RESEARCH REPORT

THE BIG SQUEEZE

How Unfunded Pension Costs Threaten Educational Equity

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pivot LEARNING

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The Big Squeeze is a project led by Pivot Learning, in collaboration with the California School Boards Association and Dr. Cory Koedel from the University of Missouri.

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I. INTRODUCTION

In 2012, after years of devastating program cuts and teacher layoffs, K-12 school district administrators and community members in California breathed a collective sigh of relief. An improving economy and voter approval of Proposition 30 began pumping billions of dollars back into California schools. After years of cuts, districts began to restore teaching positions, reduce class sizes, and bring back counselors and other supports to improve student opportunities and achievement.

Less than a year later, Governor Jerry Brown pushed through the Local Control Funding Formula (LCFF). As the first major change to California's education finance model in 30 years, LCFF is designed to improve educational equity by providing districts with billions of dollars in supplemental and concentration grant funding to serve low-income students, foster youth, and English learners. As LCFF has been phased in, districts have received additional funding for these students and more local control over spending. In exchange for this freedom, LCFF requires district leaders to work with their local communities to design a Local Control Accountability Plan (LCAP) detailing how they are using LCFF funds to improve educational equity.

The following year, just as districts began to create their first LCAPs, policymakers in Sacramento shifted their attention toward another priority, the state's massively underfunded teacher pension plan. The California State Teachers' Retirement System (CalSTRS) is one of the largest pension funds in the nation. The fund covers educators from the state's K-12 and community college districts and, in 2014, had a portfolio valued at nearly $190 billion. However, after years of chronic underfunding, CalSTRS had a $75 billion funding gap[1] and, like pension systems in many other states, was projected to eventually run out of resources to pay the pensions owed to hundreds of thousands of current and future retirees.

To fill this funding gap, in June 2014 Governor Brown quietly signed Assembly Bill (AB) 1469. To the chagrin of many in the education community, AB 1469 vastly increases the pension burden felt by local school districts by, in part, mandating that district payments into the CalSTRS pension system increase over a seven-year period: from 8.25 percent of teacher salaries to 19.1 percent of teacher salaries.[2] At the same time, the Governor signed legislation increasing district contributions to the California Public Employees' Retirement System (CalPERS), the pension fund that covers non-certificated school employees such as administrative staff and custodians. These two pieces of legislation have translated to large increases in pension contributions for districts. While districts paid approximately $500 per pupil in 2013-14 for employee pension costs, they will pay $1,600 per pupil in 2020-21. As a result, California's districts will pay $9 billion per year towards employee pensions in the school year 2020-21.[3]

In the first two years of rate increases, the new costs were absorbed by surges in LCFF funding and one-time state grants. During this time, many K-12 district leaders focused on implementing new state academic standards, providing long-overdue pay increases, and restoring staffing to a semblance of pre-recession levels. But in subsequent years, even as the economy has continued to improve and California voters extended Proposition 30, school communities have struggled with their pension obligations and other rising

NATIONAL CONTEXT: PUBLIC SECTOR PENSION COSTS

California is far from a unique case. Collectively, teacher pension funds across the country have accumulated approximately $680 billion in debt.[4] In the 1990s, almost all states increased the retirement benefits that were promised to teachers. Several reports have examined this issue at the national level and have found that in many states, the failure to address rising pension costs has begun to crowd out local spending in other areas of education, including teacher salaries. This issue has been particularly pressing in states that have not increased spending per student since the recession.[5]

costs—significantly straining district budgets. As pension costs continue to rise, this squeeze is being felt more acutely each year.

Despite the continued strength of the economy, instead of adding programs, districts and school boards are once again talking with their communities about what to cut. So far, many districts are finding ways to trim costs without significantly impacting core services. But in the coming years this will become more challenging—many district leaders expect that without state action the need will arise in the near future to increase class sizes, cut programs, or reduce services. The students who stand to lose the most are those who already need the most—including low-income students, English learners, students with disabilities, and trauma-impacted youth—as well as those who have historically and systematically been denied equal opportunities to learn, particularly students of color.

For several years, district leaders have been aware of and concerned about the impact of rising pension costs on educational equity. In some communities, school board members, union representatives, community leaders, and other stakeholders are beginning to feel this squeeze and are attempting to find local solutions. But more must be done, particularly at the state level. Given the scale of the crisis and the extent to which students are likely to be harmed, far more attention and broad engagement is required.

Indeed, the impact of the pension squeeze will not be solved until educators, policymakers, researchers, advocates, and community leaders collectively acknowledge and highlight the scope of the problem and work together to generate solutions. Our students and communities need to attract, support, and retain the highest quality teachers—and we cannot do this without offering teachers fair compensation, including strong retirement packages. This is particularly true in California, where teachers are not eligible for Social Security.

In theory, students should not be harmed because past leaders have made shortsighted decisions and faulty assumptions. However, in practice, today's students are the ones who will experience fewer support services, fewer enrichment opportunities, and less individualized instruction—even as California's students are more diverse in terms of background and need than ever before. And our early career teachers are also being shortchanged. Despite the fact that many of them leave before vesting in the pension system, these teachers will be asked to contribute the same, and potentially even more, to fund the state's pension shortfalls—all while facing careers teaching in schools with larger class sizes, less support in the form of aides and tutors, and without the resources to meet the social and emotional needs of their students.

BUILDING THE EVIDENCE BASE

Since LCFF was passed, researchers and advocates have paid considerable attention to issues of community engagement, equity, and fiscal transparency. They have sought to document the role of stakeholders in the LCAP process, trace the extent to which funding is reaching the students it is intended to support, and examine whether spending decisions are sufficiently transparent to the public.[6]

When it comes to educator pensions, much of the research has focused on the size of the liabilities and the performance of pension plans,[7] or the impact of rising pension costs on overall education spending.[8] To date, there has been little research on how California's increasing pension obligations are impacting educational equity.

The "Big Squeeze" project seeks to bridge that gap. This analysis focuses on the impact of pension costs, and benefit costs broadly, on district spending in California, particularly on services for low-income, English learner, and foster youth student populations targeted by LCFF as well as other historically underserved students. The Big Squeeze studied 10 years of budget information from a sample of California school districts, including actual expenditures for school years 2010-11 through 2016-17 and projected expenditures for 2017-18 to 2019-20. Researchers surveyed California school board members, primarily school board presidents, on the impact of rising pension and other benefit costs on their school districts spending. Finally, researchers conducted interviews and focus groups of school district leaders, key policymakers, and budget experts in Sacramento and throughout California.

