

Date: March 13, 2012

To: Chairman Southard and Members of the School Board

From: H. Alan Seibert, Superintendent
Michael R. Crew, Director of Business

Subject: Proposed Budget for Fiscal Year 2013

Budget Narrative

We are pleased to present a budget for FY 2013 which represents what we hope is the continuation of a too slow recovery from the worst recession in recent memory. While Federal stimulus funding and artificially low VRS rates have alleviated budget difficulties in the past 3 years, for FY 13 we have been forced to look at budget cuts and for the first time using a small amount of year end fund balance to balance the budget.

The General Assembly adjourned on March 10 without passing a budget and will return in special session on March 21. The enclosed budget was constructed by using the House-passed budget and the Senate budget that failed after being passed in committee only.

Revenue is provided by a modest State funding increase (mostly due to increased State funding for the State share of higher VRS rates) and a small change anticipated in local funding due to changes in debt service paid by the City and to reflect the cost of a shared position.

The total budget presented to the Board for discussion at this time is \$43,704,802 which consists of \$ 42,039,382 for the School Fund and \$ 1,665,420 for the Cafeteria Fund. This proposed budget overall is \$ 684,146 or 1.6 % higher than the original adopted budget of \$43,020,656 for the current year. As explained in previous reports to the Board, this modest increase is more than offset by required contributions to VRS that result in a significant revenue gap.

The proposed budget addresses cost increases in the areas of VRS employer pension, health credit, and life insurance contributions, health insurance, special education and English Language Learners. In addition, sufficient funding is provided for utility and fuel and maintenance based on recent cost trends. Personnel costs include assumptions on position attrition and other cost reductions discussed later.

Enrollment Outlook

Enrollment in the current year has remained relatively stable and consistent with the prior year. Fall membership was 3,866 this year and final Average Daily Membership (ADM) for the year is expected to be about 3,850-3,860 versus 3,859 a year ago. Next year's budget is built using the same 3,830 conservative ADM estimate as in the past few years.

Attachment F has more details on enrollment projections that shows a healthy upward trend in enrollment over the next 5 years.

Status of State Revenue

The composite index for FY 13 and 14 is .6372 State share and local composite index of .3628. (For FY 11 the State share of SOQ expenditures was .6484 and the local share was .3516., so comparatively speaking, Salem's "wealth" as measured by the composite index based on real estate values, adjusted gross income, and retail sales increased slightly from the previous biennium.)

The House- passed budget would have increased State revenue by about \$682,000 and increased the VRS pension contribution rate to 16.34% while the Senate budget that failed would have increased State revenue by \$813,000 and increased the VRS pension contribution rate to 17.77%. (The current teacher contribution rate is 11.93%.) In either case, total VRS costs would rise by \$1.1 to \$1.3 million, depending on the final rate adopted.

The State revenue budget for the Board's consideration on March 13 was developed by analyzing the House (approved) and Senate (never approved) budget proposals as we typically do with the assumption that a combination of the two may eventually emerge from a conference committee. In the end, the proposed budget presented includes an increase of total State revenue including sales tax of \$783,277 due to the following:

- \$108,517 net increase in Basic Aid and Sales Tax
- \$641,061 increase in VRS pension and life insurance reimbursements

- \$78,384 increase in special ed. Regional reimbursement revenue for State share of higher costs
- \$112,302 increase in K-3 Class Size Reduction funding
- \$118,258 increase in textbook funding
- (\$327,324) decrease in one time funding in FY 12 for “Additional Support for School Operations”
- Other net state revenue changes \$52,079

Differences in Senate and House Budget Bills

The House budget bill and the Senate Finance Committee budget bill had the following differences before the budget process was halted:

House:

