Date: November 16, 2021

To: Board of Education, Minneapolis Public Schools

From: Ed Graff, Superintendent

RE: Pro forma Financial Projections – General Fund

Overview

The pro forma operating projection for the Minneapolis Public Schools (MPS) General Fund has been updated for fiscal years 2023 through 2027. This pro forma uses the current fiscal year 2022 as our baseline.

While our previous pro-forma indicated MPS could become insolvent as early as fiscal year 2024, that date has been delayed to 2027 due to the unexpected and welcome introduction of $159 million in COVID-19 relief funds, as well as recaptured funds due to higher than normal vacancy rates.

As we stated in last year's pro-forma, we presume that the Comprehensive District Design (CDD) will be successful. Our projections anticipate enrollment will continue to decline in the short-run but decelerate until the district begins increasing its enrollment again by the 25-26 school year. Our analysis finds that, regardless of whether the CDD succeeds, the district is burdened by an unsustainable fiscal structure and should seek to identify and act on cost efficiencies to prevent entering statutory operating debt in the 2027-28 school year.

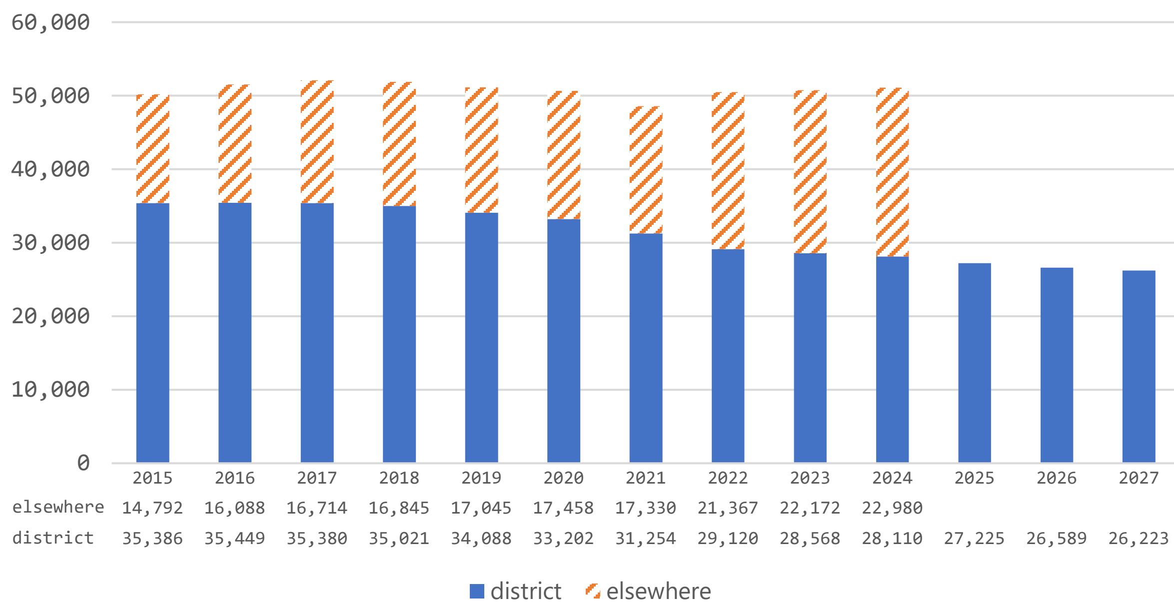
	Budget	Pro-Forma Projection				
	FY22	FY23	FY24	FY25	FY26	FY27
General Fund Revenue	$653.9M	$653.3M	$626.2M	$557.8M	$555.0M	$556.3M
General Fund Expenses	$655.5M	$632.1M	$639.5M	$615.1M	$624.9M	$635.9M
Change in Fund Balance	($1.6M)	$21.2M	($13.3M)	($57.3M)	($69.8M)	($79.6M)
End-of-Year Balance	$129.5M	$150.7M	$137.4M	$80.2M	$10.3M	($69.3M)

NOTE: Table assumes a 5% vacancy rate in FY22 however, current rate is running higher

Enrollment

Enrollment has declined more rapidly than anticipated compared to prior years. We are projecting a reduction in student enrollment to 29,120 this year based on our October 1 count[1], and that by FY27 district enrollment will fall to 26,233. This represents an average annual decline of 2.1%, or a 9.9% total decrease from this year's count.