KEY FINDINGS AND RECOMMENDATIONS

Our research reveals that districts' pension and other benefit obligations are rapidly increasing. As a result, districts are spending proportionally less money on salaries for teachers and other certificated staff. They have also cut services, including those for the student groups targeted by LCFF. And they expect to make even more cuts in the future that may severely hamper efforts to improve educational equity.

The Big Squeeze explores ways in which local district leaders and communities are addressing this crisis, and offers recommendations for how district leaders, along with community stakeholders, can best navigate the squeeze. In addition, this analysis offer recommendations for what state leaders can do to improve the situation for local school districts and the students they serve, balancing their commitment to both teachers and students in order to advance educational excellence and equity.

DATA SOURCES & METHODOLOGY

Our study drew on three data sources: 1) school district budgets, 2) school board member surveys, and 3) interviews and focus groups. Each of these is described below.

DISTRICT BUDGETS

To measure the impact of rising pension costs on district spending, researchers constructed a longitudinal database consisting of 10 years of budget information for a sample of California school districts.

DISTRICT SAMPLE

Researchers did not have the capacity to collect data from all of the approximately 1,000 school districts across California. Therefore we drew an initial sample of 150 California districts. We designed the sampling procedure to randomly draw districts from size-based strata, such that we oversampled large districts. We oversampled large districts for two reasons: a) substantively, they account for more students in California and b) practically, they have more accessible and complete projected budget information. The initial sample of districts does not include:

- Charter schools, which have increased financial flexibility and can choose to opt out of the CalSTRS system.[9]
- Districts without student enrollment data in 2013-14 (the year before AB 1469 rate increases began).
- Districts with enrollment less than 1,500 students in 2013-14.

DATA COLLECTION

For the 150 districts examined, we collected restricted and unrestricted General Fund expenditures, which are uniformly coded using California's Standardized Account Code Structure (SACS)—a system that categorizes expenditures such as teacher salaries, staff benefits, and textbooks. We collected actual and projected expenditures as follows:

- For the seven school years from 2010-11 to 2016-17, we collected *actual* expenditure data, which are publicly available through the California Department of Education.
- For the three school years from 2017-18 to 2019-20, we collected current and projected budgets from school district websites. In most cases, we collected 2017-18 board-approved budgets, which also included projections for the 2018-19 and 2019-20 school years. In cases where 2017-2018 budgets were not available online, we attempted to obtain the information by calling district offices.

Of the 150 districts initially sampled, we were able to construct a complete data panel of budgets over the entire 2010-11 to 2019-20 timespan for 98 of them. Among districts with missing data, the vast majority are missing key budget information for one or more of the three "projected budget" years (2017-18 to 2019-20). Compared to all California districts, this 98-district sample is disproportionately large and unified (this stems from both the initial oversampling of large districts and the fact that larger districts tend to have more complete budget information). We performed a number of checks between the original 150-district sample and the final balanced panel sample we use in this analysis to ensure that the results are not unique to the balanced sample alone. Correspondingly, The Big Squeeze sample accounts for 10 percent of California districts, but more than one-third of California public school students. The share of students in our sample who are low-income, foster youth, and/or English learners (a category the state calls "unduplicated") is a close match to the state average. Additional details about our 98-district sample, including a comparison of key characteristics to state averages and a list of the specific districts in the sample, are available in a technical appendix that can be found at www.pivotlearning.org/BigSqueeze/TechnicalAppendix.

SCHOOL BOARD MEMBER SURVEYS

In collaboration with the California School Boards Association, Pivot issued a web-based survey to presidents of the approximately 1,000 Local Education Agency (LEA) school boards and county boards in the state of California. Pivot conducted follow-up phone calls to the districts in the original sample of 150 districts. Within the 150-district sample, the response rate was 45 out 150, or 30 percent. Of the remaining LEAs in the state, 70 responded, for a response rate of approximately 8 percent.

The low response rate to the survey among districts outside of the initial 150-district sample (8 percent) raised the concern that the districts that responded are a particularly self-selected group (i.e. their leadership may be especially worried about pension issues). To examine this possibility, researchers compared survey responses across the two samples to see if the group with the lower response rate indicated more pension problems and concerns. Although there are some small differences between the groups, both gave substantively similar responses to the survey questions on the whole. Therefore, they are combined in the analysis that follows, for a total count of 115 surveys.

Nearly all of the respondents to the survey who chose to provide their names were school board presidents.

INTERVIEWS AND FOCUS GROUPS

Pivot conducted nine interviews and focus groups with 17 individuals. These individuals represent seven school districts, two community organizations, and one professional association (as described in Appendix A). Researchers selected districts that reflect diversity in terms of geographic location, enrollment, urbanicity, and the percent of the student body that is socioeconomically disadvantaged. In addition, the research team contacted districts that have been vocal in the news and other forums about how pensions are affecting their budgets and communities. The research team also interviewed pension experts from the California Legislative Analyst's Office.

II. KEY FINDINGS

California's pension squeeze is reducing the share of district budgets devoted to teacher salaries and prompting district leaders to make cuts to programs and services, including services for students who are low-income, English learners, or otherwise marginalized in our system. Specifically, school districts' pension and other benefit costs are impacting their budgets in five key ways:

1. Pension costs, as a proportion of district budgets, have risen dramatically in the last six years and will continue to increase.
2. District leaders must contend with not only increasing pension obligations, but also other rising costs.
3. Increasing pension and employee benefit costs are impacting district spending on teacher salaries.
4. Districts have made cuts to programs and services and expect to make more cuts in the future because of pension costs.
5. In order to pay for pension cost increases, districts are tapping into funding sources intended to serve low-income students and English learners.

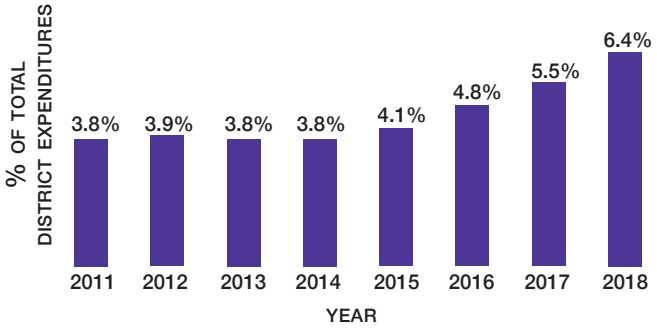
FINDING 1:
PENSION COSTS, AS A PROPORTION OF DISTRICT BUDGETS, HAVE RISEN DRAMATICALLY IN THE LAST SIX YEARS AND WILL CONTINUE TO INCREASE.