- Higher VRS teacher pension contribution rates for employers--- 11.93% currently to increase to 16.34% of salary (including health care credit and 5% employee-paid share).
- VRS group life goes from .28% to 1.19% (same as Governor and Senate)
- House restored non-personal inflation assumption that Governor had removed
- House removed Governor’s additional \$250,000 for Jobs for Virginia Graduates program as well as \$300,000 for Preparation Pilot Initiative and \$1,000,000 for Communities in Schools
- Added 3rd grade to the calculation for Early Reading Intervention funding
- Budget bill included language giving School Boards the option to require employees to pay up to 5% of the employee VRS contribution. (Note: this budget bill language may be superseded by VRS pension reform that just occurred at adjournment)
- Maintains VPSA technology funding

Senate:

- Higher VRS teacher pension contribution rates for employers 11.93% currently to 17.77% of salary (including .60% health care credit and 5% employee-paid share).
- VRS group life goes from .28% to 1.19% (same as Governor and House)

- Would have included additional sales tax on internet businesses
- Cut funding for Youth Development Academy, Preparation Pilot Initiative, and Communities in Schools that Governor had proposed
- Maintains VPSA technology funding

Final State Budget

We will revise the State revenue estimates again when the State adopts a budget.

Federal Funding

The major changes to Federal funding in FY 13 is as follows:

- Jobs Bill Funding ends 9/30/2012 so there is no budget for FY 13. There may be a small amount of carryover funding that will be budgeted later. The funding was used for the 2% bonus in FY 12 (other than certain positions not eligible that were paid with local funds) plus 4 middle school teaching positions and a nutrition position.
- The PEP grant continues in Year 2 of 3 with a budget of \$200,400
- Flow Through special education grant and Title I grant for disadvantaged students continue in FY 13.

While we always budget assuming a grant continues, if the federal government cannot agree on a budget, it is reported that it is possible that Flow Through and Title I could be cut by 9.6% effective January 1, 2013 which amounts to about \$100,000 on an annual basis

Local Revenue

Local funding from Salem City will change next year very little at this point unless the City notifies us of a change. Here are the changes:

- The City pays 100% of debt service currently for the school division. The debt payment on outstanding debt (before South Salem project's bond issue) goes down by \$97,068 next year
- City subsidy of \$18,420,000 which has been level for the past few years is budgeted with an increase of \$99,494 as an adjustment to reflect the City funding part of the Software Project Manager personnel costs next year—otherwise, no increase is anticipated at this point.

Funding from Fund Balance

The FY 13 budget includes a request to City Council to allow the school division to use \$290,782 in fund balance carried over from last year on a one-time basis to balance the budget.

In FY14 if no improvement occurs in the school revenue picture, the school division intends to make up for the use of fund balance with additional cuts to travel, wellness, dues, furniture, other instructional support accounts, instructional supplies, length of contract reductions, and position attrition reductions in the budget.

Cost Increases planned for in the budget

Certain cost increases were planned for in the budget such as:

- VRS cost increases of \$1,326,823 due to higher rates for pension contributions and group life insurance
- Funding for 1 new IT position and school division part of the net cost of Software Project Manager position (\$99,324+ fringes on IT position)
- Increased software maintenance costs for G/L and payroll software and fingerprinting (\$26,000)
- Increase in regional special education tuition \$106,064)
- Increase in Dual Enrollment paid to Va. Western (\$30,000) offset by a revenue account
- Increase of \$24,000 for trend of increasing English Language Learners services
- Increase in software maintenance for PowerSchool and City Internet services (\$20,390)
- New account for locally funded special education services (\$45,000) which are now exceeding federal grant funding in the Flow Through grant, which traditionally paid for all of those services
- Increased testing cost including expanding MAP testing (\$10,300)

Notable Budget Reductions in the Proposed Budget to Help Offset Cost increases

Budget cuts have been included in the FY 13 budget as follows to construct a workable budget:

- 2 teaching positions and 1 instructional position eliminated by attrition
- Reductions in certain extended contracts assumed
- No additional pay was budgeted for teachers who complete additional education—their pay would remain the same for next year (\$32,500)
- Salaries reduced by approximately \$40,000 for 4 day furlough of 12 month professional employees during spring break
- Instructional supplies were cut by 10% (\$32,000) from requests, which were level funded as a starting point
- Textbook budget cut by \$25,590 (some will be purchased in FY 12)
- SOL during the year remediation cut by \$12,525
- Travel was cut by 10% or \$5,000
- Wellness program cut by 50% or \$5,000
- Tuition assistance cut by 20% or \$4,400
- Contingency fund of \$25,000 in last year's budget eliminated
- Natural gas budgets were reduced by 8%

Other Budget Characteristics

- No school buses are funded in the operating budget as in prior year. Capital reserve funds will be used to purchase 2 buses (typically) in the fall assuming funding is sufficient at that time
- Little or no capital outlay is funded except for technology accounts that are required to receive State VPSA funding
- Cafeteria Fund-A \$.05 increase in student and adult lunch prices is recommended due to federal school lunch program requirements and also a \$.25 increase in recommended in breakfast prices for students and adults

Other Revenue

Non-Resident Tuition—NO changes proposed

The Board has requested an updated recommendation on non-resident tuition fees annually at budget adoption. In FY 11, the Board increased tuition from \$300 to \$500 with employees' children at \$150. No changes are recommended for FY 13.

Operating Expenditures-Level funding As a Starting Point

This budget is generally designed to maintain the current instructional and remediation program level-funded except where cuts could be made or mandatory cost increases were occurring.

Salary and Fringes:

- All salary accounts and fringe benefit accounts have been adjusted to today's actual salaries
 - *2 teaching positions and one instructional assistant position are assumed to be eliminated through attrition*
- *A recommendation on employee compensation and benefits will occur in May as needed*
- *Funding is included for the REWIP program*

Health insurance costs, which will cost the division a total of \$ 3.4 million next year, have been budgeted in anticipation of a possible 10% increase effective October 1 based on national market trends.

The final cost cannot be known each year for the annual contract renewal on October 1 until rate negotiation takes place later in the spring. Market trends point to a 10-11% increase just on medical inflation alone. Salem's claims experience will impact the rate as well.

The amount of \$130,000 has again been budgeted throughout in health insurance in anticipation of continuing the annual payment to a VML trust fund for the GASB 45 postemployment benefits liability.

Because employees are now paying 10% of single subscriber rate, only a modest budgeted increase of \$28,282 is added to the budget at this time.

Technology funding is included at the minimum amount necessary to receive the \$206,000 in VPSA state revenue (local match of \$41,200 required). Depending upon the availability of Capital Reserve funds after closing out the year on June 30, the Board is typically asked to supplement these funds in the fall.

VRS Pension Contribution rates—the proposed budget uses the **17.77%** higher Senate pension contribution rate for teachers, up from the current rate of 11.93%. For VRS group life insurance, 1.11% is used.

An increase of \$1,326,823 for the total increased pension/health credit/life insurance contribution rate is shown on page 133 and will be spread later to individual line items.

The contribution rate for the “non-professional” group, which is based on an actuarial report, will be **13.67%** in FY 13, up from 12.19 % in FY 12. This rate is set based on an actuarial report.

Other operating accounts such as maintenance and utilities are adjusted based on trend but are consistent with the current year. Of particular note is the fact that natural gas budgets were reduced slightly since gas costs are at an all-time low.

Cafeteria Fund-Federal Regs. Require Price Increase in Lunches

The Cafeteria budget, also a balanced budget of \$1.6 million, is a challenge to maintain as a break-even operation.