Figure 1. Resident ADM by School Attendance



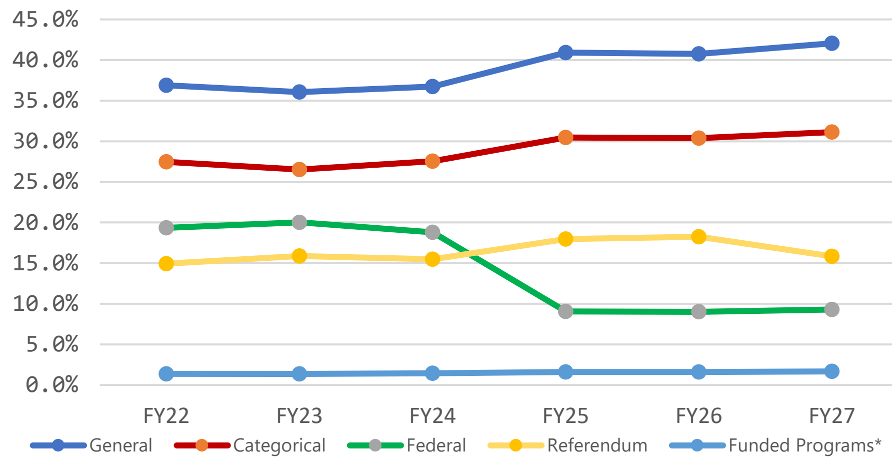
We are currently examining our enrollment declines in an effort to segment out the different reasons families leave MPS, re-engage families accordingly and adjust programming as needed and possible. It is worth mentioning that post-pandemic enrollment declines are a national trend in urban district. We look to have a clearer understanding of why families are choosing to leave MPS as more data becomes available.

Revenue

MPS receives revenue through multiple channels, the largest being state aid, the local property tax levy, and federal funds designated for specific purposes. The complex patchwork of Minnesota's educational finance laws results in a revenue stream from the state that comes with specific requirements. For example, MPS receives funds specifically for Special Education and English Language Learners.

[1] Average Daily Membership (ADM) is the average number of students enrolled with MPS on any given day during the school year.

Figure 2. General Fund Revenue Types as a % of Total



Earlier this year the legislature passed an education finance bill that increased the basic formula by 2.45% in FY22 and 2.0% in FY23. The basic formula should continue to increase at a 2.0% rate through the pro forma period.

Additionally, state-level and levy funding tied to district student enrollment is expected to increase at the same rate as the basic formula. We also assume that state aid tied to MPS's free- and reduced-price lunch (FRL) will decrease with declines in the number of students served. This assumption is optimistic since FRL counts have been decreasing faster than overall enrollment. MPS has put in place an aggressive effort this past year to ensure that all eligible families report this status and will continue to do so.

Since most MPS revenue is tied to enrollment, we expect our overall revenue to decrease significantly over the next five years. Where the legislature is expected to increase funding, revenue will still decline or be flat, since the funding increases will not offset the decline.

Expenses

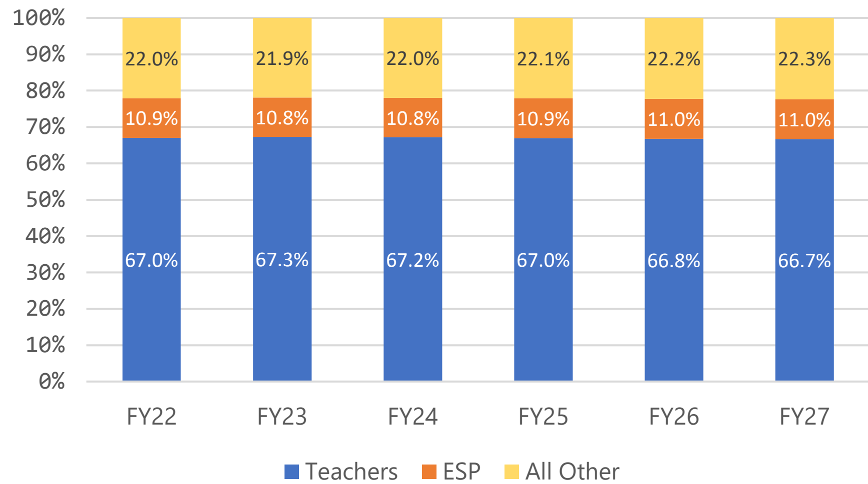
MPS expenses are expected to increase over the next five years due to contractual and bargained wage increases and the potential for inflation that may run higher than increases to our revenue.

