SENATE FISCAL AGENCY
MEMORANDUM

DATE: December 9, 2004

TO: Members of the Senate

FROM: Gary S. Olson, Director

RE: Current Financial Status of the Detroit Public Schools

Pursuant to provisions of the State School Aid Act, local school districts must report to the State a summary of their finances for the prior fiscal year by November 15 of each year. The Detroit Public Schools (DPS) transmitted this financial data to the Department of Education on November 15, 2004. The DPS data for the fiscal year ending June 30, 2004 (FY 2004) stated that the General Fund of the DPS closed FY 2004 with a deficit of $48.7 million. On November 18, 2004, Dr. Ken Burnley, Chief Executive Officer of DPS, also announced that the DPS was facing a projected General Fund deficit of $150.0 million in the FY 2005 budget. The combination of the $48.7 million FY 2004 budget deficit and the projected $150.0 million FY 2005 budget deficit leads to a $198.7 million imbalance between estimated revenues and expenditures in the DPS budget. Dr. Burnley then proposed a plan to eliminate the projected deficits.

On December 7, 2004, Governor Granholm held a press conference to announce actions her Administration was taking to deal with the urgent financial problems in the DPS. This memorandum provides background information on the factors that have resulted in the DPS budget deficits, a summary of the DPS proposal to deal with the budget deficits, and preliminary information concerning the Governor's plan to deal with the deficit.

As soon as the scope of the financial problems in the DPS became apparent, the Senate Fiscal Agency (SFA) began to gather information on the financial situation in the DPS. On November 22, 2004, the SFA organized a meeting in Lansing with representatives of DPS, staff members of the House Fiscal Agency, the Office of the State Budget, the Department of Treasury, and the Department of Education. The DPS was represented at this meeting by Robert F. Moore, Jr. Senior Deputy Chief Executive Officer of DPS. Other DPS officials at this meeting included the Chief Financial Officer and the Chief Legal Counsel of the DPS. The purpose of this meeting was to gather information from the DPS to better understand the issues that lead to the budget deficits. The DPS provided information at this meeting and in follow up communications that have resulted in the SFA developing a sound understanding of the issues that led to the budget deficit.

FY 2004 DPS Budget Deficit

The DPS closed FY 2004 with a $48.7 million General Fund budget deficit. This deficit occurred in spite of the fact that the district had a positive reserve balance in the General Fund of $74.7 million at the beginning of the fiscal year. In total, FY 2004 General Fund expenditures exceeded the amount of General Fund current year revenues by $123.4 million. This budget deficit of $123.4 million represents 7.6% of final FY 2004 General Fund expenditures.

Table 1 provides a summary of the factors that led to the $123.4 million imbalance between FY 2004 current year revenues and expenditures in the DPS budget. These factors included the following:

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Full Day Kindergarten: The DPS instituted a full day kindergarten program that resulted in increased expenditures of approximately $20.0 million.

Wrap Around Pre-School and After School Programs: The DPS expanded existing pre-school and after school programs for students. The estimated additional expenditures from these programs were approximately $15.0 million.

Class Size Reduction Initiative: The DPS instituted a class size reduction initiative to limit class sizes in grades K-3 to a maximum student/teacher ratio of 25 to 1. The estimated additional expenditures from this initiative were approximately $30.0 million.

School District Security: The DPS increased spending on a broad range of security initiatives by approximately $10.0 million above the initial amounts assumed in the budget.

Grounds/Maintenance: The DPS increased spending on grounds and maintenance at school buildings by approximately $5.0 million above the initial amount assumed in the budget.

Adjustments to Pupil Count: The final budget assumed approximately 1,250 students more than were actually counted in terms of the basic foundation allowance payments from the State. This overestimation of pupils reduced revenues by $8.9 million.

Pro-Rata Reduction: The DPS revenues were reduced by $11.1 million reflecting a pro-rata reduction in State School Aid payments during the fiscal year.

