UNCERTAINTY AHEAD:
School Finances in the Face of COVID-19

School districts have seen their operations upended by COVID-19, with classroom teaching canceled and districts scrambling to move instruction online. Districts have larger reserves than in 2012, yet they face great challenges and uncertainty as they draft preliminary 2020-21 budgets. That uncertainty includes potential cuts in critical state aid, particularly if federal relief for state revenue losses is not forthcoming.

For school districts around Wisconsin, this year's spring budget deliberations represent an exercise in the unknown. The impact of COVID-19 has left districts with an unusually difficult and speculative task as they prepare their financial plans for the upcoming school year.

First, districts are dealing with the unanswered question of whether and how they will be allowed to open schools this fall, and what that may mean for their workforce and technology needs. Second, the pandemic's impact on state tax collections means lawmakers may need to re-open the current two-year state budget and consider a potential freeze or cut in school aids. Given the severity of the current downturn, such an outcome looks increasingly possible in the absence of federal aid to offset the hit to state revenues.

This has happened before – the state cut aid to schools in the wake of the Great Recession and essentially froze aid in one of the years following the 2001 recession. The move could hit districts in Wisconsin particularly hard given our system of funding schools.

Schools depend more on state aid than other local governments in Wisconsin and less on property taxes, which are more under the control of local leaders. A loss in state aid could lead to higher local property taxes or spending cuts. Districts such as the Milwaukee Public Schools (MPS) with the most underserved students generally depend the most on state aid while districts with greater property wealth depend more on property taxes.

School districts in Wisconsin have raised their core reserve levels in recent years and these fund balances could help to absorb part of the heavy blow from COVID-19. Yet districts still must grapple with emergency and unexpected spending from the crisis on top of the potential loss in state aid. Over the next two months, districts will be struggling to forecast these losses and needs as they craft their preliminary 2020-21 budgets.

Finally, reserve levels vary quite widely by district and MPS is one notable exception to the trend of larger fund balances. Though the recently approved $87 million referendum will help MPS going forward, the lack of reserves could exacerbate the challenges ahead for the state's largest district. In addition, the 20 largest districts started 2019-20 with generally healthy balances overall but were expecting a modest decline in reserves this year even before the coronavirus hit.

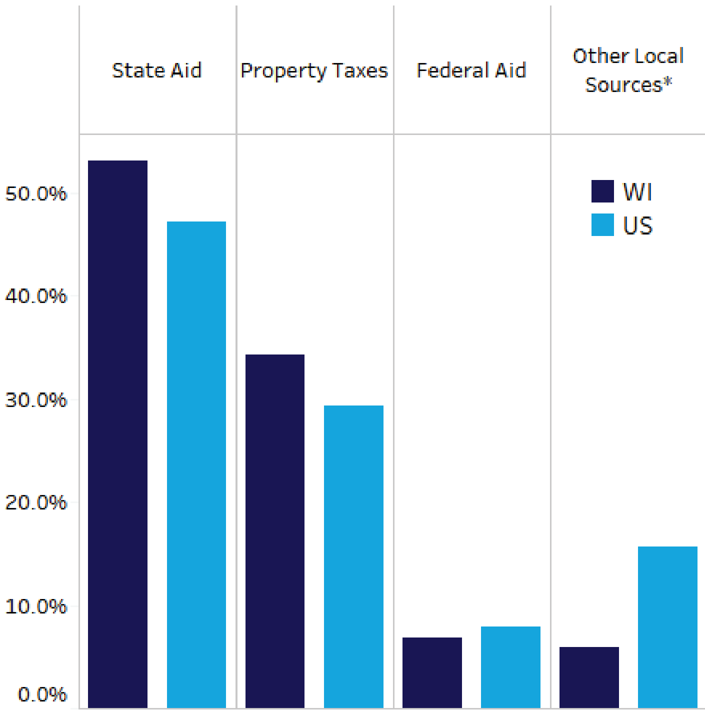
REVENUES AT RISK

At the moment, schools districts' key revenues might appear more stable than those of some other local governments in Wisconsin such as counties, which are already seeing a sharp decline in sales tax collections; or cities and villages, which have some reliance on declining revenues from room taxes as well as licenses, permits, fines, and fees. Yet school districts face substantial risks of their own given their reliance on state aids, and the state's heavy dependence on revenues from its 5% sales tax and falling income and corporate taxes.