Bargaining

MPS is currently in bargaining with most of our employee unions. While we have already reached tentative agreements with the union representing our custodians and the professional unions, we are still at the table with a number of groups and are in mediations with the unions representing teachers, principals and school bus drivers.

While MPS currently has received additional dollars as a result of the American Rescue Plan, we have emphasized that the American Rescue plan money is a one-time grant, in which all funds must be spent by September 2024. Using these funds for ongoing costs, such as wage increases further imperils the MPS financial outlook.

Figure 3. Salary Share by Bargaining Unit



Staffing

MPS anticipates both short- and long-term cost reductions due to staffing issues.

In the short term and due to the circumstances surrounding the pandemic, MPS and all school districts have had a difficult time this school year filling positions, especially for roles such as school bus drivers, food service workers, and childcare providers. This has resulted in significant revenue savings as outlined in the following paragraph. Year-to-date, MPS has seen vacancy rates of around 12%. We assume that vacancy rates will return to 5% for most groups, which is more typical of past vacancy rates.

In the long-term, MPS assumes all positions will be filled for the teachers' union despite some remaining vacancies this year due to hiring challenges. However, we are adjusting the number of positions every year based on projected enrollment. We budget 120% of the number of teachers required to account for classroom teacher prep time. The extra funding is used to pay for specialists and other teachers who are working with students in the classroom during teacher prep time. As a result of declining enrollment, MPS expects to see a reduction in 219.5 fewer classroom teacher FTEs from FY22 to FY27, resulting in a reduction in expenses of $96.6 million over the five years.

Projected Teacher FTEs To Meet Classroom Size Targets	FY22	FY23	FY24	FY25	FY26	FY27
Kindergarten	140.9	126.3	126.3	126.3	126.3	126.3
Grades 1-5	593.7	501.0	491.6	486.8	483.3	485.6
Middle School	239.1	222.4	218.3	211.8	202.6	193.6
High School	319.0	308.3	303.8	284.0	273.7	267.7
Total FTEs	1292.7	1158.0	1140.0	1108.8	1085.8	1073.2
Change from FY22		-134.7	-152.7	-183.9	-206.8	-219.5
Associated Savings		$13.9M	$16.0M	$19.7M	$22.6M	$24.5M

Finally, it is important to note that, aside from what has been specifically outlined, we have not included any additional staffing or major expenses in this pro forma.

Schools

MPS operates 69 school sites throughout the city and additionally contracts with outside providers to operate 12 alternative schools and hospital sites. In FY22, school-based expenditures of $368 million were budgeted directly to our district-operated schools. This amount includes the cost of school administrators, teachers, support staff including administrative and educational supports, special education budgeted directly to schools, utilities, and engineering services. It does not include the cost of transportation, which has a $37.3 million budget. It also excludes the cost of Special Education services not determined during the budget process, or about $37 million.

Budgeted Expenses Directly in Schools

	Number of Schools	School Admin	Regular & Vocational Instruction	Instructional & Pupil Support	Special Education	Sites & Buildings	Total Direct Expenditures in Schools
K-5 Elementary	42	$6.9M	$109.9M	$17.3M	$29.3M	$12.4M	$175.8M
K-8 Schools	2	$0.3M	$11.5M	$2.5M	$3.0M	$0.6M	$17.9M
Middle School	8	$1.3M	$27.7M	$6.5M	$11.5M	$2.9M	$49.9M
High School	9	$2.0M	$60.8M	$13.7M	$17.9M	$5.8M	$100.2M
Special Education	4	$0.7M	$3.7M	$1.6M	$11.8M	$0.6M	$18.5M
District Alternative	4	$0.4M	$3.3M	$1.2M	$0.2M	$0.5M	$5.5M
Total	69	$11.7M	$216.9M	$42.7M	$73.9M	$22.8M	$367.9M

Note: Does NOT include the cost of Transportation.