Other Adjustments: Other factors that have an impact on the final level of the DPS budget imbalance included increased expenditures for employee health care costs and the inability of the DPS to achieve employee concessions that were assumed in the budget. These and other miscellaneous expenditure adjustments totaled $23.5 million.

The fact that the DPS closed FY 2004 with a $48.7 million budget deficit means this deficit will be carried forward into FY 2005. The FY 2004 deficit of $48.7 million effectively becomes a negative revenue item in FY 2005. Therefore, the projected FY 2005 budget deficit will be a combination of the FY 2004 deficit and the projected deficit for FY 2005.

Table 1
Detroit Public Schools
Analysis of FY 2003-04 Current Year Budget Deficit
(millions of dollars)

Items Leading to FY 2003-04 Budget Deficit	
Full Day Kindergarten Programs	$ 20.0
Pre-School and After School Programs	15.0
K-3 Class Size Reduction Initiative	30.0
District Wide Security Enhancements	10.0
Building and Grounds Maintenance Enhancements	5.0
Adjustment to Revenues for Reduced Pupil Count	8.9
Adjustment to Revenues for $74/pupil Pro-Rata Reduction	11.0
Other Miscellaneous Adjustments	23.5
Total Items Leading to Current Year Budget Deficit	**$123.4**

Source: Senate Fiscal Agency analysis based on discussions with Detroit Public Schools.

FY 2005 DPS Budget Deficit

On November 18, 2004, Dr. Ken Burnley of the DPS announced that the DPS was projecting a $150.0 million imbalance between FY 2005 General Fund revenues and expenditures. This imbalance was evident in spite of the fact that the DPS approved an FY 2005 budget on June 25, 2004, that was balanced between estimated revenues and expenditures. Table 2 provides a summary of the factors that have led to this projected budget deficit.

Table 2

Detroit Public Schools
FY 2004-05 Budget Analysis
(millions of dollars)

FY 2004-05 General Fund Revenues (Enacted Budget)	**$1,555.6**
Adjustments:	
Revenue Loss Due to Actual Pupil Count	(17.0)
Medicaid Revenue Adjustment	2.4
Adjusted FY 2004-05 General Fund Revenues	**$1,541.0**
FY 2004-05 General Fund Expenditures (Enacted Budget)	**$1,555.6**
Adjustments:	
Adjust Base Spending for Actual FY 2004 Expenditures	$ 50.0
Special Education Spending	8.1
Full Day Kindergarten Funding	24.4
Failure to Achieve Labor Concessions	33.0
Classroom Teacher Adjustments	10.0
Failure to Achieve Early Retirement for Teachers	6.0
Utility Cost Increases	3.5
Other Miscellaneous Cost Increases	8.1
Health Insurance Cost Adjustments	(2.7)
Teacher Staffing Adjustments	(5.0)
Adjusted General Fund Expenditures	**$1,691.0**
Projected FY 2004-05 General Fund Deficit	**$ (150.0)**

Source: Senate Fiscal Agency calculations from data provided by the Detroit Public Schools.

The FY 2005 projected budget deficit was caused by many of the same factors that lead to the FY 2004 budget deficit. The FY 2005 budget approved by the district did include some major reductions to spending from the level of the prior fiscal year. The FY 2005 budget eliminated a total of 2,100 positions that had been funded in the prior fiscal year. The district closed a net five school buildings during the summer of 2004 in an effort to reduce costs. Other expenditure reductions made by the DPS included reduced spending on contracts, supplies, materials, and travel.

Based on data that the SFA has received from the DPS the following factors have led to the FY 2005 projected General Fund deficit of $150.0 million. These factors include:

Actual FY 2004 Expenditures: Actual FY 2004 expenditures exceeded the numbers used as a base for the FY 2005 budget by approximately $50.0 million. This base spending adjustment accounts for the largest component of the FY 2005 projected budget deficit.

Student Membership Count: The actual Fall 2004 student membership count was 3,800 students below the level assumed in the FY 2005 budget. This reduced estimated revenues by approximately $17.0 million.