U.S. Census Bureau data show K-12 districts in Wisconsin rely on state payments for 53% of their total

Figure 1: WI Schools Rely More on State Aid

Share of 2017 Revenue by Source, WI K-12 Districts Vs US



Source: U.S. Census Bureau; *Includes parent govt contributions

revenues, compared to just 47.1% for districts in the country as a whole (see Figure 1). However, those numbers may overstate the amount of direct state aid to Wisconsin districts since they include state credits that are used to lower down K-12 property taxes for home and business owners.

That likely leaves Wisconsin districts at least somewhat more exposed to revenue declines. For now, state aid to school districts is written into law through the 2019-21 budget approved last year. However, the administration of Gov. Tony Evers said earlier this month that losses in state revenues such as income, sales, and corporate taxes could exceed $2 billion over the next year even as demand and costs grow for state services such as Medicaid health care for the newly unemployed.

So far the state has received substantial federal aid to respond to COVID-19, but officials do not believe the money can be used to offset revenue losses. Depending on the size of the resulting state budget gap and the degree of additional federal aid, the state might be forced to cut spending to meet its constitutional obligation to balance its budget. As Figure 2 on page 3 shows, aid to school districts is the state's biggest expense and would be one of the likely targets.

State budget troubles and impacts on school aid can lag a recession, though the sudden onset of this crisis likely means more immediate fallout. Amid the lingering effects of the 2001 recession, state aid to schools stayed flat in 2004. Following the Great Recession and the end of federal stimulus dollars to states, state aid to school districts in Wisconsin fell by more than $400 million in 2012, though the state provided districts with savings by requiring teachers to make higher contributions for their benefits.

The risk from a state aid cut could be greatest for districts that have lower property values and as a result depend more on state aid in their budgets. These are districts that tend to serve the state's largest populations of low-income students, students of color, and students with disabilities.

For example, Department of Public Instruction data show MPS receives 62.6% of its instructional fund revenues from state aid. The share of state aid is high in many other urban districts such as Janesville (65.7%). And the same can be true in rural districts as well.

Districts with higher property values receive less state aid and rely more heavily on property taxes. For example, the Madison school district receives only 23.3% of instructional fund revenues from state aid and the Waukesha school district receives 41.6%.

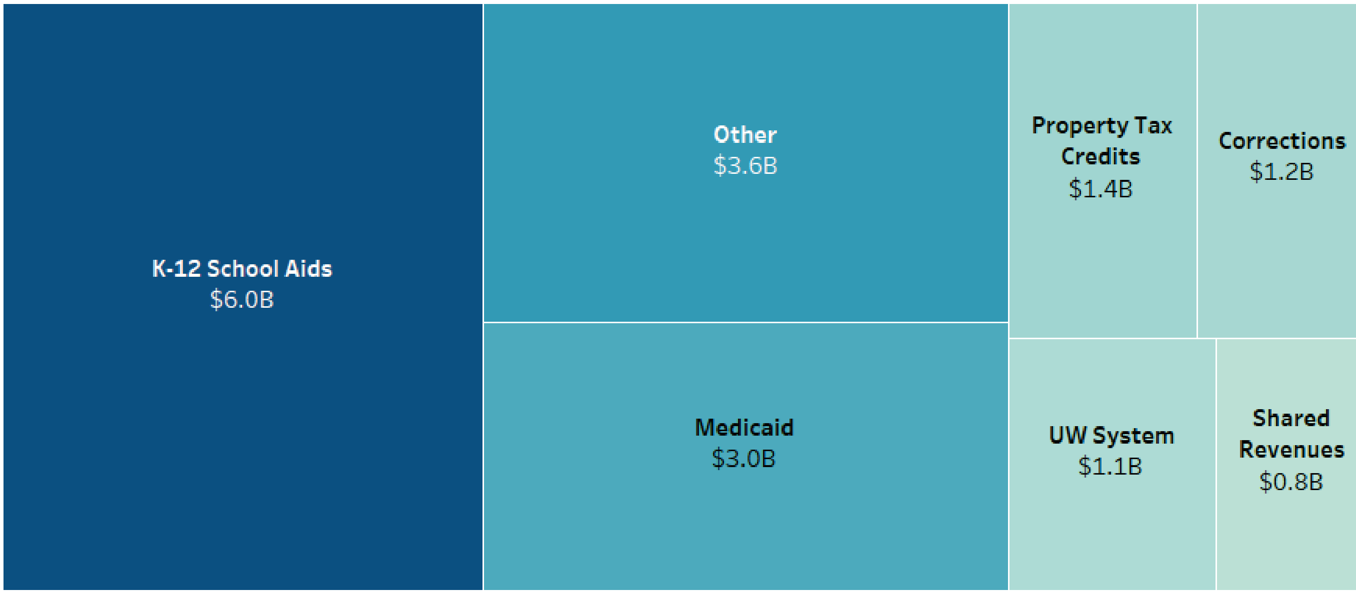
Though a challenge for property owners and districts in good times, this aspect of the state's school financing system could provide some level of additional stability for these districts if state aid declines. That depends, however, on whether lawmakers and Evers make changes to state caps that limit how much districts can raise per pupil in property taxes and general state aid.