Schools are required to maintain certain staffing levels in accordance with the MPS predictable staffing plan. Expenditures should continue to be budgeted in accordance with that plan. The number of teachers has been adjusted in each year to account for declining enrollment.

Staffing (FTEs) Budgeted Directly in Schools

	Classroom Teachers	Other Licensed	Non-Licensed Staff Support	Admin	Other	Total FTEs
K-5 Elementary	1156	190	657	62	17	2082
K-8 Schools	114	27	63	5	1	210
Middle School	395	74	219	19	0	707
High School	679	114	312	34	5	1144
District Alternative	36	10	16	2	0	64
Special Education	61	38	146	5	1	251
Total FTEs	2441	453	1413	127	24	4458

Special Education

Providing state-mandated special education services continues to be an essential and important part of MPS's ongoing operations. However, a significant portion of the cost of providing these services was promised but is not provided by the state or federal government. MPS must use general education revenues to pay for these services. The difference (underfunding) between MPS's expenses to provide special education services and the aid provided by the state and federal government for those services is an unfunded mandate. In FY22 and the five subsequent years, cumulative unfunded expenditures of around $277 million are anticipated in the pro forma projections.

Special Education Revenue & Expense

	FY22	FY23	FY24	FY25	FY26	FY27
Revenue	$70.9M	$70.8M	$70.8M	$70.8M	$70.8M	$70.8M
Expense	$111.3M	$113.5M	$115.8M	$118.1M	$120.4M	$122.9M
Cross Subsidy	($40.4M)	($42.7M)	($45.0M)	($47.3M)	($49.6M)	($52.0M)
Cumulative impact of cross-subsidy	($40.4M)	($83.1M)	($128.1M)	($175.3M)	($225.0M)	($277.0M)

COVID-19 Relief Funding and American Rescue Plan

In response to the COVID-19 pandemic, the federal government distributed several rounds of special grant funding intended to offset the extra cost to districts of responding to the virus. Entering the year, MPS had about $71 million of funds on hand from the second round of the Elementary & Secondary School Relief Fund (ESSER II). Of these $71 million, around $65 million were included in the FY22 budget.

In January 2021, the federal government passed the American Rescue Plan (ARP), a $1.9 trillion economic stimulus bill intended to help the economy recover from the COVID-19 pandemic. Included in the ARP was a third installment of the Elementary & Secondary School Emergency

Relief Fund (ESSER III), which distributed $170 billion in one-time federal funds to schools throughout the country. MPS has been allocated $159.5 million of those funds.

Following notification of the grant, MPS engaged internal and external stakeholders to create a plan for spending these incremental funds, which was presented to the Board in September.

ESSER III Expenditures

Category	FY22	FY23	FY24	FY25	Total Cost
Staff & Program Continuity	0	36,953	37,713	0	74,666
Address Impacts to Learning	4,064	17,515	19,317	441	41,336
Safe & Healthy Schools	2,280	14,138	2,607	0	19,026
Highly Qualified Staff	4,901	5,512	4,766	0	15,179
Social, Emotional, & Mental Health	1,810	2,069	2,095	0	5,975
Community Partnerships	1,092	1,096	1,100	0	3,288
Total Expenditures	14,148	77,283	67,597	441	159,469

Of the $159.5 million, about $75 million was designated to provide for staff and program continuity by offsetting operating deficits. The remaining $85 million was designated for a variety of purposes centered on five primary themes of addressing impacts of unfinished learning, safe and healthy schools, highly qualified staff, social-emotional and mental health, and community partnerships. In the MPS projection, the plan is executed as presented to the Board, although we recognize there are likely to be modifications to the plan in the future.

District Expenditures

Apart from ESSER III funding, budget dollars will be allocated across different functions as they have in past years. Compared to other districts in the metro area, our spending on administration, student instruction, and special education is similar to the average percentage of the total budget with more spent on support for teachers and students, and less on sites and buildings.