Like most government agencies, districts spend most of their resources on employee compensation. A typical California district spends 80 percent of its budget on compensation, with 59 percent spent on teachers, 9 percent on administrators, and the remainder on other certificated staff (e.g. certified librarians and counselors and classified custodians).[10] The remainder of the budget is spent primarily on consultant services, outside contracts (e.g. special education or transportation), books and supplies, technology, and maintenance.

Pensions are a piece of this total compensation, and the amount going to these pension costs is steadily increasing. In fact, spending on the teacher pension plan—CalSTRS—more than doubled between 2011-12 and 2017-18 in our sample of 98 districts.[11] As a share of the total budget, this meant an increase from 3.8 percent to 6.4 percent of expenditures (see Figure 1). We can expect these shares to continue to rise, since by 2017-18 districts were only partway through the legislated increases in CalSTRS contributions being phased in by AB 1469 (the final year of legislated increases is 2020-21).

While the CalSTRS cost increase may seem marginal, the impacts can be significant. Moreover, CalSTRS is not the only pension cost that districts face: CalPERS costs are also rising. As mandated costs such as these increase, the percentage of a district's budget that is discretionary is reduced.

FIGURE 1: CHANGE IN CALSTRS EXPENDITURES, AS A PROPORTION OF TOTAL DISTRICT EXPENDITURES IN SAMPLE DISTRICTS



LCFF and the strong economy initially softened the blow by increasing funding for all districts through the base grant and the distribution of one-time funding. Higher poverty districts have additionally benefited from supplemental and concentration grant funding. Pension costs have also been backloaded, with smaller increases in the early years of LCFF and much higher increases coming after 2016-17. As a result, when AB 1469 was first implemented, districts were initially able to absorb these costs.

However, as pension and other fixed costs increase, districts have less flexibility with their revenue. In coming years, as the contribution rate increases per AB 1469, and assuming that overall revenues flatten, pension costs are projected to become an even larger portion of district budgets. A leader from a mid-sized Northern California district told us that he expects benefit costs to double over a five-year period starting from 2014-15 and "that means that basic salaries and other operating expenses are shrinking as a percentage of the dollars of revenue."

Survey respondents confirmed this; 100 percent of respondents indicated that their districts experienced increased pension costs over the last three years, and 91 percent reported that their districts experienced increased health care costs over the same time frame. A stunning 57 percent indicated that they expect these costs to result in deficit spending in 2018-19.

FINDING 2:
DISTRICT LEADERS MUST CONTEND WITH NOT ONLY INCREASING PENSION OBLIGATIONS, BUT ALSO OTHER RISING COSTS.

Pensions are not the only cost that is increasing. Other expenses, such as special education, energy, and wages, are also on the rise. The pressures brought on by these cost increases and other annual adjustments are exacerbated in districts with declining student enrollment—which often see costs grow even as revenues flatten or decline. Districts with increases or decreases in their English learner or low-income populations can also experience fluctuations

in revenue since LCFF allocates resources according to need. While tying budget dollars to district size and student need makes sense, it can create complication and uncertainty at the local budgeting level.

One leader from a mid-sized Central Valley district expressed concern about the idea put forth by some that schools have plenty of new funding to cover pension costs, stating, "they omit step and column, they omit rising operational costs, such as the fuel tax increase, and how it affects our services for delivery of food. Our costs for all services continue to grow."

These cost pressures come at a time when LCFF also places additional requirements on districts—requirements that are meant to protect students and expand equity, but that can at times feel constraining, according to some district leaders.

Under LCFF, districts are required to use supplemental and concentration grants to increase and improve services for low-income, English learner, and foster youth students. These investments are essential to closing opportunity gaps and improving student outcomes. District leaders expressed concern that the pension increases complicate their efforts to comply with LCFF. By law, districts are required to include a broad range of stakeholder groups when developing the LCAP, but some leaders report that this consultation often results in requests for additional services, which come with additional costs. As one leader from a mid-sized Central Valley district told us, "every stakeholder group has been informed that everyone should stake their claim in the LCAP. We have existing stakeholders, special interest groups, all vying for funds, and all want to be included in LCAP. We are providing these services, but now everyone wants a [costly] single line item."

Some district leaders, however, shared examples of ways in which they are working with stakeholders to improve programs while cutting costs. For example, a leader from a large Southern California district shared that its schools responded to stakeholder feedback by expanding their music education and dual language immersion offerings. The district has been able to control costs by maintaining larger class sizes.

Several district leaders noted that pension obligations are now exceeding the size of their supplemental and concentration grants, hampering their ability to provide increased or improved services while covering other costs. For example, in a district where approximately 50 percent of students qualify for free- or reduced-price meals, the Chief Business Officer argued that rising pension costs were undermining the flexibility promised by LCFF:

"The governor [Governor Jerry Brown] says, you used to get categorical dollars, now you're getting supplemental and concentration grants. But you have to proportionally show that students generating those dollars are benefiting from them. At the same time, in my case, the cost of step and column increases for teachers, and the benefits, CalSTRS and CalPERS, exceeds the number of new dollars I'm getting."

FINDING 3:
INCREASING PENSION AND BENEFIT COSTS ARE IMPACTING DISTRICT SPENDING ON TEACHER SALARIES.

District leaders are still making investments in their staff and services, often by increasing salaries to attract and retain the best educators. In districts that feel the pressure of a growing teacher shortage and direct competition with neighboring communities, leaders and their stakeholders can feel particularly compelled to drive salaries and benefits higher. In addition, as total education revenues have climbed steeply in recent years, teachers and their bargaining units have justifiably sought a share of those increases.

An analysis of district-reported teacher salary data from the years following the Great Recession reveals that average teacher salaries increased by approximately 17 percent from 2011 to 2017, from $67,900 to roughly $79,100.[12] Despite these increases, it is likely that rising pension costs have dampened the ability of districts to invest in teachers. Put another way, the increase would be larger if not for the rapid rise in pension costs. Of surveyed school board members, 88 percent of respondents indicated that higher pension and benefit costs have restricted their district's ability to provide higher salaries for teachers.

Analysis based on The Big Squeeze's 98-district sample shows that spending on certificated salaries as a share of district budgets has declined since 2010-11 and will continue to decline into 2019-20. As a share of district budgets, benefit costs, which include pensions, are projected to increase by 5.4 percentage points, while certificated salary costs are projected to decrease by 4.7 percentage points (see Figure 2). This effect is more pronounced in districts with declining enrollment, with benefit costs projected to increase by 6.3 percentage points while certificated salary costs are projected to decline by 5.7 percentage points.

