 budget also allocates these \$33 million in state funds towards the UFT contract.

State aid advance. The schools are receiving another one-time boost of \$50 million because the state is increasing the amount of education aid advanced to the city. The state is permitting the city to use \$171 million of the aid for the school year that begins in September 2003 during the last two weeks of the upcoming school year. The \$171 million anticipated advance is \$50 million more than the prepayment of aid for the school year that is about to begin. The budget allocates \$20 million of the \$50 million increase towards the teachers' contract and \$30 million towards general program support.

The state's practice of each year advancing a portion of school aid began back in 1991 when the state advanced \$70 million to the city to mitigate the impact of mid-year

reductions in education aid. As long as the practice is repeated indefinitely with each advance at least equaling the prior year's payment, the effect on the city's budget will be at worst neutral.

Teachers for Tomorrow funding swap. The state has also allowed the city to allocate \$16 million in previously untapped Teachers for Tomorrow grant funds towards alternative teacher certification programs. The \$16 million includes \$8 million for the upcoming school year plus \$8 million of unused funds from the last school year. The enhanced grant flexibility enables the school system to support its Teaching Fellows program with state funds rather than city funds. The \$16 million in city funds freed up for 2003 by this funding swap have been reallocated towards the teachers' contract, bringing the total of nonrecurring resources supporting the UFT contract to \$275 million.

Other education one-shots. The budget includes \$317 million in other one-shot actions. In all, the budget relies on \$592 million in revenues that cannot be counted on for 2004. Such a heavy reliance on nonrecurring sources to fund baseline educational services means that the budget for 2004 faces a significant shortfall from day one. Some of the key one-shots used to construct this year's budget include:

Surplus roll. Roughly \$116 million in funds not spent in 2002 by the community school districts and high school divisions is rolled into this year. Much of the savings result from decisions to alter the timing of purchases and contracts rather than programmatic changes. This action has made 2002 spending \$116 million smaller and 2003 spending \$116 million higher.

Transfers from expense to capital. The city is transferring \$119 million worth of projects from the 2003 expense budget to the capital budget. The transfer, for this year only, effectively frees up \$119 million for other education operating expenses. The transferred items include emergency building repairs as well as minor capital projects selected by the School Construction Authority trustees. The salaries of architects and engineers employed by the education department have also been transferred as have some technology projects.¹

The \$119 million in new borrowing includes \$82 million in city and \$37 million in state financing. The borrowing by the city will raise its annual debt service by around \$10 million per year, assuming no other capital program changes.

Legal resolution. Another \$52 million one-shot results from resolution of a lawsuit filed in 1991 by school bus contractors. The City Comptroller had been holding the funds in trust pending the outcome of the lawsuit in which the bus companies claimed that the schools had been shortchanging them by not properly adjusting daily bus rates to reflect inflation. The courts determined that the school system had properly adjusted the bus rates and the Comptroller has released the trust.

programs by \$5.5 million; and saving \$8.0 million by reducing custodial allowances due to lower costs for materials and supplies (pending consultation with the custodians' union).

Previous efforts to streamline central administration functions have had limited success. During the past four years, central administration headcount has held steady at 1.7 percent of total headcount. The number of filled positions listed under "central administration" in the school system's financial status reports rose from 2,192 in the spring of 1999 to 2,398 in the spring of 2001 before dipping to 2,357 as of May 2, 2002.² The total number of full-time equivalent employees has moved similarly, rising from 131,426 in 1999 to 138,439 in 2001 before dipping to 137,013 in 2002.

Reducing central headcount has been difficult in part because many employees are unionized and protected from layoffs. Some employees presumably were waiting for the school system to offer early retirement incentives. The Chancellor expects significant numbers of central staff to depart by August 14, the deadline for participating in the early retirement program initiated in June.

2003 Budget Relies Heavily on One-Shot Resources	
<i>Dollars in millions</i>	
Increased reliance of debt financing	
Bonding of prior-year state aid	\$433
Bond proceeds used to close prior-year receivables	(227)
Free up expense budget dollars with city bond financing	82
Free up expense budget dollars with state financing	37
Other nonrecurring resources	
Increase state aid advance from \$121m to \$171m	50
Rollover of 2002 district surpluses into 2003	116
Legal judgement resulting in release of funds held in trust	52
One-year lag before state aid intercepted by bond bank	33
Funding swap, flexible use of Teachers for Tomorrow	16
Total nonrecurring resources	\$592

SOURCE: IBO.

Central savings initiatives. In recent years the school system has faced increasing pressure to wrest savings from its central operations in order to direct more resources towards the classroom, or at least to protect instructional services from potential budget cuts. The education department has developed a plan to leverage the consolidated purchasing power of the school system to obtain \$55 million in procurement savings. (See the July 3rd issue of *Inside the Budget*.) Another strategy targets \$87 million in savings by streamlining central functions.