Special Education Spending: The DPS is now projecting that actual expenditures for special education programs will exceed the budgeted amount by approximately $8.1 million.

Federal Grant Funding: The FY 2005 DPS budget had assumed that additional Federal funds under the No Child Left Behind Federal initiative would be available to fund expanded programs such as full day kindergarten. These Federal funds will not be available reducing estimated revenues by approximately $24.4 million.

Projected Labor Concessions: The FY 2005 DPS budget assumed savings of $33.0 million from employee concessions. Agreements on these concessions have not been reached resulting in increased expenditures.

Distribution of Students: The FY 2005 DPS budget was built on assumptions of the distribution of students across the 257 schools throughout the district. Actual student distribution varied from the budget assumptions, resulting in approximately $10.0 million of expenditure increases.

Early Retirement Program: The FY 2005 DPS budget assumed savings from a negotiated early retirement program with teachers. This early retirement program was not agreed to by the teacher union resulting in approximately $6.0 million of expenditure increases.

Utility Costs: The FY 2005 DPS budget assumed a fixed price for natural gas contracts for the district. The actual cost of natural gas purchases will exceed the budgeted amount by approximately $3.5 million.

Other Cost Increases: A variety of cost increases including additional bus routes, bus passes, the rehiring of 74 security officers and additional substitute teachers will result in increased expenditures of approximately $8.1 million.

Medicaid Revenues: The DPS is now projecting that it will receive approximately $2.4 million more in Medicaid funds than assumed in the budget for student health care costs.

Reduction of Teachers: Due to the unanticipated drop in student enrollment the district did not need to fill 97 teaching positions assumed in the budget. This change will reduce expenditures by approximately $2.7 million.

Health Insurance Costs: It now appears that final expenditures for employee health insurance costs will be lower than the budgeted amount. This change will reduce expenditures by approximately $5.0 million.

All of these factors, when combined, have led to a situation where a balanced FY 2005 DPS budget approved in June 2004 is now in deficit by $150.0 million. This projected deficit equals 8.8% of the projected level of FY 2005 General Fund expenditures.

Detroit Public School Deficit Reduction Plan

On November 29, 2004, Dr. Ken Burnley met in Lansing with representatives of the Governor's office and the Legislature leadership to provide an overview of the plan that the DPS had prepared to eliminate the combination of the FY 2004 budget deficit and the FY 2005 budget deficit. The plan outlined by Dr. Burnley had two key components. First, the DPS was asking the State to amend State law to allow the DPS to sell a deficit bond to provide the cash necessary in FY 2005 to eliminate the combined FY 2004 and FY 2005 DPS deficit of $198.7 million. The DPS then provided a general outline of spending reductions that would be put in place during FY 2006 to bring the budget into balance. This FY 2006 budget proposal would have to include the approximately $20.0 million of debt service obligations related to the debt bond. The spending reductions outlined in this FY 2006 budget included the combination of school closings, employee lay offs, employee concessions, and other miscellaneous spending reductions. The spending plan also was built on certain assumptions regarding pupil counts and the level of State basic foundation allowance aid to be received by the DPS.

Governor Granholm's Proposal to Eliminate Detroit Public Schools Deficit

On December 7, 2004, Governor Jennifer Granholm, State Treasurer Jay Rising, and State Superintendent Tom Watkins held a press conference to announce the Granholm Administration’s response to the fiscal problems being faced by the DPS. The Administration’s plan included several key components.

Local Advisory Board: The Governor will appoint an advisory board of local Detroit citizens that will immediately begin meeting to review the finances of the DPS. This local advisory board is anticipated to include representatives of business groups, labor unions, City of Detroit officials, and other interested parties. The advisory group is to work with the DPS to review the finances of the district and to develop recommendations for changes that will assure the long-term fiscal health of the school district.