Expenditures as a % of total FY20 General Fund Expenses	District & School Admin	District Admin Support	Instructional & Pupil Support	Regular & Vocational Instructio n	Special Education	Sites & Buildings
Minneapolis	6.2%	3.5%	19.7%	48.2%	19.9%	5.8%
Other Large Districts						
Saint Paul	7.1%	2.8%	17.1%	44.5%	20.0%	9.6%
Anoka-Hennepin	5.2%	2.8%	17.3%	46.6%	20.5%	9.9%
Rosemount-Apple Valley	7.9%	3.5%	13.6%	48.3%	20.0%	9.8%
Osseo	6.5%	2.5%	16.3%	48.8%	18.2%	9.5%
South Washington County	7.5%	3.9%	15.0%	46.7%	18.3%	12.2%
Seven County Metro Area	7.2%	3.5%	16.6%	46.5%	18.9%	10.2%

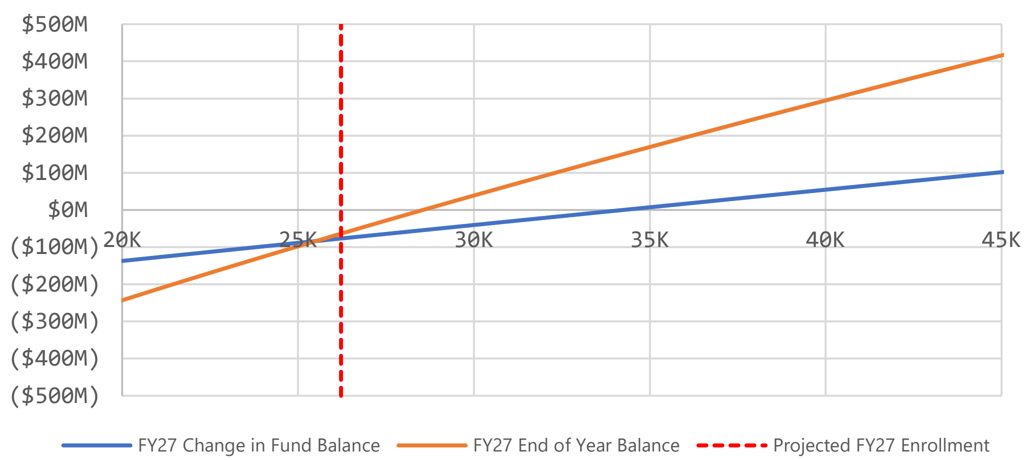
Discussion

In previous years, MPS has asserted the impossibility of solving cost structure issues purely through enrollment increases. However, our current belief is that while doing so would be technically possible, it would be very difficult as outlined below.

In the past, we assumed that the legislature would not increase the education funding formula in their biennial budget bill. This belief was based on widespread consensus that the economic damage related to COVID-19 would only be undone through years of recovery.

However, economic recovery has been faster than most anticipated. Instead of dealing with the double-digit unemployment and massive funding shortfalls, the legislature instead found full employment and a surplus of funds. In the last legislative session, the basic funding formula was increased by 2.45% in FY22 and 2% in FY23. This provided a needed boost to our financial outlook.

Fig 4. FY27 Financial Metrics Relative to Enrollment



In our model, Figure 4 reflects the relationship between enrollment and the financial impact of that enrollment. Based on our current modelling, with no changes to any of the assumptions except constant enrollment growth, MPS might be able to remedy many of its fiscal issues if it were able to achieve an annual enrollment of about 37,000 students by FY27, while substantially decreasing expenses (where the blue curve intersects the *x*-axis).

This would be an increase of about 11,000 students, or over 40%, from what we are currently projecting, and equates to constant annual growth of around 5%. Even constant growth resulting in enrollment above 30,000 (where the orange curve intersects the *x*-axis) would stop our general fund from being fully depleted.

Figure 5. Projected vs Needed Enrollment by Year to Resolve District Fiscal Issues

