DISCUSSION DRAFT
December 1, 2009

The Honorable Charles J. Colgan
Chairman, Senate Finance Committee

The Honorable Lacey E. Putney
Chairman, House Appropriations Committee

Gentlemen:

As your respective appointees to the Joint Subcommittee on Elementary and Secondary Education Funding, we are pleased to submit this report.

Background

As you know, the originating language in the 2006 Appropriation Act created a technical workgroup of staff from various agencies to study certain education funding issues. In order to provide legislative direction to this work and to ensure a public process, language in the subsequent 2007 Appropriation Act, instead, restructured this work as a small joint subcommittee of two members of the money committees to help provide on-going direction regarding the General Assembly's constitutional responsibility for public education finance in Virginia. In 2008 the membership was expanded to four members each and in 2009 the membership was expanded to five members each, with a reporting date of December 1, 2009.

2009 Appropriation Act (Item 1)

> H. 1. The Chairmen of the House Appropriations and Senate Finance Committees shall each appoint ~~four~~ *up to five* members from their respective committees to a joint subcommittee to provide on-going direction and oversight of Standards of Quality funding cost policies and to make recommendations to their respective committees *by December 1, 2009*.

> 2. The Joint Subcommittee on Elementary and Secondary Education Funding shall: ~~1~~ *a*) study the Commonwealth's use of the prevailing salary and cost approaches to funding the Standards of Quality, as compared with alternative approaches, such as a fixed point in time salary base that is increased annually by some minimum percentage or funding the national average teacher salary; and ~~2~~ *b*) review the "federal revenue deduct" methodology, including the current use of a cap on the deduction*; and c) review the methodology for establishing a consistent funding cap process for all state funded instructional and certain support positions*.
>
> 3. The school divisions, the staff of the Virginia Department of Education, and staff of the Joint Legislative Audit and Review Commission, are directed to provide technical assistance, as required, to the joint subcommittee.

Summary of Key Issues

The Joint Subcommittee met three times during 2009 - on June 18, 2009, September 14, 2009, and November 9, 2009. (One meeting originally scheduled for August 19, 2009 was cancelled due to a conflict with the Special Session called by Governor Kaine on the same afternoon.) Meeting agendas are attached. At these meetings, key issues discussed by the Joint Subcommittee included:

1.) "Federal revenue deduct"
2.) Cap on funded support positions
3.) Early retirement incentives
4.) Options for creating a statewide health insurance program
5.) Triennial census of school-aged population
6.) Composite Index of Local Ability-to-Pay

1.) "Federal Revenue Deduct." At the September 14, 2009 meeting, Kent Dickey, Assistant Superintendent for Finance, Virginia Department of Education, reviewed the so-called "federal revenue deduct" methodology. The purpose of the deduct, initially proposed in the 2004 Session by Governor Warner, was to eliminate expenditures from the base fiscal year that were from federal funds so that they do not impact the re-benchmarked cost of SOQ Basic Aid. The original proposal was to deduct 100 percent of certain federal funds, for a savings at the time of over $300 million for the biennium. The General Assembly instead adopted a policy of deducting about 30 percent of such funds, since the other 70 percent of costs are determined by, and therefore limited, fixed staffing standards, not prevailing costs.

The federal revenue deduction is based on each school division's revenues from the following six federal programs: Title I (economically disadvantaged students), IDEA (special education), Perkins, (career and technical education), Title IV-A (safe and drug free schools), Title V-A (innovative programs), and Title II-A (improving teacher quality). The final amount of each school division's capital expenditures from federal funds is deducted. The deduction from Basic Aid is based on subtracting 30 percent of either the lower of each school divisions' actual per pupil amount or the statewide prevailing amount, which was $502.97 in Chapter 781.

Since 2004, a concern with adjustments to the federal revenue deduct as a savings measure for the state has been the disproportionate impact on school divisions that receive greater amounts of federal revenues from the six programs because of their higher concentrations of economically disadvantaged students. (The deduct reduces state funds only; school divisions continue to receive 100 percent of these federal revenues.) The subcommittee has no recommendations regarding any alternative adjustments to the federal revenue deduct at this time.