The reduced budget shares devoted to teacher salaries imply that districts are making cuts to positions, increasing class sizes, refraining from filling vacancies, and/or foregoing or limiting salary increases. Districts are spending less on staffing[13] than they would be if benefit costs were not rising.

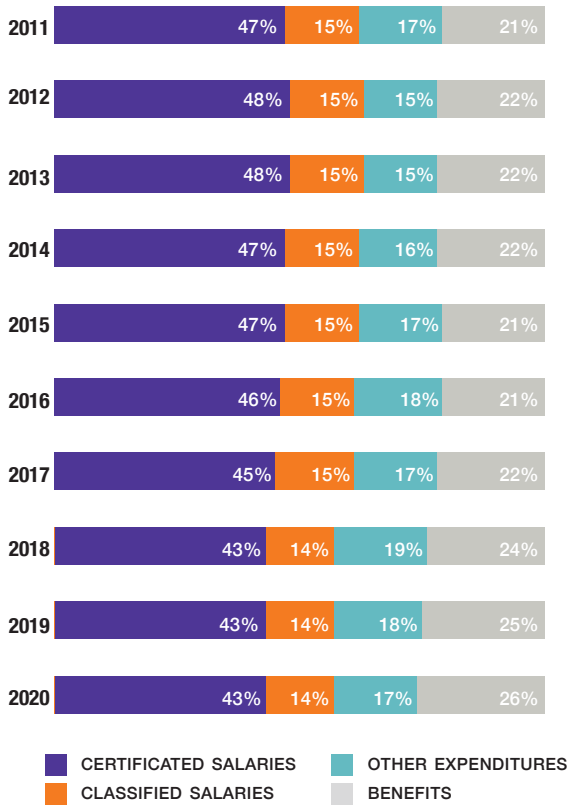
District budget experts agree. Said the leader of one professional association, "In some districts, those that are not your high wealth [districts]…every time they have retirements, they're just not filling those positions."

A reduced workforce means fewer services for students. California's staff-to-student ratios in areas

such as teachers, counselors, and librarians are already among the worst in the nation.[14] In addition, California's school nurses serve many more students than nurses in other states.[15] This only exacerbates opportunity gaps, as students in the highest-poverty schools are already far less likely to have access to counselors and librarians than students in more affluent schools.[16]

The squeeze from rising pension costs will worsen these conditions, pushing critical services and supports further out of reach for many students, especially those with high needs. Further, teachers' working conditions will likely suffer as they teach larger classes with fewer support staff to assist them and their students.

FIGURE 2: AS A SHARE OF TOTAL EXPENDITURES IN OUR 98-DISTICT SAMPLE, SPENDING ON CERTIFICATED SALARIES HAS DECREASED, WHILE SPENDING ON BENEFITS HAS INCREASED



FINDING 4:
DISTRICTS HAVE MADE CUTS TO PROGRAMS AND SERVICES AND EXPECT TO MAKE MORE CUTS IN THE FUTURE BECAUSE OF PENSION COSTS.

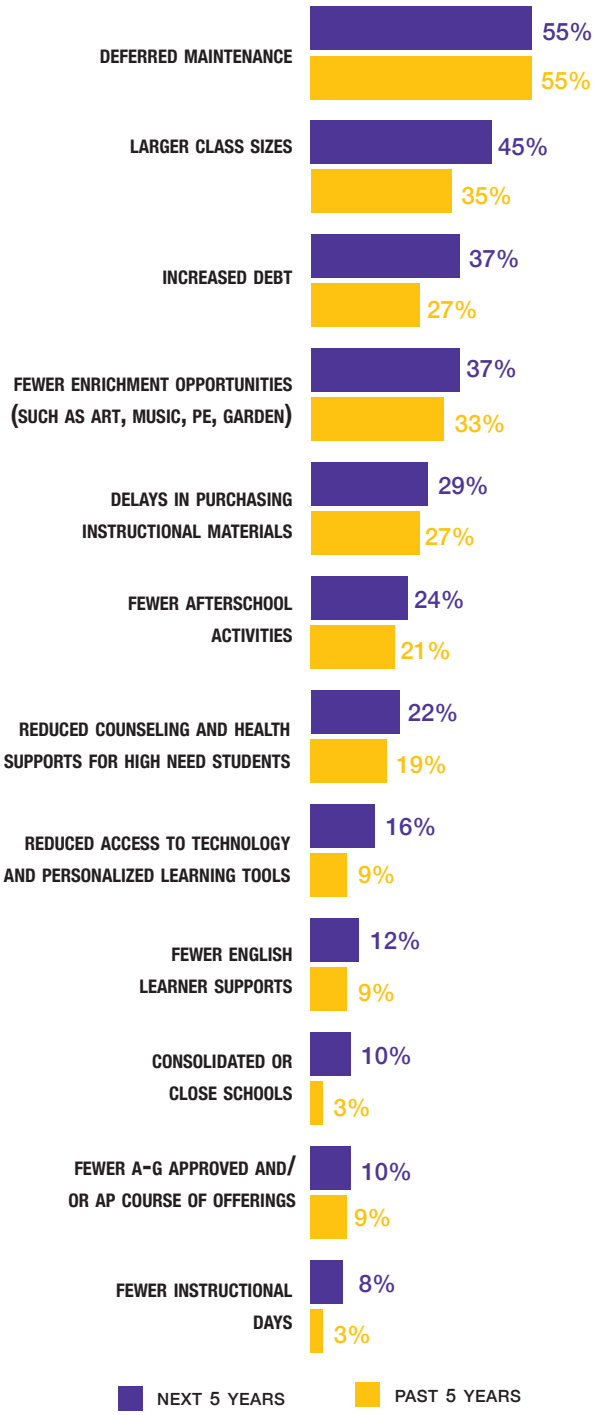
Districts have already made cuts in response to the pension cost increases. Surveyed school board presidents were asked what changes their districts have made over the past five years, and what adjustments they plan to make over the next five years, in response to the rising cost of pension and health benefits. The most common response from survey respondents was deferred maintenance—which suggests that districts are holding off on repairs and routine maintenance on aging buildings. More than 50 percent of respondents said they had deferred maintenance in the past five years, and a similar percentage say they expect to defer maintenance in the future. One focus group participant, a leader from a mid-sized Central Valley district, said that their district is cutting in small ways too, asking themselves questions like, "How often do we clean the room? Mow the grass?"

