THE SCHOOL DISTRICT OF PHILADELPHIA

ADOPTED BY SCHOOL REFORM COMMISSION
SEPTEMBER 10, 2012

FIVE YEAR FINANCIAL PLAN
FISCAL YEARS 2013-2017

440 N. Broad Street, Philadelphia, PA 19130

If you have a disability and the format of any material on our web pages interferes with your ability to access the information or you have a question regarding the School District's website accessibility, please contact us via any of the following means for assistance:

The School District of Philadelphia
Office of Family and Community Engagement
440 N. Broad Street, Suite 114
Philadelphia, PA 19130-4015
Email: ask@philasd.org
Tel: (215) 400-4000
Fax: (215) 400-4181

To help us respond in a manner most helpful to you, please indicate the nature of the accessibility problem, the web address of the requested material, your preferred format in which you want to receive the material (electronic format (ASCII, etc.), standard print, large print, etc.), and your contact information (name, email, telephone, and physical mailing address).

The information set forth in this Five Year Financial Plan for the Operating Budget, the assumptions and the related notes attached hereto (the "Plan"), is as of September 7, 2012, has been prepared by The School District of Philadelphia (the "School District") from its books and records and other information available to the School District, and the School District is solely responsible for its content. The School District makes no representation as to whether the information set forth in the Plan is sufficient for the purpose of evaluating the affairs or financial condition of the School District. As to information contained in the Plan which was derived from public sources, the School District makes no representation as to the accuracy or completeness of such information.

Some of the information contained in the Plan has been derived from School District books and records which have not been audited. Such information is qualified in all respects by changes which might be occasioned had an audit been completed.

The budget projections contained in the Plan, prepared by the School District, do not include an evaluation of the support for the assumptions underlying the projections. The achievement of any of the results set forth therein is dependent upon future events, which may or may not occur. Actual results may vary from those as projected and such variances could be material. Moreover, the projections might differ from those as presented, if an evaluation of the support for the assumptions underlying the projections had been undertaken and such differences could be material.

IF AND WHEN INCLUDED IN THE PLAN, THE WORDS "EXPECTS," "FORECASTS," "PROJECTS," "INTENDS," "ANTICIPATES," "ESTIMATES," "ASSUMES," AND ANALOGOUS EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. THE ACHIEVEMENT OF CERTAIN RESULTS OR OTHER EXPECTATIONS CONTAINED IN SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS DESCRIBED TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. INCLUDED IN SUCH RISKS AND UNCERTAINTIES ARE: (i) THOSE RELATING TO THE POSSIBLE INVALIDITY OF THE UNDERLYING ASSUMPTIONS AND ESTIMATES; (ii) POSSIBLE CHANGES OR DEVELOPMENTS IN SOCIAL, ECONOMIC, BUSINESS, INDUSTRY, MARKET, LEGAL AND REGULATORY CIRCUMSTANCES; AND (iii) CONDITIONS AND ACTIONS TAKEN OR OMITTED TO BE TAKEN BY THIRD PARTIES, INCLUDING SUPPLIERS, BUSINESS PARTNERS AND COMPETITORS, AND LEGISLATIVE, JUDICIAL AND OTHER GOVERNMENTAL AUTHORITIES AND OFFICIALS. ASSUMPTIONS RELATED TO THE FOREGOING INVOLVE JUDGMENTS WITH RESPECT TO, AMONG OTHER THINGS, FUTURE ECONOMIC, COMPETITIVE, AND MARKET CONDITIONS AND FUTURE BUSINESS OR LEGISLATIVE DECISIONS, ALL OF WHICH ARE DIFFICULT OR IMPOSSIBLE TO PREDICT ACCURATELY. FOR THESE REASONS, THERE CAN BE NO ASSURANCE THAT THE FORWARD-LOOKING STATEMENTS INCLUDED IN THE PLAN WILL PROVE TO BE ACCURATE.

The School District disclaims any obligation or undertaking to release publicly any updates or revisions to any of the information contained in the Plan to reflect any changes with regard thereto or any change in events, conditions or circumstances on which any such information is based.

Transmittal Letter from the Chief Recovery Officer

September 7, 2012

To the Members of the School Reform Commission:

Since this spring, management has indicated the need for a financing this fall to bridge an anticipated operating shortfall, and has stated that a Five Year Financial Plan would be required as part of that financing.[1] In order to complete the financing in October, the approval of the issuance of the bonds is required from the State Public School Building Authority at its September meeting. To facilitate that approval, I request that the Commission act to approve the attached Five Year Financial Plan for The School District of Philadelphia in advance of your next regular meeting.