2.) FY 2010 Cap on Funded Support Positions. In the 2009 Session, GF savings of $340 million in FY 2010 was included in the adopted budget by "capping" funded support positions. Federal stimulus dollars mitigated 86 percent of this reduction in FY 2010.

Virginia's approach to costing the SOQ has two major components: 1) Use of quantified standards, to estimate the minimum number of personnel required (instructional positions), and 2) use of "prevailing" school division unit costs (support positions and operational costs; instructional and support salary levels).

The cap on funding support positions, initially proposed by Governor Kaine in the introduced budget, establishes a link to the number of support positions to the number of SOQ-funded instructional positions. SOQ funding supports about 70 percent of total actual instructional positions. The cap translates into a reduction of about 35 percent of funded support positions from 35,695 in FY 2009 to 22,811 in FY 2010. From FY 2001 to FY 2010, in absolute numbers, SOQ funded instructional positions have increased by 22 percent while funded support positions increased by 47 percent. Relative to the growth rate of funded positions per 1,000 students, instructional positions have increased 14 percent and support positions have increased by 38 percent. During the 2004 Session, the General Assembly 1) completed the phase-in for restoring funding for certain administrative support positions that had been inadvertently dropped in FY 1993; and 2) made revisions to the SOQ to add several instructional positions. Appropriation Act language directed re-benchmarking to be calculated two ways, with and without the change in methodology, and directed the State Board of Education to evaluate the appropriateness of 1) the existing staffing standards for instructional positions, and 2) establishing ratio standards for support positions, with the objective of maximizing resources devoted to the instructional program, to report by November 1, 2009.

At each meeting, the Joint Subcommittee received updates from State Board of Education President Mark Emblidge on the work of the Board's Standing Committee of the SOQ, which is a Committee of the whole. The work plan included: participation and involvement of education entities and the public; collection and analysis of data provided by school divisions; research and analysis by an outside consultant; examination of all facets of the SOQ staffing standards; identification of best practices; and formulation of recommendations.

At the September 14, 2009 meeting Dr. Emblidge indicated that major activities from May to August included: three public forums, a 90-day public comment period (May 1 – July 31), and receiving the preliminary report from Augenblick, Palaich, and Associates. Most of the comments to date were in opposition to any reductions in the Standards of Quality and any permanent cap on support positions. Several comments recommended increased flexibility to school divisions' use of state funding to hire needed personnel.

Also at the September 14 meeting, Anne Wescott, Assistant Superintendent for Policy, Virginia Department of Education, discussed the preliminary review and analysis of the Virginia SOQ by Augenblick, Palaich and Associates. The study included a literature review of the research on staffing ratios and ratios used in other states. Key findings include: positive impact of small class sizes in grades K-3; little research on the effect of class sizes in middle and high school; and across several areas while smaller is better, there is little discussion of optimal sizes. Four states that use personnel as the key funding factor are: Alabama, North Carolina, Delaware, and Tennessee. The consultants also reviewed the school efficiency reports to date, but determined that they did not provide any insight as to appropriate levels of support staffing.

At the November 9 meeting, Anne Wescott presented the Board's report. The report includes several proposed cost-neutral revisions to the Standards of Quality statute, sets out several policy directions for the Board, and lists areas for further study. Regarding support positions, the Board recommends: permitting support services to be used for instructional costs; defining categories of personnel who make up support services, specifying how they are funded, and requiring transparency; and studying the feasibility of converting prevailing costs for each major category of support services into ratios.

While the support positions cap constitutes a revision to the SOQ funding calculation methodology for the state and school divisions, the Joint Subcommittee recognizes that, given the revenue outlook, it is unlikely that sufficient general fund revenues will be available to address a modification to the FY 2010 funding methodology for support positions in 2010-12 biennium.

3.) Early Retirement Incentives. As a follow-up to proposals discussed during the 2009 Session, at the June 18, 2009 meeting, the Joint Subcommittee received a general overview of local early retirement incentive plans (ERIPs) across the state and heard an overview from David Baker, Chief Financial Officer, for Fredericksburg City Public Schools' existing ERIP.