The second most frequently cited cost-cutting measure was increasing class sizes. More than a third of respondents said their districts had already increased class sizes, and 45 percent indicated that they would do so in the future. Many focus group participants spoke to this as well. One leader from a large Southern California district said that they have negotiated to set class sizes at 30 students per teacher, adding, "once we were able to get the class size language, that gave us breathing room." While this may help balance the budget, larger class sizes often means fewer supports for vulnerable students who benefit from teacher support and differentiated instruction.

More than a third of respondents said they expect their districts to offer fewer enrichment opportunities over the next five years, including art, music, PE, and gardening. Nearly a quarter of respondents anticipate reducing afterschool activities, and one in five anticipates their districts will be forced to reduce counseling and health supports for LCFF-identified student groups. These cuts will have devastating effects on all students, and particularly on students whose families do not have the means to offer enrichment opportunities outside of school, on those whose families rely on afterschool programs so they can work, and on students who need additional academic, social, and emotional support.

Less than 10 percent of survey respondents said their districts have reduced access to technology and personalized learning tools, cut English learner supports, reduced A-G and/or AP course offerings, offered fewer instructional days, or consolidated/closed schools. However, the likelihood of these cuts will only increase in the next five years. For example, the percentage of survey respondents indicating that their districts plan to decrease access to technology and personalized learning tools in the future is almost twice as large as the percentage reporting having already made these changes (16 versus 9 percent). Similarly, the number who say their districts plan to offer fewer instructional days in the future is 8 percent, up from 3 percent who report having already made such a change. Many of these cuts would have disproportionate impact on LCFF-identified student groups who stand to benefit the most from individualized supports and additional instructional time. And given their clear benefits, they actually should be areas for increased district investment.

FIGURE 3: COST-SAVING CHANGES SURVEY RESPONDENTS SAY THEIR DISTRICTS HAVE MADE AND PLAN TO MAKE IN RESPONSE TO THE RISING COST OF PENSION AND HEALTH BENEFITS (N=115)

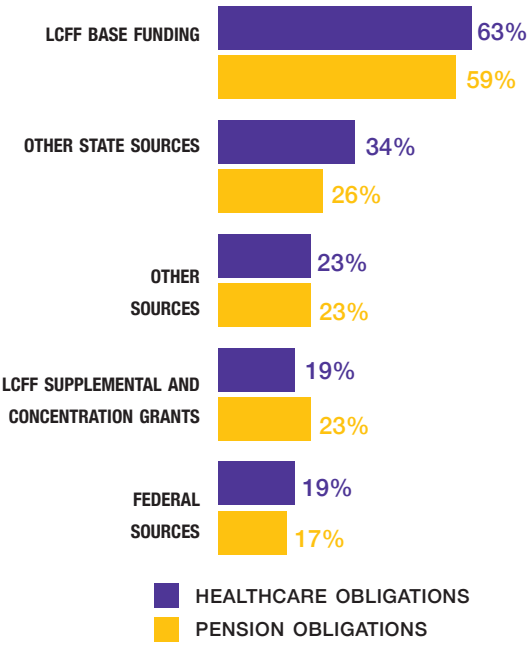


Note: Survey options were included as "check all that apply," so categories do not sum to 100 percent.

FINDING 5:
IN ORDER TO PAY FOR PENSION COST INCREASES, DISTRICTS ARE TAPPING INTO FUNDING SOURCES INTENDED TO SERVE LOW-INCOME STUDENTS AND ENGLISH LEARNERS.

Pension and health care costs are rising fast enough that they are encroaching on supplemental and concentration grants, which are supposed to be protected for LCFF-identified student groups. Many districts say they are unable to pay for rising pension and health care costs using their base funding alone, with nearly a quarter of survey respondents indicating that their districts are using some of their supplemental and concentration grant funding to support their rising pension costs. One fifth indicate that they are using these funds to pay for their health care costs. (See Figure 4.)

FIGURE 4: RESOURCES SURVEY RESPONDENTS REPORT USING TO PAY FOR PENSION AND HEALTH CARE OBLIGATIONS (N=115)



Note: Survey options were included as "check all that apply," so categories do not sum to 100 percent.

The squeeze is evident when we compare changes in revenues to changes in expenditures. As discussed in Finding 1, CalSTRS expenditures in the 98-district sample more than doubled between 2010-11 and 2017-18. Most of this increase has happened since 2013-14, as AB 1469 began to phase in. Yet during that same time period, those 98 districts received, on average, only 36 percent more in base funding—the foundational dollars intended to cover basic educational services. With pension costs rising faster than base revenues, it is not wholly surprising—but still alarming—that some districts are dipping into other funding sources to make ends meet.

Indeed, district leaders told researchers that they are "becoming very creative with supplemental and concentration dollars." But this creativity does not translate to needed innovations in how to best serve students. As one district leader put it, "when your base dollars can no longer absorb the mandatory cost, to stay competitive with compensation packages around the area, you begin to look [at]…base expenditures that may qualify to shift over to supplemental and concentration dollars, and free up resources for things like mandatory costs like pensions and compensation packages."

As pension costs increased as a portion of the total budget, several district leaders noted that their pension costs are now exceeding their LCFF supplemental and concentration grants. Using publicly available 2017-18 data for the 98-district sample, researchers estimate that 44 percent of the districts spent more on CalSTRS and CalPERS than they received in supplemental and concentration grants. In total, these 98 districts received about $3.2 billion in supplemental and concentration grants in 2017-18. They had collectively budgeted to spend $2.1 billion in CalSTRS and CalPERS costs that same year.[17] This exacerbated the feeling that districts had been subjected to a bait-and-switch by state policymakers, who had promised more revenue and then required districts to pay accelerating pension costs that eroded the value of that revenue.

This situation is already impacting the ability of districts to provide additional services to students identified as LCFF student groups. Two-thirds of survey respondents indicated that increased pension and benefit costs have already impacted their ability to provide supplementary supports and services to these students. As their pension, benefit, and other costs increase, the squeeze on supplemental and concentration funds will likely worsen, further reducing services. This pressure will intensify even more if the economy flattens or goes into a recession.