The Financial Plan presents a major challenge to the District and its management. The School District faces approximately $200 million in annual structural shortfalls that were mitigated via one-time "fixes" in FY 2012, and hence roll forward into FY 2013 and beyond if not addressed. At the same time, the School District's costs are escalating. If we were to continue on a trajectory based on the FY 2012 cost structure, we would face a financial shortfall of approximately $1.35 billion over the planning horizon.

A shortfall of this magnitude necessarily brings with it difficult decisions, as this Financial Plan reflects. However, the Financial Plan also demonstrates that it is possible to bring expenditures back in line with revenues, but only with significant sacrifices.

Management must find recurring additional revenues or recurring additional expense reductions for the period FY 2014 to FY 2017 to reach structural balance. We are committed to that end.

As I discuss at greater length below, the Financial Plan is not a budget; it can and will evolve over time. So, an affirmative vote does not determine with certainty that the measures the forecast contemplates will all be implemented exactly as presented. The financial markets will look to you, the governing body, to constantly evaluate the School District's financial circumstances annually via this long-term planning model, and commit – with your vote – to the difficult steps that will be necessary to achieve and maintain financial balance.

The starting point for the Financial Plan is the straightforward vision you have set out for the School District: a safe, high quality education for every student, delivered in a manner that is fiscally

[1] As a matter of sound financial management and in accordance with the Accountability Agreement among the District, the City and the Commonwealth, the District would resume multi-year financial planning in any event.

responsible and sustainable. Guided by this vision, management recommends an approach to dealing with the shortfall that prioritizes the educational program, recognizing that means making hard choices elsewhere.

The Financial Plan is, importantly, a statement of what is currently possible – not what is ultimately desirable. This Financial Plan provides for only a base level of education services, limited by the means currently available to the School District. To be absolutely clear, to fully execute on the vision you have set out more recurring revenue will be critical going forward.

Like any organization in need of revenue, it is incumbent on the School District to demonstrate that we are managing efficiently and effectively. To that end, this document charts a course for the financial management of the School District for five years, marked by needed fiscal discipline and operating efficiency throughout the system. It sets out efficiencies we must achieve in our operations and with our personnel and charter partners. This is a course we must follow if we are to convince the investing community and our many stakeholders to provide the resources we truly need to support the educational system Philadelphia's children deserve.

Further, this document demonstrates the sacrifices our financial crisis is forcing on our students. Again, in our judgment, we simply cannot cut existing services in our schools further than they have been cut already. After a certain point, schools cease being schools. As noted, we must make painful choices elsewhere, and those choices are set in relief in the following major recommendations:

- We recommend that we borrow $300 million to finance our deficit for FY 2013 and part of FY 2014, because at this point the initiatives left to us to cut costs to achieve fiscal balance will take that long to implement. We must proceed with the greatest care; a deficit borrowing is an extraordinary action that we will not be able to undertake again in this planning horizon. Under the best of circumstances, we will be living with the payment obligations of this financing for some time to come, adding an estimated $22 million each year to our already significant debt service burden. And so we must make sure that we use the time this money buys to truly rebuild our financial underpinnings.

- We recommend closing a number of school buildings because they are underutilized and in poor condition, and the money we are spending on heating, cooling, cleaning, and repairing empty, dilapidated space could be better spent on teaching and learning. We realize that this may create confusion and disruption for many families, and so we take on this task seeking to ensure a better utilized system that will better serve our children. This will mean, in particular, paying close attention to the academic performance of school programs and separating them from the state of the buildings the programs happen to be in. Quality school programs must be preserved, even if their buildings must change.

- We recommend asking more of our employees to come to the table and contribute directly to the educational program of the School District, as the members of our largest blue collar union did this summer. We know that this will mean real sacrifices for hard working professionals who are already being asked to do more with less, under difficult conditions. We do this because without such assistance this Financial Plan cannot succeed, as the bulk of our expenses are in personnel costs.

- Most painfully, even given all these budget adjustments, we are left with a level of funding available for investing in the creation of new high quality seats that we do not believe is sufficient to fully implement the vision you have established. Management will continue to pursue the tradeoffs needed to expand high quality seats, but can only do so within the realities of our revenues and expenses.