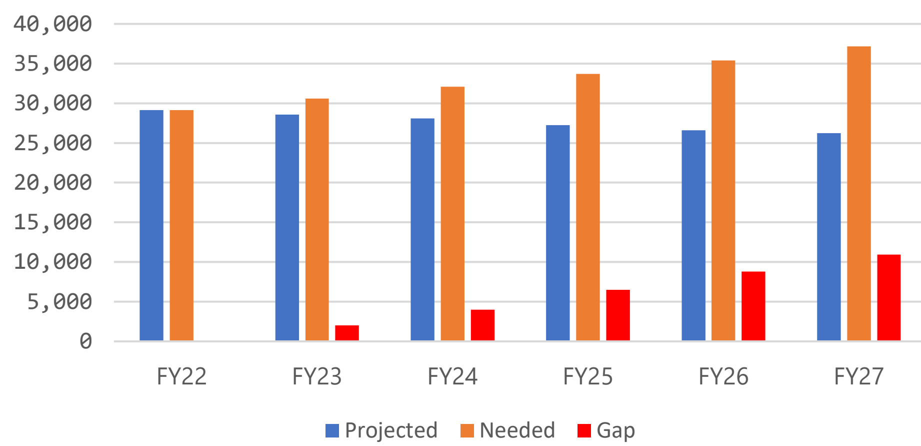
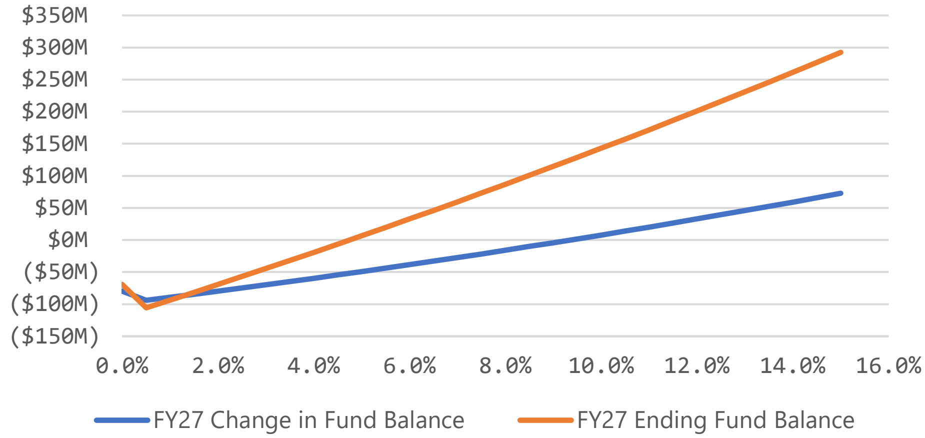


Figure 5 depicts the increasing gap between projected enrollment (blue) and the needed enrollment (orange) to achieve fiscal sustainability. Based on the MPS five-year enrollment trend, we consider this outcome unlikely.

The Pro Forma and MPS' financial outlook is also highly dependent on collective bargaining and the costs of settled contracts. The single most sensitive variable in any model of finances for MPS is the possible cost increase of our contract with the Minneapolis Federation of Teachers (MFT).

Another sensitive driver in this model is the growth rate of the basic aid formula. While we are assuming that 2% annual increases continue indefinitely, a different result could significantly impact our numbers. Figure 6 examines the relationship between growth in the funding formula (between FY24 and FY27) and FY27 financial outcomes.

Figure 6. Relationship between growth in basic formula and FY27 financial outcomes.



The blue curve crosses the *x*-axis around 9.5%. This means that to fix our fiscal structure in the timeframe of the pro forma projection, everything else being equal, we would need to see 9.5% annual increases in the basic funding formula.

The orange curve crosses the *x*-axis close to 4.75%. This means that, all else being equal, if the basic funding formula were increased by 4.75% annually between FY24 and FY27 we would end the year with a positive fund balance.

We have examined three different approaches MPS could take to achieve fiscal sustainability:

- increasing enrollment
- reducing wages
- unprecedented increases in the basic funding formula.

There are other ways that we could address our fiscal issues, such as full funding of special education from the state. That said, none of these approaches are realistic. It is unwise to project moving from 55% to 80% market share in five years, or to project unrealistic increases in funding from the legislature. Additionally, MPS cannot expect to retain the talent needed to educate children by implementing severe wage cuts.

Risks and Opportunities

No financial projection can anticipate exactly what the future will bring, and our pro forma projection is no different. In this section, we outline some of the financial risks and opportunities that MPS may face that could materially impact our conclusions.

Risks

Collective Bargaining and Wage Increases

MPS expenses are particularly dependent contractual requirements and bargained improvements since the vast majority of our budget funds salary and benefits. Bargaining parameters and agreements will have a material impact on our long-term financial outlook.