To put it another way, increases in pension costs—when passed through to local school districts—represent a large sum of money that could otherwise be spent on staffing to support unduplicated students. For example, if one mid-sized Northern California district's $8.4 million CalSTRS payment was shifted off its books, that savings would pay for 80 additional English Language Development teachers.[18]

63%

OF SURVEY RESPONDENTS SAID THAT

INCREASED PENSION AND BENEFIT COSTS HAVE IMPACTED THEIR ABILITY TO PROVIDE SUPPLEMENTARY SERVICES TO LCFF-IDENTIFIED STUDENTS GROUPS

(n=103)

LOCAL REVENUE SOURCES CAN HELP BALANCE BUDGETS—BUT THEY CAN ALSO EXACERBATE INEQUITIES

The majority of school district funding comes from state sources and local property taxes, but approximately five percent comes from other local sources. There are several ways for California districts to currently raise additional local revenue when base funding is inadequate, but many of these exacerbate inequities. Districts can:

- Partner with local education foundations and accept parent and community donations—which are generally higher in more affluent areas.
- Pass school construction bonds to improve their facilities with 55 percent of the vote, although these are often designed in a way that benefits wealthier districts.[19]
- Pass parcel taxes to increase contributions from home and business property owners with a two-thirds vote; these are more likely to pass in high-wealth communities.
- With their local municipalities or counties, propose a range of tax increases to support educational services or initiatives such as preschool or after school programs.

As pension and other benefit costs continue to rise, communities could turn to these local and more inequitable sources of funding in order to support local schools and save critical services. Recently, one district in an affluent county passed a parcel tax to offset their rising pension costs. In this county, community leaders acknowledged that a dependence on parcel taxes could exacerbate existing resource inequities. Wealthier areas, they noted, might be able to absorb pension increases in the near-term, while less wealthy areas would find it far more difficult to raise local revenue and would be forced to make deeper cuts. This helps makes the case for a statewide solution that will benefit all communities, and particularly those with lower tax bases and greater student needs.

III. WHAT CAN LOCAL SCHOOL DISTRICTS DO TO AVOID THE BIG SQUEEZE?

Some district leaders have already responded to rising pension costs by cutting services. Others told us that they have sought to raise revenue through parcel taxes and bonds, and several have increased their reserves to safeguard future years' budgets.

Financial prudence, however, has not always been popular. Several districts shared that they feel pressure from their unions and community to immediately spend any increased funding on new services and salary increases. To be sure, these demands have merit. Unfortunately, districts are in the tough position of having to balance the books now and with an eye to the future, while also aiming to provide the highest-quality services to students and attractive compensation to employees.

WHAT OPTIONS DO SCHOOL DISTRICTS HAVE?

1. **Collaborate with stakeholders to understand the Big Squeeze, make tough decisions, plan ahead, and advocate for a state-wide solution.** District leaders underscored how important it is that all education stakeholders understand how rising pension costs are impacting district budgets so that they can engage as a community to identify solutions. They acknowledge that some stakeholders, including select board members and highly engaged parent leaders, understand the fiscal situation. But they noted that the growing public awareness of how ballooning pension costs are affecting public services like police and fire departments is not yet fully extended to schools. District leaders expressed concern that stakeholder groups like unions and parents generally focus their attention on revenue increases and expect that these increases will translate into higher staff salaries and more student services. For these reasons, labor relations and community relations become especially important as districts make decisions about how to add or reduce staff or services.

   District leaders should build the capacity of community stakeholders to meaningfully engage in planning, which they can do by educating members of School Site Councils, District English Learner Advisory Committees, PTAs, and other committees and councils; providing information on the impact of the pension situation during school board and community budget presentations; and broadly communicating with the public about the fiscal situation through a variety of communication platforms that work best for their community stakeholder population, which may include newsletters, traditional and social media, and text messaging—with translation provided as necessary.

   In addition, districts should integrate community conversations about their short and long-term financial situation into their LCAP development process. Too often, the focus is on how to spend additional state funding and not on the district's long-term (3-5 years) financial situation. During these conversations, district and community members can focus on identifying and sustaining impactful investments in student learning. For example, in one small Northern California district, community members worked with district leaders to build a six-year financial projection and develop a plan to address pension and other costs while maintaining support for schools.

   By openly communicating with stakeholders about the fiscal situation and engaging stakeholders in decisions, districts can build a foundation of trust with their communities. With this foundation, districts leaders engage stakeholders when weighing tradeoffs, determining how to equitably allocate scarce resources between schools, and setting longer term goals and priorities.

   District leaders and stakeholders can also begin to build the broad coalitions necessary to advocate for a state-wide solution to the problem. Rather than pointing fingers at local leaders and stakeholders for causing this crisis and fighting over increasingly limited resources, they can work together to fight for the funding necessary to fund a high-quality education for every student.

2. **Realign instructional goals with the budget.** As budgets get tighter, districts have a choice: They can apply across-the-board cuts, or they can become more strategic about spending. Now is the right time to align expenditures with educational objectives at the district and school levels. While this has been the overall goal of the LCAP, most districts have chiefly focused, so far, on restoring services lost during the Great Recession or increasing services using new supplemental and concentration funding.

   Now, districts should shift to figuring out how to improve services—ideally in ways that do not come with additional cost. For example, districts leaders could replace a non-college preparatory ninth grade math course with a different math course that meets University of California and California State University eligibility requirements, taught by the same teacher. This change to the master schedule would bear no cost but would significantly improve college-going opportunities for students.

In one declining-enrollment district with limited supplemental and concentration funding, district leaders took early steps to cut costs and raise revenues. Using the Smarter School Spending approach, this district's finance and education services departments came together to align their instructional goals with their budget strategy. This work has now expanded to include a broader range of stakeholders at the community and school levels, with the goal of promoting data-driven, student-outcome focused conversations on financial investments in an era of limited resources.

3. **Only make investments that the district can sustain.** Even as districts face a looming financial crisis, many are making investments that will be challenging to sustain. For example, in fall 2017 the Sacramento City Unified School District negotiated an 11 percent raise for district teachers. Unfortunately, the County Superintendent of Schools went on to reject the district's budget, predicting that this raise imperiled district reserves.[20] While it is crucial to invest in teachers, particularly in high-cost areas, new spending must account for rising pension and other costs and should also be weighed against other investments in student learning. Prudent financial decision making is of the utmost importance given the structural budgeting challenges facing school districts in California.

WHAT IS SMARTER SCHOOL SPENDING?