Of course, as with any long term planning, none of these choices are set in stone. Circumstances will change, and we will need to change the plan along with them. For example, if we are able to achieve more savings than projected here, or receive new revenues, we would recommend that those new, additional funds received first be used to increase the investment in high performing seats. ***For now, we have a hole in our finances that we must fill before we can build anew.***

While recognizing this possibility for change in the future, this document makes only those assumptions about revenues and expenditures that are reasonable under the current circumstances. We believe that is consistent with the commitment you have made to candor and transparency about the fiscal state of the School District. Only by being plain about the facts of our circumstances can we begin the necessary public conversation about where we as a public school system go from here.

This is not a forecast that any of us like or want. However, I can say candidly, this Financial Plan is the only realistic course available given the constraints upon us. In every respect – academic, operational, financial – the School District is a "bare bones" operation. We face serious challenges, and will need help from every quarter over an extended period of time to overcome them fully. In the meantime, the entire School District is committed to your vision and using the resources we do have to deliver the highest level of education possible while maintaining a discipline of financial responsibility and sustainability.

Thomas E. Knudsen
Chief Recovery Officer and Acting Superintendent

School District of Philadelphia
Five Year Financial Plan for Fiscal Years 2013 - 2017

This Five Year Financial Plan presents a snapshot of the finances of the School District of Philadelphia (SDP) as best they can be understood and projected as of this date. Starting from a potential shortfall of $1.35 billion over a five year planning horizon – a shortfall driven by sharp drops in federal and especially state revenues in recent years, as well as growing obligations for wages, benefits, and charter payments – the Financial Plan presents an approach to closing that shortfall and achieving a balance between SDP's revenues and expenses. It also presents a compelling case for additional revenues to support the level of educational investment our students require. This type of long-term planning has not been practiced at the SDP for a number of years. The Financial Plan represents the commitment of the School Reform Commission (SRC) and SDP management to transparency and fiscal discipline, as reflected in the Education Accountability Agreement signed last year.

The Financial Plan sets out a specific scenario for matching revenues and expenditures. This exercise serves a number of purposes: it helps SDP leadership forecast and manage fiscal challenges years in advance; it helps elected officials and the public understand and make judgments about the scale and scope of those challenges and what levels and types of support are needed by SDP leadership to deal with them; and it helps financial markets make judgments about the levels of financing needed to meet the objectives in the Financial Plan.

What this Financial Plan does not do is anticipate a desired end state or commit the SDP to a specific set of actions or investments. Rather, it is a projection based on the known expenditure and revenue picture, with some very broad and basic assumptions applied to bring them into structural alignment where they diverge. Within the broad categories in which the Financial Plan calls for savings, there are options for how those savings might be achieved. Furthermore, as circumstances inevitably change over the course of the five year period – as revenue projections shift, new policies and programs are implemented, as students move into, out of, and around the City – the Financial Plan will evolve.

Indeed, it is important to understand that this is a living document. Of course, the closest-in years are best understood. Conversely, significant changes could occur by Fiscal Year 2017. Therefore, the SDP will maintain the practice of updating this document annually.

It is also important to be clear that this document represents a financial framework only. It does not contemplate specific reform strategies, like the "Achievement Networks" proposed in the spring of 2012. It projects forward spending levels on a core academic program that are comparable to current levels, without making a specific determination as to how that spending is structured.

Five Year Financial Plan: Context, Guiding Principles and Key Assumptions

The Five Year Financial Plan is intended as a guide to the efforts required to achieve structural balance over a long term planning horizon. As these efforts must take into account the organization as it currently exists, the Financial Plan cannot be understood as a standalone document, but must be considered in the context of the organization's recent history.

The planning work was made more difficult by the changes that immediately preceded it – two successive years of budget reduction efforts that had already trimmed many of the areas of greatest savings opportunity, including:

- **School Budget Cuts -- $264+ million**: Dramatic cuts to school budgets included reductions in nursing and counseling staff levels as well as cuts to sports, music, and arts programs.

- **School Operating Support Cuts -- $42+ million**: Dramatic cuts to school police, climate support professionals, maintenance staff, and other direct supports to schools.

- **Central Office Cuts -- $67+ million**: Dramatic cuts to critical central office functions like finance, accounting, and human resources. Central office staff were reduced by nearly 50%.

- **Reform Contract with SEIU 32BJ -- $100+ million**: In July 2012, SDP leadership signed a new collective bargaining agreement with its largest blue collar union that preserved jobs while restructuring wages and benefits and materially increasing operating flexibility to save the District over $100 million over the contract term. Direct contributions from the blue collar workforce to the educational mission of the organization will amount to as much as 10% of compensation over the life of the contract.