Absent a change to revenue limits, property taxes should be somewhat more reliable, given that taxes for the current year were levied in December 2019 and the amounts due will not be impacted at all by any loss in value. Also, any decline in property values experienced by districts in 2020 will not directly affect 2021 levies, as those will be based on values determined as of January 1 of this year. As such, the brunt of any substantial declines in property value would not be felt directly by school districts for two years (the 2021-22 school year).

If property values do decline in the future, school districts under state law can raise property tax rates to

Figure 2: Aid to Schools is Largest Expense for State

State General Purpose Revenue expenditures in billions, 2019



Source: Wisconsin Annual Fiscal Report; (Other includes tech colleges, comm. human service aids, & income tax credits but not fund transfers.)

make up for that. Unlike the levy limits placed on cities and counties, the revenue limits on schools also allow them to raise their property taxes to make up for any loss in general state aids. In addition, the large number of referenda passed in recent years gave many districts additional authority to raise taxes.

However, some school board members may feel reluctant to approve such tax increases given the economic challenges faced by businesses and residents. In addition, if lawmakers and Evers did lower state aid payments, they could also lower revenue limits on districts to prevent school boards from making up as much of the lost aid through higher property taxes.

Going forward, local governments also could face difficulties or delays in receiving property taxes. While many property owners have already paid their December property tax bill in full, most local governments allow citizens to pay their bills in installments during the first several months of the following year and may face difficulties collecting taxes from jobless workers and stressed businesses.

Counties take on the task of collecting delinquent property taxes for K-12 districts and other taxing entities in their area, which should eliminate exposure for schools. However, recently approved state legislation allows counties and other taxing entities such as school districts to waive penalties and interest on late property tax payments through October 1, potentially creating a one-month additional delay on such revenues for school districts and other local governments. That could add to whatever cash flow challenges they may already have and put greater pressure on their reserves if any.