Smarter School Spending, managed by the Government Finance Officers Association (GFOA), is a nationally tested approach that aligns strategic planning and budgeting over the long-term to ensure the sustainability of district finances and investments in improving student outcomes. The process allows districts to make strategic investments in their top academic and organizational priorities while accounting for external factors such as pension costs and the ups and downs of state education budgets. Smarter School Spending has five key stages: 1) planning and preparing; 2) setting priorities; 3) paying for priorities; 4) implementing the strategic finance plan; and 5) ensuring long-term sustainability. GFOA supports a national, multi-district coalition implementing the model. Pivot has worked with five districts in California to pilot the approach and continues to support districts that use Smarter School Spending as a basis for their strategic planning, budgeting and Local Control Accountability Plan (LCAP) development.[21] Learn more at smarterschoolspending.org.

IV. WHAT CAN THE STATE CAN DO TO AVOID THE BIG SQUEEZE?

Local communities can do their best to weather the pension squeeze storm, but solving the pension crisis will require decisive action at the state level. Unfortunately, there are no easy fixes. Solving this problem will demand political courage and a willingness to take a long view.

It is critically important that California find a way to balance its twin commitments: those promises it has made to current and retired teachers, and the moral, constitutional, and civic obligation it has to students who will determine the future of the Golden State.

WHAT OPTIONS DO STATE LEADERS HAVE?

1. **Increase state revenues.** California is spending more and more of its finite education budget to fulfill its obligations to retirees and address unfunded pension liabilities, which leaves fewer resources available for students and teachers today—even as its student population is growing increasingly diverse and as child poverty remains high.[22] **To maintain its commitments from the past while also investing in today and the future, the state must increase the size of the education budget itself.**

   California could raise revenue through tax-based options, including tax increases and/or by rolling back Proposition 13. Importantly, any tax increase should be designed to increase state revenues. It would be unwise (and perhaps unconstitutional) to return to the era when local communities had wide latitude to tax themselves for schools because this generates the potential for severe inequities between high- and low-wealth communities. *(See Sidebar: **Local Revenue Sources Can Help Balance Budgets—But They Can Also Exacerbate Inequities.**)* Further complicating any new tax measure is the new federal cap on state and local tax deductions. With a $10,000 limit on their deductions, homeowners may be less supportive of new or increased state and local taxes that can no longer be deducted on their federal tax returns.

2. **Move unfunded liabilities outside of Proposition 98, or increase the size of the guarantee**. School districts should contribute to CalSTRS and CalPERS for current employees. It is quite another thing, however, to ask them to contribute to the unfunded liabilities that CalSTRS and CalPERS have accrued over time. Under AB 1469, districts are responsible for a substantial share of legacy costs, and this presents a significant impediment to the delivery of education services now and for the foreseeable future in California. The state should absorb some or all of these costs by moving them outside of the Proposition 98 minimum guarantee, freeing up districts to spend more on their current teachers and today's students. Governor Gavin Newsom took a step toward this in his proposed January 2019 budget, and the state could adopt and build upon this modest but important action. Alternatively, or in addition, the state could increase the Proposition 98 minimum guarantee to reflect the increased pension legacy costs districts are being asked to absorb.

3. **Consider approaches from other states.** Retirement security should not be taken away from teachers or any other public employees. This is particularly important in California, where teachers are not enrolled in Social Security. At the same time, there are a variety of ways in which the state can restructure programs to reduce debt, eliminate loopholes, and limit the growth of liabilities moving forward. One way that other states have approached this question is to consider retirement programs that blend defined contribution and defined balance plans. While that may not be the path forward for California, reforms could allow the system to better serve the needs of those who teach for less time. The current system disadvantages teachers who do not stay in the field for their entire careers. About 30 percent of California teachers leave before their pensions vest at five years of service, meaning they receive no pension benefits at all. And, unless teachers serve for roughly 35 years, they are unlikely to enjoy future pension payments that are worth more than their own contributions.[23]

4. **Only make promises that the state can sustain.** Our state's newly elected leaders are arriving in Sacramento with a long wish list. Unfortunately, some of their most promising ideas, such as expanding access to preschool and universal health care, will be expensive. These programs are not tied to a sustainable funding stream. Because of California's boom and bust budget cycles, promising programs are often cut without generating sustainable impacts. These extremely important policy initiatives must be funded with sustainable revenue sources. To achieve their goals, state leaders will have to address California's system of taxation and rising pension costs.

V. CONCLUSION

California school districts are struggling to afford steeply rising pension costs, and the situation has become dire. School leaders, teachers, and families are increasingly being asked to accept larger class sizes, fewer support staff, less course sections, and other reductions in services. When cuts like this happen, students with greater needs or that are already underserved suffer the most: they receive fewer of the academic interventions, social and emotional services, and expanded learning opportunities that support their success in school and beyond. In California, these students are the majority—60 percent are low-income,[24] and more than a third are current or former English learners.[25]

Without significant new investments in K-12 education, Californians can expect more of these cuts in the near future, especially if the state experiences an economic downturn—which many economists warn looks likely.

Reverberations of this fiscal crisis are being felt both nationally and in California. In 2018 and already in 2019, teachers around the nation have made national headlines as they rightly protested low wages and inadequate resources. This wave of protest has reached California. Teachers and local communities are demanding that state leaders meaningfully invest in public schools. Rarely are they demanding fixes to our pension system, but as this report has shown, massive unfunded pension costs are an important part of the puzzle—and fixing them must also be part of the solution.

The dismal fiscal situation is matched by a long-standing crisis in academic outcomes. In 2018, just half of California students met standards in English language arts, and fewer than four in 10 students met standards in math. Only 80 percent of Latino students, 73 percent of Black students, and 68 percent of English learners graduated from high school.

Our public education system needs billions in additional resources to address these gaps and provide a high-quality education to *every* student. By one estimate, a merely adequate education would require a whopping $26 billion *more* than what California now spends, or an additional $4,686 per K-12 student.[26] With pension costs expected to rise to over $9 billion in 2021, it will be impossible for California to adequately fund its schools without also addressing the pension squeeze. This will require hard choices by state and local leaders and a financial commitment from citizens. In the coming years, California's elected leaders, together with the public, must answer the question raised by Paul Taylor of the Pew Research Center: "How can we keep our promises to the past while ensuring that we do not starve our future?"[27] We urge California's leaders to maintain commitments to its teachers and retirees, while investing in the future: our students.

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APPENDIX A: DISTRICT SUMMARY

The research team conducted interviews with stakeholders from seven school districts. Those districts are summarized below.