Additional Enrollment Erosion

This year, we have seen enrollment far underperform expectations, which we considered in building the budget projections. There is the risk that enrollment will decline faster or in greater numbers than we are anticipating.

Political Risk

As a public school system, most of our funding comes from government sources. As a result, our funding streams as well as our expense obligations can be impacted by the political decisions of elected officials and the results of legislative initiatives. Additionally, our governing board is an elected body and subject to the election cycle. We recognize that decisions made by elected officials at the federal, state and local levels, regardless of the reason, may have a material impact on our financial sustainability and our long-range outlook.

Inflation (Revenue)

Given the country's unprecedented political and economic environment, we recognize that the likelihood of a sustained period of high inflation is greater than it has been in many years. There is a risk that our funding streams will not keep up with any period of prolonged inflation while also facing increased demand in the marketplace for labor and goods. This might have an adverse and material impact on our ability to fund ongoing operating expenses.

Unforeseen Expenditures

There is always the possibility that unforeseen circumstances may result in necessary but unforeseen expenditures, such as those experienced during the COVID-19 pandemic. Although we cannot plan for what we do not know, there is always the possibility of such expenditures being large enough to impact our financial outlook materially and adversely. Additionally, this pro forma assumes that we will not have any new spending, either for positions or for contracts or goods.

Inflationary Pressure (Expenses)

We are subject to several collective bargaining agreements, which set wages at certain levels. We do not have the ability to reduce wages or benefits without the consent of these bargaining groups. As written, the contracts continue enforce upon expiration until a new agreement is reached, providing little control over MPS's cost of labor. As these contracts are not indexed to inflation and are written in nominal dollar values, a prolonged period of higher-than-normal inflation may affect future expenses.

Opportunities

Competitiveness

This pro forma budget relies on enrollment projections that incorporate recent changes that are greater than anticipated. At the same time, we are currently implementing the Comprehensive District Design, the purpose of which is to increase the quality of our schools and their appeal to families. We believe that we have an opportunity to turn MPS around, increase enrollment, and improve the financial sustainability of MPS.

Referendums and Levies

We currently receive local property tax revenue through two voter-approved levies: an operating referendum and a capital projects levy dedicated to technology costs. Both levies will require voter approval to extend beyond their expiration.

Conclusion

Given the current footprint and cost structure of MPS, the school district appears likely to remain stable through 2026. This is an improvement over previous findings that had anticipated insolvency as early as fiscal year 2024. This improved outlook is based on receiving the federal COVID-19 relief fund and higher-than-normal vacancy rates throughout the pandemic. While MPS may have an opportunity to improve its fiscal outlook by attracting and retaining new families, the three best areas in which to find efficiencies remain staffing levels, physical footprint, and compensation structure. Putting MPS on track for long-term fiscal sustainability will likely require a combination of efficiencies in all three areas.

Appendix 1 – Five Year Projection

Minneapolis Public Schools
Preliminary Pro-Forma, Fall 2021

	2022	2023	2024	2025	2026	2027
Starting Fund Balance	131,075	129,489	150,718	137,433	80,158	10,327
State Aid	379,575	369,488	365,627	361,452	358,473	358,074
Levy	138,920	144,016	133,984	136,894	137,549	139,275
Covid Relief	72,409	80,840	67,597	441	0	0
Grants/Title	54,019	50,000	50,000	50,000	50,000	50,000
Funded Projects	9,000	9,000	9,000	9,000	9,000	9,000
General Fund Revenue	653,922	653,344	626,208	557,788	555,022	556,349
			-4.2%	-10.9%	-0.5%	0.2%
Salaries	351,192	344,296	355,353	348,676	353,803	359,842
Extended Time	18,666	15,841	17,038	13,723	13,997	14,277
Reserves	5,057	5,290	5,396	5,503	5,613	5,726
Fringe	131,371	123,046	125,185	124,035	125,851	127,995
Contracts	116,570	109,858	101,937	96,481	98,411	100,379
Supplies	25,326	25,103	25,917	18,414	18,783	19,158
Equipment	145	141	146	151	154	157
Misc.	7,181	8,541	8,520	8,079	8,241	8,405
General Fund Expenses	655,509	632,115	639,493	615,063	624,853	635,939
Change in Fund Balance	(1,586)	21,229	(13,285)	(57,275)	(69,831)	(79,590)
Ending Fund Balance	129,489	150,718	137,433	80,158	10,327	(69,263)