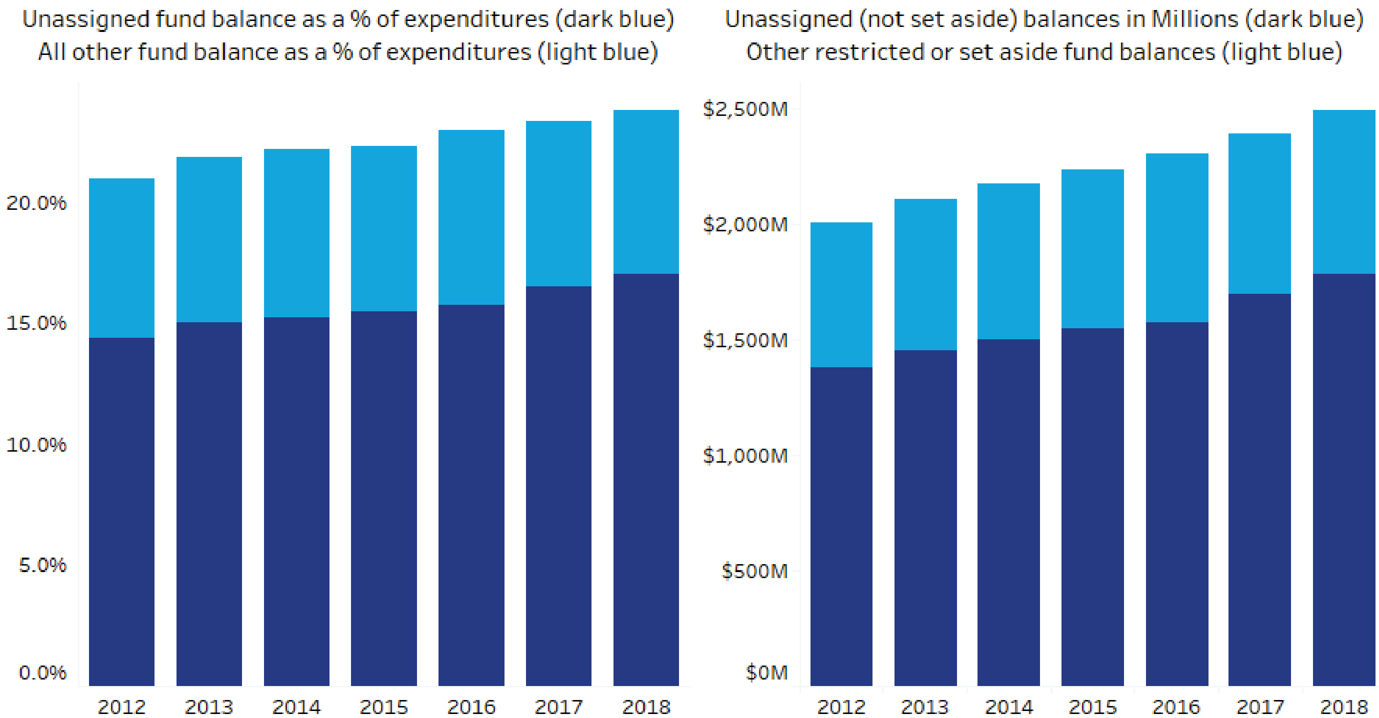
BOLSTERING BALANCES

Indeed, one factor in how vulnerable individual districts are to financial shock from crisis-related reduced revenues or new spending needs is the state of their reserves. To give a sense of schools' reserves, we looked at the fiscal year-end balances and annual spending for each district in its general fund, or main set of accounts, as well as its special education fund and certain minor funds used for instruction.

These funds pay for the key school operations such as teaching, pupil and staff services, administration, and transportation but do not cover non-classroom costs like food service, community recreation, and most debt payments and capital projects. We then compared the combined fund balances for each district to the total annual spending in those instructional funds.

These fund balances should not be seen as cash resting in place in districts' bank accounts. They represent assets minus liabilities at a given point in time and

Figure 3: Fund Balances Growing for State School Districts Overall



Source: Department of Public Instruction

many districts will see lower balances at other points in the year such as the fall. Besides cash, the assets also include substantial receivables in the form of outstanding property taxes and state aid and property tax credit payments that are due to districts on June 30 of each year but not yet in hand.

Finally, it's important to note these balances represent a one-time source of funds. By their nature, they cannot offset a permanent loss in revenue or increase in costs.

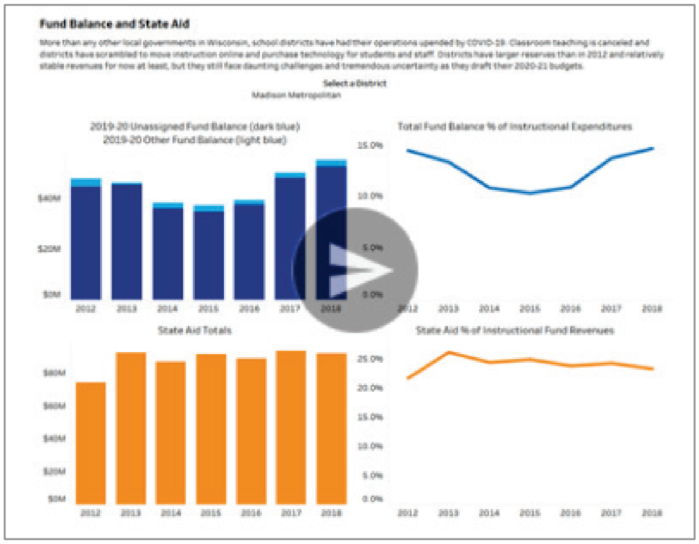
The most recent available statewide data from the Department of Public Instruction show that as of June 30, 2018, the state's 421 districts had $1.78 billion in total balances in these funds that were unassigned, or not restricted or formally set aside for other purposes. As the dark blue bars in Figure 3 show, the cash and other assets amounted to 17% of the $10.48 billion in spending from these funds by districts statewide during the 2017-18 school year. If the balances were all in cash (note once again that they are not), they would cover about nine average weeks of district spending without new revenues.