According to an August 2008 Virginia Education Association report, 38 school divisions have existing ERIPs, 11 of which are IRS qualified plans, and 19 of which include an employer contribution to health insurance. A Virginia Retirement System document shows 33 school divisions had ERIPs in the 2008-09 school year. Minimum retirement ages range between 50 and 55. Most require a certain number of years of services in the school division.

Under Fredericksburg's plan, participants annually receive twenty percent of their final contracted salary, not to exceed $15,000 for up to five years. Participants are required to work twenty days per year on projects/assignments to be determined by the Superintendent or their designee. Service as a substitute teacher may fulfill the twenty day requirement. Annual total cost of the plan has risen from $75,000 to $225,000 over the last ten years. Annual savings vary depending on replacement and tenure. Recent changes increased the local service requirement from 10 to 15 years and decreased the benefit term from 7 to 5 years.

The Joint Subcommittee recommends that any state-supported early retirement incentive plan, especially given the current funded status of the Virginia Retirement System, direct the full actuarial cost to participating localities.

4.) Options for Creating a Statewide Health Insurance Program. The Joint Subcommittee received a presentation from Sara Wilson, Director, Virginia Department of Human Resource Management (VDHRM), on September 14, 2009: "*Options for a Statewide Health Insurance Program for School Divisions*". The presentation had three major components: review of two legislative actions that occurred during the 2009 Session; review the current status of school divisions participating in the Local Choice Plan; and finally the advantages of a statewide plan and a proposed action plan to design and implement a new statewide health care plan for school divisions.

House Bill 2632 (2009), as introduced by Delegate Shannon, directed the Department of Human Resource Management to develop a proposed statewide optional health insurance plan for all teachers, and an alternative plan covering all employees and retirees of local school boards. The proposed amended bill expanded the language to include local government employees and added language on administration of the plan. In addition, during the 2009 Session, a budget amendment approved in the Senate's budget, provided authorization to the VDHRM to create a statewide health insurance program for employees of Virginia public school divisions. Ultimately, neither the proposed amended bill nor the Senate budget amendment passed both Houses.

Collectively, Virginia has 132 school divisions with 191,000 employees who are eligible for health care coverage. Currently, only thirty school divisions, with about 12,000 employees, participate in The Local Choice (TLC) plan offered by the state. The TLC was established in 1990 by the General Assembly and is designed to be managed in the same manner as the state's health care plan. It is self-funded with experience rating pools that are based on group sizes ranging from 1 to over 2,000 employees. The plan includes a stop-loss protection for larger experience rated groups, and components that are included in the state's plan such as employee assistance program, CommonHealth, and disease management. The TLC was developed exclusively for school divisions and political subdivisions that have a combined enrollment of about 46,000 members.

A statewide plan would potentially be able to offer cost savings through economies of scale that currently do not exist for school divisions' individual plans. The creation of a single plan would reduce redundant administrative and procurement expenses, lower costs associated with pooling of shared risks, drug, health, and dental components.

Designing a statewide plan would take several key steps: 1.) complete an actuarial analysis: a.) collect claims data from all school divisions; b.) compile differences in the different employee contribution rates, carrier discounts and measure the degree of managed care needed; c.) evaluate impact of opt out to any premium adjustments, and administrative costs; and d.) determine final costs and the viability of the plan; and 2.) determine employer/employee premium share splits.

A minimum level of funding would be required on the onset of the implementation of the proposal to cover the costs associated with the actuarial and procurement expenses, hiring of staff to administer the plan, the information system and to disseminate information on the plan. First year funding would be required to cover costs of Initial claims payments, IBNR and accounting reserve minimums.

The Joint Subcommittee believes that school divisions could potentially benefit from the development of a tailored statewide health care plan designed to lower associated costs, through an economy of scale, and a shared participant pool

for negotiation of provider charges. Therefore, the subcommittee recommends future consideration of development of a statewide health care plan for school employees and possibly local government employees if funds are available to fund such a statewide actuarial study and plan.

5.) Triennial Census of School-Aged Population. Susan Perrone, Statistician, Weldon Cooper Center at the University of Virginia presented: "*Virginia's Triennial Census: A preliminary study of process, accuracy, and options*", on September 14, 2009.