The \$87 million central savings plan was unveiled in May and presented to the Mayor and City Council prior to the June budget adoption. It includes two items previously identified in the city's gap closing program: recouping \$4.1 million from private schools that overcharged for services to preschool special need students and reducing central administrative contracts by \$3.6 million. The plan would reduce spending within each of the education department's central divisions by up to one-third. Some of the new downsizing proposals include rolling over \$6.5 million in central office accruals (another nonrecurring resource); reducing food and transportation for after-school and holiday

Constraints in identifying additional savings. The Mayor has asked all city agencies to plan for cuts equal to 7.5 percent of their budgets—\$379 million for the schools. These savings would be on top of the department's previously announced central savings plan and follow significant budget reductions absorbed by the school system in 2002, including \$180 million—\$175 per pupil—cut from allocations to each school district. Because much of the education budget is essentially not discretionary, achieving the proposed savings would require a larger percentage reduction in the areas of the budget directly under the Chancellor's control.

The schools' \$12.4 billion budget includes over \$2.1 billion in federal and state reimbursable programs and \$792 million reserved for collective bargaining (primarily for the new teachers' contract). Of the remaining \$9.4 billion, \$628 million passes through to private and parochial schools, and \$130 million goes to the New York Police Department's school safety division. This leaves roughly \$8.7 billion of spending under the school system's direction.

Roughly \$1.2 billion of this \$8.7 billion, however, is largely

beyond the Chancellor's control. This includes \$607 million for pupil transportation, \$313 million for food services, and \$231 million for utilities and leases. Expenditures on utilities and leases are primarily determined by market conditions. State regulations determine pupil eligibility for free or subsidized transportation, while federal regulations determine eligibility for free or subsidized meals. With spending on these services largely driven by external factors, it will be challenging to identify significant savings in these areas.

The remaining \$7.5 billion of the department's budget consists of \$5.5 billion in salaries and wages, \$1.4 billion in fringe benefits, and \$634 million in contracts, equipment, supplies and other goods and services. The \$379 million in proposed cuts would largely have to come from this \$7.5 billion portion of the department's budget, effectively a 5 percent cut (10 percent of city funds).

While some savings could conceivably be achieved by reducing staffing levels, contractual work rules cap pupil-teacher ratios. Legal obligations to provide individualized special education services further constrain the department's flexibility in implementing staffing cuts. In addition, the budget includes \$167 million in health and welfare benefits for retirees and an estimated \$89 million in paid sabbaticals for teachers and supervisors. Spending on these contractual obligations cannot be reduced without union concessions.

Maintenance of effort. The recently enacted school governance reform requires New York City to maintain its contribution to the school system's expense budget from one year to the next. Under the new state law, the city's adopted budget for an upcoming year must provide at least as much in city funds as the current year's modified budget; an exception is made if city revenues decline. But the city will not be obligated to provide sufficient funds to maintain services at the prior year's level. The benchmark for the 2004 budget—the first year subject to the new requirement—will be the current budget for the schools as of June 2003.

The MOE provision pertains only to the schools' operating budget and excludes city education spending for debt service and pension contributions. The city plans to increase its education pension contributions by \$776 million between 2002 and 2006 to cover recent losses from equity investments as well as to increase pension benefits in accordance with recent state mandates and the UFT contract.

Under the Mayor's Executive Budget released in April, the school system was expected to provide the city with

\$362 million in budget savings, including \$8 million in revenue the schools were to generate. When these plans were announced there was concern that this amount of savings could not be obtained without having a direct impact on the delivery of educational services. The adopted budget included several changes that effectively offset the proposed budget reductions by nearly \$325 million. According to the Mayor and the Council, these changes would prevent cuts in instructional services in the upcoming school year.

These changes left virtually all of the proposed Executive Budget reductions in city funds for the public schools in place, however. In effect, \$323 million of city spending was supplanted with a \$122 million increase in state general support for the public schools and roughly \$201 million from one-shots (among those discussed above).³ The only city funds restored to the budget were \$1.7 million of the \$3.4 million in proposed cuts to City Council initiatives. Thus, the amount of city-funded spending that will have to be maintained for 2004 starts from a lower base. In addition, any reductions in city funds implemented during the current fiscal year—such as the \$379 million requested by the Mayor—would further lower the maintenance of effort level for 2004 by an equivalent amount.

Despite the supplanting of city funds, the amount of city funding for the schools in the 2003 budget is \$289 million above the 2002 level. This increase stems from growth in day-to-day operating costs, not from any new programs. In subsequent years, with the growing labor costs and the need to replace this year's one-shot revenues with city tax-levy dollars, the city funds are expected to account for the bulk of increases in the departmental budget. Thus, meeting the MOE requirement should be a fairly easy task for the city in the next few years. Providing sufficient resources to enhance, or even maintain, services will be considerably more difficult.

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ENDNOTES

¹ The city appears to be bonding out the salaries of skilled trades personnel for a second time. The salaries are bonded for a first time when the School Construction Authority reimburses the education department for the salaries with money that comes out of the city's capital budget.

² According to the education department, central headcount fell by 354 positions in 2002, under a broader classification that includes the elimination of positions that were already vacant and positions based in the field.

³ In June, the mayoral forecast of state revenue for the upcoming school year increased by \$148 million, including an increase of \$122 million in general support aids and \$26 million in restricted aids. The state revenue budget for 2003 went up by \$231 million, but the change included the \$50 million advance and the \$33 million for prior-year payments.