Those totals were part of a gradual but steady increase in fund balances in data going back to the 2011-12 school year. On June 30, 2012, districts had a total of $1.38 billion in unassigned balances in these instructional funds, or 14.4% of spending. Over the six years that followed, districts collectively added nearly $403 million in fund balances that were not set aside for a specific purpose.

Though the overall balances have grown as a share of districts' spending over time, at least part of the reason is that the statewide spending increases in these funds have been relatively modest in recent years, generally at or below 2%. Several dozen districts also did not report any unassigned balances.

The instructional funds listed above often have additional balances that are restricted in their use (shown in the light blue bars) such as gifts and donations. Other examples might include inventories, money set aside for a remodeling project, or funds that a self-insured district must maintain to cover potential costs from its plan.

If the fund balances are expanded to include those amounts that are restricted or already committed to other purposes, they increase to $2.49 billion as of June 2018, or 23.8% of spending, up from $2 billion



and 20.9% in June 2012. Once again, however, this larger figure should be used with caution because much of this amount has already been set aside for specific purposes and is not available for a district's other needs. As of June 2018, 43 districts had total fund balances of less than 15% of expenditures, but that number was down from 56 districts in June 2012.

The interactive dashboard above allows readers to compare fund balances as well as potentially at-risk state aid amounts across districts, but it should be used with care. Every district has its own circumstances and may use different practices in saving or earmarking funds, making it complicated to draw comparisons.

Even in the best of times, school districts lean on these balances. State school aid payments are made in five installments and property taxes are typically received in January, February, and August. Fund balances can help districts avoid some short-term borrowing that they might otherwise need to pay salaries and other monthly costs while waiting for these uneven revenues. In addition, the balances may contribute to better bond ratings for a district, which can produce savings on borrowing through lower interest rates. For these reasons, drawing down a fund balance could lead to higher costs for districts later on.

There is no one single standard for districts to use in setting fund balances, but one target would be maintaining enough general fund balance so the district does not have to use short-term borrowing to ensure positive cash flow. The Wisconsin Association of School Business Officials reports that roughly 160 of the state's 421 districts must issue temporary cash flow notes each year – that number would grow if statewide school fund balances fall.

Districts Coping with Unexpected Spending

The immediate challenge for schools in recent weeks has been coping with the sudden halt to in-person instruction. Districts across the state have incurred costs for computers, virtual learning platforms, software licenses and other technology, and old-fashioned copier costs as they seek to provide students with what they need to learn at home and online.

Some schools have also had to spend money to ensure hotspots or other forms of internet access are available to students living in poverty or in regions where it is not available. Other potential expenses include additional cleaning work and supplies and protective equipment for staff. High-poverty districts may also be incurring unanticipated and unreimbursed costs to provide meals to students and their families during school shutdowns.