DPS Multi Year Budget Plan: The Governor has asked the administration of the DPS to develop a plan that would bring the district's revenues and expenditures in balance over a two- to five-year period. This plan is expected to include detailed revenue and expenditure assumptions leading to a balanced budget. This revised budget plan would begin with the FY 2006 DPS budget.

Refinancing of Existing DPS Debt: Pursuant to provisions of the Revised School Code (MCL 380.1225), the DPS borrowed from the Michigan Municipal Bond Authority $210.0 million of State aid anticipation notes in August 2004. Pursuant to statutory requirements, these State aid anticipation notes must be repaid by August 2005. State aid anticipation notes are designed to provide local school districts with the ability to borrow funds on a short-term basis to meet school district cash flow needs. The State aid anticipation notes are repaid with future State School Aid payments to the school district.

Section 1225(3) of the Revised School Code provides for a procedure to be used if a school district is unable to repay the amount due on borrowing from State aid anticipation notes. The law provides that if a district defaults on the repayment of these notes, the State Treasurer may enter into a refinancing agreement with the school district that would ensure the ultimate repayment of the notes over an unspecified time period. If the DPS does default on the $210.0 million of borrowing due to the Michigan Municipal Bond Authority by August 2005, the State Treasurer could extend the repayment of these notes. This scenario would provide the DPS with additional FY 2005 revenues of $210.0 million. This is approximately the amount of additional revenue needed by DPS to close out the school year without additional budget reductions. This debt refinancing would result in an increase in debt service obligations for the DPS over the ultimate course of the notes' repayment. The amount to be repaid on an annual basis would depend on the length of the schedule to repay the notes and the interest rate charged by the State on this repayment schedule.

State Treasurer Jay Rising has not committed to the DPS that he will exercise this default option, but has made it clear to the DPS that such an option would be considered if the DPS and the local advisory group develop a long-term plan to bring the DPS back to a solid fiscal basis. Pursuant to State law, the Legislature would not have to pass any legislation for the Treasurer to exercise this debt refinancing option.

Supplemental DPS Financial Data

In order to provide some historical context to the financial situations facing the DPS, Attachment A provides a summary of DPS revenues, expenditures and membership pupil counts for the period FY 1994-95 through FY 2003-04. The final column on the attachment is a calculation which provides for the expenditures per pupil over this 10-fiscal year period. The source of this data is the annual data that the DPS reports to the State by each November 15.

As illustrated in the attachment, the DPS has experienced a significant drop in the number of pupils in recent years. Over the 10-fiscal year period covered in the attachment, pupil counts peaked at 173,871 in FY 1997-98 and have declined to 150,415 in FY 2003-04. This represents a decline of 23,456 pupils or 13.5% over the past six fiscal years. Expenditures of the DPS have continued to grow over this time period. During FY 2004 DPS expenditures increased by 3.9% from the prior fiscal year; at the same time, revenues declined by 2.1%. This imbalance between FY 2004 revenues and expenditures is the basis behind the current fiscal problems facing the DPS.

/kjh

Attachment

Attachment A

Detroit Public Schools Financial Data Revenues, Expenditures, and Pupil Counts				
Fiscal Year	**Revenues (millions)**	**Expenditures (millions)**	**Actual Pupil Counts**	**Expenditures Per Pupil**
1994-95	$1,198.4	$1,210.7	167,551	$7,225.9
1995-96	1,298.0	1,326.1	169,996	7,800.8
1996-97	1,325.2	1,275.6	173,080	7,370.0
1997-98	1,359.7	1,291.0	173,871	7,425.0
1998-99	1,406.3	1,382.3	173,848	7,951.2
1999-2000	1,431.0	1,439.7	168,213	8,558.8
2000-01	1,454.6	1,490.8	162,693	9,163.3
2001-02	1,606.8	1,573.5	159,694	9,853.2
2002-03	1,544.2	1,573.1	157,003	10,019.6
2003-04	1,511.8	1,635.1	150,415	10,870.6

Source: Department of Education data and Senate Fiscal Agency calculations.