Appendix 2 – Revenue Calculation

	Budget	2023	2024	2025	2026	2027
Basic Revenue (Formula)	219,991	214,122	215,058	212,059	210,893	211,974
Declining Enrollment	2,254	1,116	915	1,995	1,478	857
Pension Adjustment	4,654	4,881	4,875	4,830	4,806	4,804
Gifted & Talented	435	406	399	386	376	371
Extended Time	8,377	7,372	7,404	7,157	7,118	7,014
Compensatory	46,516	43,719	43,049	41,616	40,576	39,984
English Learner	4,007	3,530	3,563	3,445	3,426	3,376
Operating Capital	1,675	0	0	0	0	0
Alternative Attend Adj	503	115	121	127	134	141
Q Comp (65% aid 35% levy)	5,647	5,273	5,296	5,120	5,091	5,017
Special Education	70,863	70,808	70,808	70,808	70,808	70,808
Integration (70% aid 30% levy)	10,125	9,794	9,644	9,323	9,090	8,958
Non Public Transportation	1,253	0	0	0	0	0
Contract Alternative	4,321	4,407	4,495	4,585	4,677	4,770
Subtotal State Aid Forecast	380,620	365,543	365,627	361,452	358,473	358,074
State Adjustments						
Anticipated Declining Enrollment Adjustment		3,946				
Fully Adjusted State Aid	380,620	369,488	365,627	361,452	358,473	358,074
Equity	1,675	1,635	1,462	1,485	1,448	1,427
Transition	6,268	6,117	5,470	5,557	5,418	5,339
Operating Capital	6,709	7,292	7,229	7,038	6,912	6,863
Operating Capital						
Local Optional Tier 1	10,038	9,807	8,769	8,910	8,687	8,560
Local Optional Tier 2	14,204	13,861	12,839	13,461	13,561	13,801
Referendum Tier 1	15,410	15,038	13,446	13,662	13,320	13,126
Referendum Tier 2	29,538	31,244	28,991	30,444	30,716	31,307
Unequalized Levy	18,910	18,107	16,577	16,687	17,458	18,575
Q Comp (65% aid 35% levy)	3,246	2,839	2,852	2,757	2,742	2,702
Integration (70% aid 30% levy)	4,254	4,198	4,133	3,996	3,896	3,839
Reemployment	430	0	0	0	0	0
Safe Schools	1,206	1,177	1,052	1,069	1,042	1,027
Judgments	392	0	0	0	0	0
Career & Tech Ed	695	846	854	863	871	880
Other Postemployment Benefit	2,548	2,954	2,954	2,954	2,954	2,954
Long Term Facilities Maint	3,345	3,446	3,446	3,446	3,446	3,446
Disabled Access		0	0	0	0	0
Lease Levy	427	433	433	433	433	433
MERF/TRA	7,088	7,088	7,088	7,088	7,088	7,088
Capital Projects Referendum	14,792	15,678	16,389	17,045	17,556	17,907
Prior year levy adjustments		299				
Subtotal Levy Forecast	141,176	142,057	133,984	136,894	137,549	139,275
Limitation Adjustments		1,030				
Referendum Adjustments	(4,174)					
Local Optional Adjustments	(1,061)					
Other Levy Adjustments	1,699					
Abatements		929				
Fully Adjusted Levy	137,640	144,016	133,984	136,894	137,549	139,275
GEER	920	0	0	0	0	0
ESSER I	7,250	0	0	0	0	0
ESSER II	64,239	3,557	0	0	0	0
ESSER III	0	77,283	67,597	441	0	0
Covid Related Grants	72,409	80,840	67,597	441	0	0
Other Grants & Title Revenue	54,019	50,000	50,000	50,000	50,000	50,000
Grants (Fully Adjusted)	126,428	130,840	117,597	50,441	50,000	50,000
Funded Projects (Fully Adjusted)	9,000	9,000	9,000	9,000	9,000	9,000
Total Revenue	653,687	653,344	626,208	557,788	555,022	556,349
Revenue/ADM	21.2	22.9	22.3	20.5	20.9	21.2