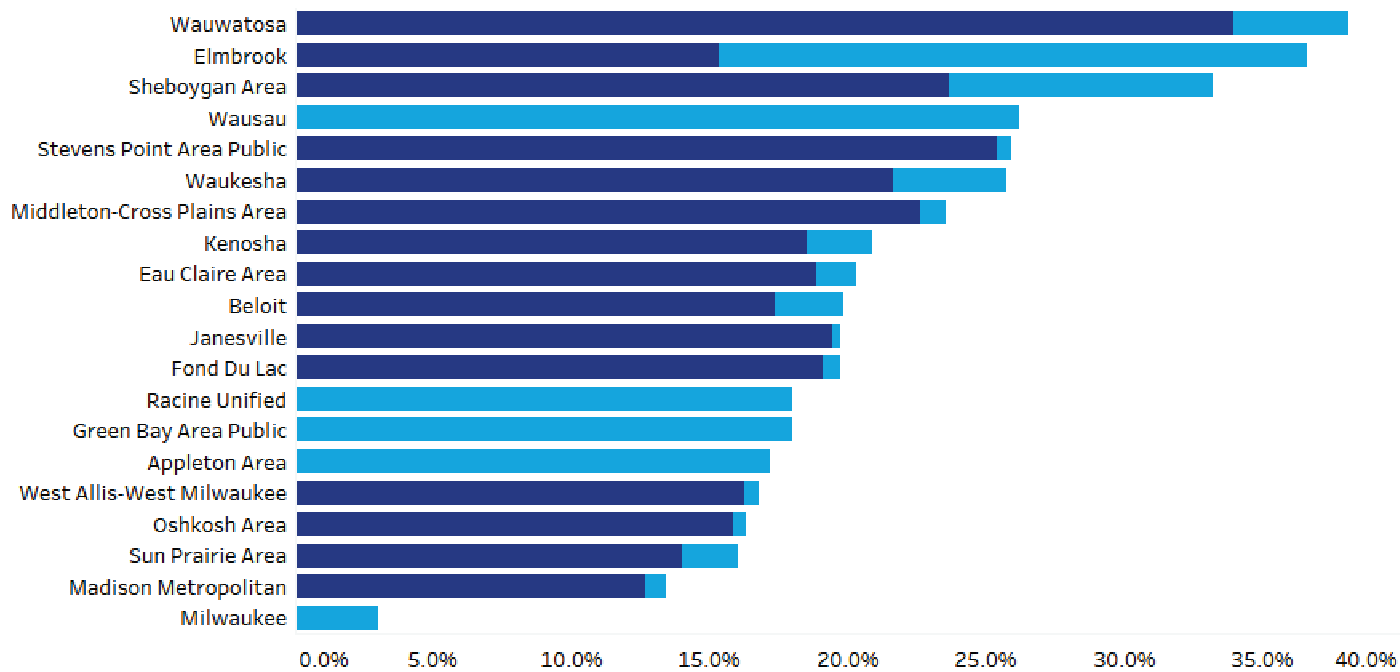
Madison school officials, for example, detailed potentially multi-million dollar impacts that included many of the costs listed above as well as hazard pay for certain essential workers such as custodians, shipping costs for student packets and computers, greater loss and damage on computers now in students' homes, and decreased reimbursement or charge revenue from transportation, food service, and community recreation programs. Finally, if the possibility of virtual summer school leads to a decline in enrollments, districts like Madison with large programs could see a decline in their revenue limits or state equalization aid since state formulas for both take summer school enrollment into account.

So far, there are no good statewide estimates on these unbudgeted losses but anecdotal evidence suggests they could be substantial. Though in some cases districts may see savings on wages, contracts, utilities, or other costs, those are uncertain at best and unlikely to make up fully for the added expenses. Districts that furlough workers, for example, may end up with higher unemployment insurance costs later, depending on how that issue is handled by the state.

Going forward, some districts may consider adding to summer school or holding down class sizes as they attempt to make up for lost learning for students affected by the pause in classroom instruction. When regular classroom instruction and student busing does resume, public health concerns may impose new restrictions such as limited seating that add to the cost. Other potential longer-term expenses could include higher health insurance premiums because of greater usage and higher employer contributions to the Wisconsin Retirement System because of the stock market plunge.

Figure 4: Fund Balances Vary Among 20 Largest Districts

2019-20 unassigned fund balance (not set aside for specific purpose) as a % of instructional expenditures (dark blue)
2019-20 other fund balance as a % of instructional expenditures (light blue)



Source: Department of Public Instruction

Last and perhaps most important, fund balances provide at least some cushion amid the current financial turmoil. The Forum has noted in the past that in uncertain political and economic times districts will try to protect or even add to fund balances as a hedge against uncertainty. Previous Forum research has shown that, since 1991, the only time these balances have dropped was in 2003 in the wake of a recession.