The cuts to school budgets and operating support for schools, in particular, resulted in direct cuts in service levels to students and families. With this in mind, it is especially important that the five year planning process be based on a clear, coherent set of principles guiding the call for any additional actions. Accordingly, SDP staff considered the following three principles when contemplating options for inclusion in the Financial Plan:

- **Impact on Students and Families**: Recognizing that improving school safety and student academic achievement are the SRC's top priorities, and the significant cuts already made to direct services to students, SDP leadership sought to put a "firewall" around school budgets, which meant looking for savings options that would not further reduce school level services.

- **Achievability:** One important purpose of the Financial Plan is to demonstrate that SDP leadership and the SRC have the resolve to bring revenues and expenditures into line. With this in mind, SDP leadership sought "achievable" savings, defined as savings that could reasonably be assumed to be derived from areas of "addressable" spend (spend not mandated by local, state, or federal law) where leadership has sufficient control and information to execute a savings or revenue producing strategy.

- **Savings Opportunity:** SDP leadership focused on the opportunities that offer the highest potential savings relative to required investments of time or dollars.

Working from this context and guided by these principles, the Financial Plan, like any long term financial projection, is based on a number of assumptions about the future of the SDP's revenues and expenditures to arrive at the balanced level demonstrated in the schedule below.

The table below reflects the Five Year Plan Projections for the School District's Operating Budget which is comprised of the General Fund, the Intermediate Unit Fund and the Debt Service Fund. The first column reflects the originally adopted Fiscal Year 2013 Operating Budget by the School Reform Commission on May 31, 2012, prior to the enactment of the Commonwealth Budget and the City Budget. The Estimated Fiscal Year Operating Budget for 2013 reflects the latest estimate prepared by the Chief Recovery Officer/Chief Financial Officer and includes the effects to revenues and expenditures based on those enacted budgets. The Fiscal Year 2014 through Fiscal Year 2017 columns reflect the currently projected Operating Budgets based on the assumptions detailed in the Five Year Plan.

THE SCHOOL DISTRICT OF PHILADELPHIA
PROJECTED OPERATING BUDGETS

As of September 7, 2012

(Amounts in Thousands)

	ADOPTED OPERATING BUDGET 2013	ESTIMATED OPERATING BUDGET 2013	PROJECTED OPERATING BUDGET 2014	PROJECTED OPERATING BUDGET 2015	PROJECTED OPERATING BUDGET 2016	PROJECTED OPERATING BUDGET 2017
REVENUES:	$	$	$	$	$	$
Local Sources:						
Total Taxes	895,192	838,721	880,264	922,635	946,315	969,787
Non-tax Revenues	90,491	110,861	104,146	105,432	107,518	109,906
Total Local Sources	985,683	949,582	984,410	1,028,067	1,053,833	1,079,693
State Subsidies:						
Gross Basic Education Subsidy	1,086,408	968,134	968,134	987,497	1,033,051	1,070,234
Less: Reimbursement of Prior Year I.U. Advances	0	(44,768)	(44,768)	(45,663)	(47,770)	(49,489)
Net Basic Education Subsidy	1,086,408	923,366	923,366	941,834	985,281	1,020,745
Debt Service Reimbursement	12,500	20,697	12,500	12,750	13,338	13,818
School District Special Education	127,611	127,611	127,611	130,163	136,151	141,052
Other	71,340	166,485	190,029	211,672	251,172	257,919
I.U. Advances	39,664	94,960	94,960	96,859	101,315	104,962
Total State Subsidies	1,337,523	1,333,119	1,348,466	1,393,278	1,487,257	1,538,496
Federal:						
Non-categorical	13,562	13,562	13,562	13,562	13,562	13,562
Total Revenues	2,336,768	2,296,263	2,346,438	2,434,907	2,554,652	2,631,751
Other Financing Sources	20,285	20,285	18,782	15,782	5,782	5,782
Total Revenues & Other Financing Sources	2,357,053	2,316,548	2,365,220	2,450,689	2,560,434	2,637,533
EXPENDITURES:						
Personal Services:						
Salaries & Wages	879,719	857,707	720,119	691,867	682,402	680,530
Employee Benefits	492,137	479,826	455,869	463,615	496,255	508,321
Subtotal	1,371,856	1,337,533	1,175,988	1,155,482	1,178,657	1,188,850
Professional/Technical Services	37,573	37,573	29,164	27,919	25,858	26,139
Utilities	65,353	62,153	48,158	48,726	51,384	52,561
Books, Supplies & Equipment	17,074	17,074	12,344	11,778	10,841	10,969
Debt Service	263,986	263,986	291,936	295,462	307,701	317,355
Non-Public School Services	13,118	13,858	13,967	13,993	14,351	14,689
Charter Schools	588,761	588,761	690,113	690,587	715,003	811,436
Property/Transportation/Communication	109,146	110,280	79,728	76,074	70,024	70,849
Payments to Other Educ. Entities & Alternative Programs	86,733	86,733	82,487	82,778	85,293	87,552
Other	383	(2,855)	(2,064)	(1,969)	(1,813)	(1,834)
New Investments in High Quality Seats	-	-	19,336	43,372	64,837	66,631
Subtotal Expenditures	2,553,983	2,515,096	2,441,155	2,444,202	2,522,136	2,645,196
Other Financing Uses	2,331	2,331	2,369	2,369	2,424	2,480
Total Expenditures & Other Financing Uses	2,556,314	2,517,427	2,443,525	2,446,571	2,524,560	2,647,676
Excess (Deficiency) Revenues and Proceeds Over (Under) Expenditures and Other Uses	(199,261)	(200,879)	(78,305)	4,118	35,874	(10,143)
Fund Balance (Deficit) July 1	(21,731)	(27,583)	74,538	294	4,412	40,286
Changes in Reserve & Designations	3,000	3,000	4,061	0	0	0
Proceeds of the 2012 Bonds	217,992	300,000	0	0	0	0
Fund Balance (Deficit) June 30	0	74,538	294	4,412	40,286	30,143