District Description	Region	Enrollment[28]	Basic Aid[29]	% Unduplicated[30]	Recent Enrollment Trends[31]
Small Northern California District	Northern	Under 5K	N	<25%	Declining
Large Central Valley District	Central Valley	Over 20K	N	>75%	Consistent
Mid-sized Northern California District 1	Northern	Between 5K and 20K	N	Between 25% and 50%	Consistent
Mid-sized Northern California District 2	Northern	Between 5K and 20K	Y	<25%	Consistent
Mid-sized Central Valley District 1	Central Valley	Between 5K and 20K	N	>75%	Increasing
Mid-sized Central Valley District 2	Central Valley	Between 5K and 20K	N	Between 50% and 75%	Declining
Large Southern California District	Southern	Over 20K	N	>75%	Consistent

APPENDIX B: ALL SURVEY RESULTS

Q1: OVER THE LAST THREE YEARS, HAS YOUR DISTRICT EXPERIENCED DECLINING ENROLLMENT?

No	41%
Yes	59%

N=114

Q2: HOW HAS THE PERCENTAGE OF UNDUPLICATED STUDENTS IN YOUR DISTRICT CHANGED OVER THE LAST THREE YEARS?

Decreased	15%
Increased	30%
Stayed the Same	55%

N=94

Q3: DOES YOUR DISTRICT FIND IT CHALLENGING TO RECRUIT AND/OR RETAIN TEACHERS?

Not Challenging	32%
Somewhat Challenging	48%
Very Challenging	19%

N=114

Q4: DO YOU EXPECT TO SUBMIT A QUALIFIED OR NEGATIVE BUDGET CERTIFICATION FOR THIS YEAR'S SECOND INTERIM REPORT (2017-2018) BECAUSE OF INCREASING EMPLOYER PENSION COSTS?

No	92%
Yes	8%

N=106

Q5: OVER THE PAST THREE YEARS, HAS YOUR DISTRICT'S CONTRIBUTIONS TO STRS AND PERS:

Increased	100%
Decreased	0%
Stayed the Same	0%

N=108

Q6: OVER THE PAST THREE YEARS, HAS YOUR DISTRICT'S COSTS FOR OTHER BENEFITS SUCH AS HEALTH CARE:

Increased	91%
Stayed the Same	9%
Decreased	0%

N=108

Q7: DO YOU EXPECT TO BE DEFICIT SPENDING IN THE 2018-2019 FISCAL YEAR BECAUSE OF INCREASING EMPLOYER PENSION COSTS?

No	43%
Yes	57%

N=101

Q8: LOOKING AHEAD TO 2018-2019, HOW DOES THE AMOUNT OF YOUR DISTRICT'S EXPECTED PENSION CONTRIBUTION (STRS AND PERS COMBINED) COMPARE TO THE SUPPLEMENTAL AND CONCENTRATION GRANTS YOU EXPECT TO RECEIVE?

Pension contributions add up to a ***higher*** dollar amount than supplemental and concentration grants do	89%
Pension contributions add up to a ***lower*** dollar amount than supplemental and concentration grants do	5%
Pension contributions ***equal*** the amounts of supplemental and concentration grants	6%

N=79

Q9: WHAT RESOURCES HAVE YOU USED TO PAY FOR YOUR PENSION OBLIGATIONS?

LCFF base funding	59%
LCFF supplemental and concentration grants	23%
Other state sources	26%
Federal sources	17%
Other sources	23%

N=115

Q10: WHAT RESOURCES HAVE YOU USED TO PAY FOR YOUR HEALTH CARE OBLIGATIONS?

LCFF base funding	63%
LCFF supplemental and concentration grants	19%
Other state sources	34%
Federal sources	19%
Other sources	23%

N=115

Q11: HAVE INCREASED PENSION AND BENEFIT COSTS IMPACTED YOUR ABILITY TO PROVIDE SUPPLEMENTARY SUPPORTS AND SERVICES TO UNDUPLICATED STUDENTS?

No	37%
Yes	63%

N=103

Q12: HAVE INCREASED PENSION AND BENEFITS COSTS IMPACTED YOUR ABILITY TO PROVIDE HIGHER SALARIES FOR TEACHERS?

No	12%
Yes	88%

N=107

Q13: HAVE INCREASED PENSION AND BENEFITS COSTS IMPACTED YOUR ABILITY TO RECRUIT AND RETAIN TEACHERS?

No	55%
Yes	45%

N=102

Q14: THINKING BACK TO THE PAST FIVE YEARS, HAS THE DISTRICT MADE ANY OF THE FOLLOWING CHANGES IN ORDER TO PAY FOR INCREASED PENSION AND HEALTH COSTS?

Larger class sizes	35%
Fewer instructional days	3%
Reduced counseling and health supports for high need students	19%
Reduced access to technology and personalized learning tools	9%
Fewer after school activities	21%
Fewer enrichment opportunities (such as art, music, PE, garden)	33%
Fewer a-g approved and/ or AP course offerings	9%
Fewer English learner supports	9%
Delays in purchasing instructional materials	27%
Deferred maintenance	55%
Increased debt	27%
Consolidate or close schools	3%

N=115

Q15: IN THE NEXT 5 YEARS, WILL THE DISTRICT MAKE ANY OF THE FOLLOWING ADJUSTMENTS IN ORDER TO PAY FOR INCREASED PENSION AND HEALTH COSTS?

Larger class sizes	45%
Fewer instructional days	8%
Reduced counseling and health supports for high need students	22%
Reduced access to technology and personalized learning tools	16%
Fewer after school activities	24%
Fewer enrichment opportunities (such as art, music, PE, garden)	37%
Fewer a-g approved and/ or AP course offerings	10%
Fewer English learner supports	12%
Delays in purchasing instructional materials	29%
Deferred maintenance	55%
Increased debt	37%
Consolidate or close schools	10%

N=115

Q16: PLEASE INDICATE YOUR LEVEL OF SUPPORT FOR THE FOLLOWING STATE-WIDE SCHOOL EMPLOYER PENSION RELIEF EFFORTS.

	Do Not Support	Neutral	Support	Strongly Support
Ballot measure (n=100)	13%	18%	29%	40%
Increased taxes (n=101)	27%	26%	34%	14%
Requiring the state to pay school employer pension increases outside of the Prop 98 guarantee from the state General Fund (n=105)	6%	2%	21%	71%

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Founded in 1995, Pivot Learning is a nonprofit organization of K-12 education experts who work directly with districts to address their biggest challenges, including raising student achievement and closing unconscionably large achievement gaps. Our mission is to partner with educators to design and implement solutions to their greatest challenges in achieving educational justice. We envision a future where our public schools provide our most underserved students with an outstanding education. In 2017, Pivot acquired the Consortium on Reaching Excellence in Education (CORE), which expanded our reach and our capacity to support research-based intervention in literacy and math.

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