A LOOK AT LARGE DISTRICTS

Not every district, however, has stores set aside. At the end of June 2018, MPS reported having just $29.5 million in reserves in its instructional funds, or 2.8% of the $1.07 billion in instructional spending in 2017-18. That gave MPS the second-lowest fund balance in the state that year as a share of spending, behind only the tiny Gresham School District, which reported a negative balance. In the report to DPI, all of those funds were listed by MPS as restricted or assigned to a specific purpose.

Because these statewide DPI data on fund balances are nearly two years old, we supplemented them by looking at individual reports filed with DPI by the 20 largest districts by enrollment. These numbers show where districts expected to be prior to the massive economic shock and likely do not fully reflect their current expectations.

These districts reported that as of June 30, 2019 their total fund balances collectively amounted to 17.6% of instructional spending, a substantial increase over the previous year. Before the current crisis, the fund balances budgeted for June 30 of 2020 for those districts were projected to dip to 16% of spending but that now outdated estimate would still be better than the 13.9% in June 2012.

Prior to the pandemic, MPS had budgeted to close this current school year with a 3% fund balance on June 30, with all of the $32.4 million being reported as restricted or set aside (see Figure 4). For comparison, the Appleton Area School District has a budget that is less than one-fifth the size of MPS but projected almost the same total fund balance of $32.6 million, or 17.1% of Appleton's spending. Racine, an urban district with a budget roughly one-quarter that of MPS, had a $45.9 million total balance, or 18% of annual spending.

In its own budget documents, MPS reports its financial data differently than in its state filings and projects a lower $14.2 million balance on June 30 in its main "school operations" fund. Both sets of numbers, however, point to the same challenge: a lack of reserves that could prove critical over the next two years.

The recently passed referendum to exceed state-imposed revenue limits gives MPS the ability to boost its operating budget by raising property taxes permanently by up to an additional $57 million in the first year and up to $87 million in year four. However, the school board will still have to decide how much of that authority to use given the current crisis. The same is true for many of the 24 other districts that have passed similar referenda for operations so far this year.

Before the crisis, the other districts among the 20 largest in the state had projected total fund balances for June 30 that ranged from 13.4% (Madison Metropolitan School District) to 36.6% (Elmbrook). Though Madison reports a below average total balance, Figure 4 shows very little of it has been set aside for a specific purpose, potentially giving the district some greater flexibility in using its balance than several other large districts.

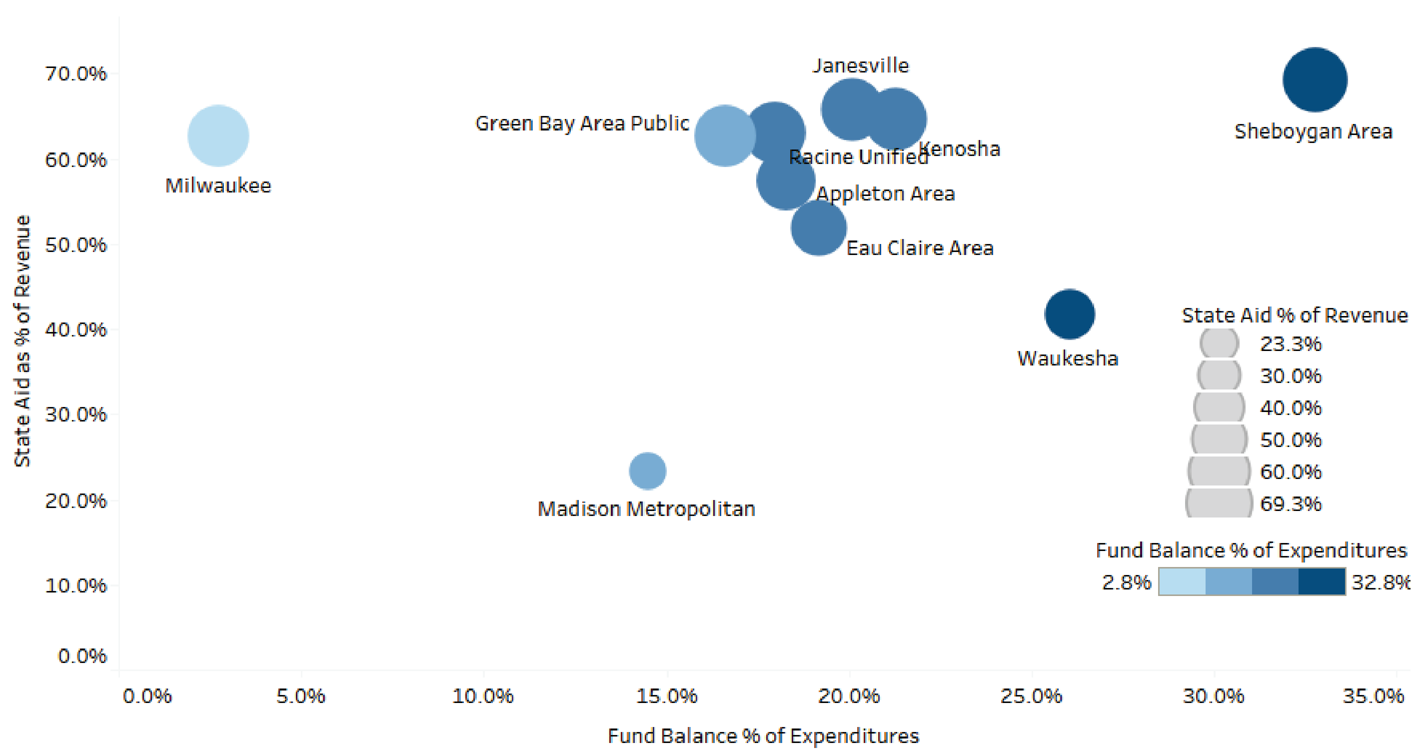
At $53.7 million, Madison had the largest unassigned fund balance among the 20 districts in raw dollars though it was smaller than most as a share of spending at 12.7%. Madison officials have sought to keep their reserves within the 10% to 15% range using a roughly similar methodology to the one used here. Madison is a good example of why it is better to look at this unassigned balance because the larger total includes $3.2 million in restricted funds placed in a special fund used for gifts and donations.