The triennial census of the school age population is required by Sections 22.1-281 – 22.1 – 286 of the Code of Virginia. The cost of conducting the census every three years is borne by the local school divisions. Divisions may contract out the collection of the data, but an actual count (as opposed to using sampling or estimates) is required. All children ages 5 – 19 are to be included in the census count, whether or not they are enrolled in the public schools. The costs to localities of conducting the census were estimated in 2008 to range from $100 (Powhatan) to $717,000 (Fairfax). Conducting an accurate census of the school-age population is a complex and difficult task, and school divisions often lack the resources and expertise to complete the census properly.

One of the alternatives to the current triennial census process is using Average Daily Membership counts for an annual count of school age children. While this approach improves the existing situation by making the count process uniform across all school divisions, it excludes students not enrolled in public schools and creates a significant fiscal impact on localities with large private school/home school enrollments.

Another alternative is to use the Weldon Cooper Center population estimates by age. This alternative also improves the current situation by removing the fiscal burden on localities and by making the process uniform for all school divisions. Use of the population estimates also enables the General Assembly to continue to allow calculation of all school-age children while improving the reliability and accuracy of the data.

House Bill 2063, as introduced by Delegate Hamilton, was one of three bills referred to the Joint Subcommittee during the 2009 Session for review. The amended bill eliminates the requirement that a census count of all school-age persons be completed every three years. It amends the sales tax allocations to localities by using average daily membership rather than the school-age population of a school division. The effective date of the bill is July 1, 2011 coinciding with the 2012-2014 rebenchmarking cycle.

The Joint Subcommittee acknowledges that school divisions will continue to be burdened with additional administrative and financial requirements placed on them as a result of conducting the next triennial school-aged census in 2011 as defined by statute. Secondly, the subcommittee supports prospective opportunities for school divisions to lower operational costs via fully vetted and reasonable

alternative approach. For that reason, the subcommittee recommends that prior to the next census cycle, further considerations be given to modifying the existing codified mandates placed on school divisions for completing the census.

6.) Composite Index of Local Ability-to-Pay. During the 2009 Session two bills were referred from the House Education Committee that dealt with the composite index funding formula. Both bills propose modifying the existing composite index funding formula calculation methodology.

The first, House Bill 2093, as introduced by Delegate Pollard, caps the composite index at 0.6000 for a school division if two conditions are met: 1.) student membership is less 2,000 during the prior school year, and 2.) student eligibility for free and reduced lunch is greater than 45 percent. Consequently, the proposed change would shift more funding responsibility to the state.

The second, House Bill 2198, as introduced by Delegate Watts, proposes significant changes to the composite index formula. The current formula uses: 1.) true real estate property values, 2.) adjusted gross income and 3.) sales tax revenues. The components are weighted with values of 0.50, 0.40, and 0.10 respectively. In contrast, the proposed bill would use: 1.) the reimbursement payment for tangible personal property tax relief, 2.) total value of real estate, adjusted by the index used for the pay differential for those state employees residing in each specific locality, 3.) median value of residential real estate, adjusted by the index used for the pay differential for those state employees residing in each specific locality, 4.) sales tax revenues, 5.) revenue collected form local personnel property tax, and 6.) revenues collected from local lodging, local cigarette, and local meal taxes.

The proposed legislation would significantly change the final composite index numbers that are calculated for each of the school divisions. Consequently, the reallocation of state funding to localities would cause some localities to receive less state funding while others would receive more.

A specific fiscal impact statement was not completed for this bill during the 2009 Session. The Department of Taxation indicated that the median value of residential real estate in each locality, and the statewide median value of real estate data is not readily available and may require additional collections from localities. Likewise, the needed details for the personal property tax revenue, and local lodging, cigarette, and meal tax revenues would require additional effort from agencies and localities.

The Joint Subcommittee would like to thank the members for presenting their respective concerns. However, absent a more comprehensive study of concerns statewide, the subcommittee cannot support nor make a recommendation

that would place additional financial burden on one school division for the benefit of another school division. Therefore, it recommends no action on either bill.

We thank you for the opportunity to jointly study these issues and hope that the dialogue that took place during these meetings will prove to be useful background for the decisions that will be before the Senate Finance and House Appropriations Committees during the 2010 Session.

Respectfully Submitted,