Trends include:

- Flat full pay student participation
- Increased Free lunch participation
- Breakfast participation up
- Increasing food costs possibly including to meet requirements for more fresh fruits and vegetables
- Commodities will continue to vary year by year
- Federal requirement to increase lunch prices gradually until full pay lunches approximate what the federal government reimburses for a free lunch

The proposed budget recommends that student and adult lunch prices be increased by \$.05 and that breakfast for student and adults be increased by \$.25 as follows:

Salem City Schools
Summary of Proposed Cafeteria Meal Prices

	<u>FY 2012</u>	<u>FY 2013</u>
Elementary Breakfast	\$1.00	\$1.25
Elementary Lunch	2.00	2.05
Middle and High School Breakfast	1.00	1.25
Middle School Lunch	2.15	2.20
High School Lunch	2.15	2.20
Reduced Breakfast	.30 (Set by fed. govt.)	
Reduced Lunch	.40	
Adult Breakfast	1.45	1.70
Adult Lunch	2.75	2.80
Milk	.40	.40
A la Carte items and ice cream	Prices adjusted as needed each year based on cost to purchase	

Lunch Price Increase of 5 cents or more will continue:

The Healthy Hunger Free Kids Act of 2010 requires that student lunch prices be evaluated annually until the price we charge for a full pay student reaches the difference in what the feds reimburse for a free lunch and what they reimburse for a full pay lunch (currently \$2.51).

For the annual calculation, divisions have to apply an inflation factor of (4.18% for FY 13) to what they charge the average full pay price and can round down to the nearest 5 cents. **No annual increase can be more than 10 cents but the goal is to gradually reach \$2.51 as the average lunch price.**

Breakfast prices have been unchanged for many years and the cost increase of \$.25 is to bring the charge more in line with the cost of the breakfast.

Personnel costs and even food costs can vary from school to school based on the experience level of employees and whether they participate in

health insurance programs, for example. Some school cafeterias will produce a “profit” to offset those which run at a “loss” while overall the fund is budgeted to break even.

A la carte items are adjusted as needed at the beginning of the school year.

Conclusions and Future Trends Beyond FY 13

Our most immediate concern is for a State budget and to learn more of the VRS reforms that have just been passed.

Beyond that, we see a recovery that is still lagging, static local and State funding in general, possibility of federal grant cuts and always uncertain international events that can derail the economy. Energy and health insurance costs and pension costs will continue to be challenges each year.

Public education reform, the federal role in education, and public pension plans are in the national spotlight at this time. These discussions will continue to impact all school systems in the coming years.

Supplemental Information--State Lottery Funds

The school division used to receive \$500,000 (then cut to \$225,000 in FY 10) from FY 99 to FY 10 for lottery funding. It was used ½ for debt service until the General Assembly eliminated it as a discreet line item and used it to fund basic education payments in lieu of other State General revenues.

Example of the Typical Cost of Salem Teacher Salary and Fringes

Salem Average Teacher Salary	\$ 53,312 (1)
Employer FICA (7.65%)	4,078
VRS Pension Cost-Employer Share (11.66%)	6,216
VRS Pension Cost-Employee Share paid by division (5%)	2,866
VRS Group Life -(Employer and Employee Share cost) paid by division (1.11%)	592
Health and Dental Insurance- Employer share	<u>6,950</u> (2)
Cost of salary and fringes of typical teacher using FY 2013 assumed rates	<u>\$ 74,014</u>

- (1) Average of Elem/ Sec teacher salary per 6/30/11 Annual School Report
- (2) Assumes single subscriber – rate varies by coverage-with 10% increase

Note: Employer-paid benefits are equal to approximately 39% of an average teacher salary above.

Salem City Schools
Basic Aid State Revenue Estimate- How It is Computed?

	<u>FY 2012</u>	<u>FY 2013</u>
3,830 (Estimated ADM) x \$ 4,847 per pupil	\$ 18,564,010	-
3,830 (Estimated ADM) x \$ 4,959 per pupil	-	\$18,992,970
Less: 1% State's Sales Tax (<i>State Estimate</i>)	<u>(3,361,974)</u>	<u>(3,283,884)</u>
Subtotal	15,202,036	15,709,086
Composite Index-- State Share	<u>x .6484</u>	<u>x .6372</u>
Total Basic Aid Revenue	<u>\$9,857,000</u>	<u>\$ 10,009,830</u>

ADM=Average Daily Membership

Note: Basic Aid State revenue is the largest single item of State revenue