Between the unexpected increases in spending and the potential loss in state aid, districts face the potential for a sizable fiscal shock. The impact could add to the potential learning gap that vulnerable students in these districts may already be experiencing given the loss of in-person instruction.

Figure 5 shows both how much the largest districts in Wisconsin are exposed to declines in state aid as well as whether they have fund balances that might help to cushion such a loss. The upper left quadrant occupied by MPS represents greater risk.

Figure 5: State Aid and Fund Balance As a Share of District Budgets

Aid and balance as % of instructional fund budget for 10 largest districts in 2017-18



UNCERTAINTY AHEAD

School districts in Wisconsin used the long economic expansion to build their reserves and have also benefited from an unprecedented rise in referenda approvals in recent years. Those factors could work in their favor as they seek to cope with the impact of COVID-19 but will vary district by district. MPS, for example, has recently passed a large referendum but has little in the way of fund balance. In addition, many districts have already made substantial efforts to hold down spending in recent years, which could make it a challenge to find further cuts.

Districts in the state also will receive help from the recently approved federal CARES Act, including an estimated $46.7 million that will go to an emergency relief fund for the state's K-12 districts, independent charters, and colleges and universities, according to the Legislative Fiscal Bureau. The act also includes an estimated $174.8 million for a second relief fund aimed at just K-12 schools in Wisconsin.

Yet these substantial funds may not offset the full impact to districts of their unbudgeted expenses and potential loss of state aid, particularly if the federal government does not provide additional assistance to state governments grappling with steep losses in their own tax revenues. Also, the federal assistance comes with conditions and districts may not be free to use it for all of their most pressing needs. So far, state elected officials have waived certain reporting requirements for districts but made no move to either add to or subtract from the aid the state has budgeted for districts.

In considering school finances amid this crisis, policymakers should note that the needs of students, families, and the broader community have grown. In an ideal world, district officials would likely want to consider a range of additional programming, including summer or supplemental schooling to help lagging students and initiatives aimed at mental and physical health. Yet there is no guarantee they can cover added costs or even their current budget, particularly in the case of districts that depend heavily on state aid.

All of this leaves district officials shouldering immense uncertainty as they consider their preliminary budgets for the school year beginning this July and decide how many teachers to hire for the fall. At a time when K-12 schools are considering how to get their students back to "normal," local leaders may need to grapple with budget cuts that could further impact the classroom.