Some of the assumptions underpinning this schedule are projections based on historical experience and the best available intelligence, while others are based on a commitment by SDP leadership to make certain reforms to the SDP's cost structures.

Key Revenue Assumptions

- **Local Tax Revenues:**
    - Total local tax revenues are projected to grow modestly on an annual basis from the FY 2013 level of $950 million to an FY 2017 level of $1.1 billion. Revenue growth projections are based on growth rates set by the City of Philadelphia in its Five Year Plan for Fiscal Years 2013-2017 as approved by the Pennsylvania Intergovernmental Cooperation Authority on September 5, 2012.
    - Included within these figures is an assumption that the SDP will be able to benefit from certain improvements in the collection of delinquent taxes that are currently being implemented. The projection assumes $48 million in revenues from the collection of delinquent taxes over five years, beyond that which would be projected to be collected using simple historical trends. Currently, more than $150 million in outstanding taxes are owed to the SDP, much of it in little-known taxes like the "liquor by the drink" tax and the "unearned income" tax, which taxes investment income.

- **Local Non-Tax Revenues:** These revenues are comprised of a variety of sources. The largest among them is the City grant, which, so long as the SDP continues to operate under a declaration of distress, is projected to be maintained at approximately $68 million per year, as required by law. Other revenues in this category include receipts from the Parking Authority and a statutory fixed payment of gaming tax receipts, as well as interest on investments.

- **State Subsidies:** Total state subsidies are projected to remain effectively flat from FY 2013 through FY 2014, and then to grow at an average of 3.4% across FY 2015-2017. The exception to this trend is the 65% of pension costs that are reimbursed by the state, which grow in line with payments to the Public School Employees Retirements System (PSERS), as shown in the Financial Plan and described below. The revenues associated with PSERS reimbursements are captured in the "Other" subcategory under Revenues in the schedule above.

- **Other Financing Sources:**
    - This category of revenue is driven mainly by surplus property sales. The projection assumes $28 million from the sale of unused SDP facilities over the

    five year period – both facilities that were already closed and unused as of this date and facilities projected to be closed in FY 2013 through the Facilities Master Planning (FMP) process. Revenue projections for facilities that were already closed as of the time of publication were based on the appraised value for those properties. Revenue projections for properties closed through the FMP are necessarily an estimate, because no specific facilities have yet been identified for closure. That estimate is based on average values for SDP facilities, transaction costs, and the likelihood that a significant percentage of those facilities would not be immediately saleable.
  - In addition to surplus property sales, this category includes revenues related to transfers from other funds, like reimbursements for services funded by Medicaid.

- **Additional Revenues from Borrowing:** The SDP has received preliminary authorization from the State Public School Building Authority to issue a deficit financing of up to $300 million of bonds to acquire a leasehold in certain SDP buildings. The SDP will use the net proceeds of the bonds for the proposed deficit. The Financial Plan assumes that the full amount is borrowed in FY 2013.

Key Expenditure Assumptions

- **Personnel and Benefits:**
  - The growth in personnel costs that SDP has seen in the past is unsustainable. This includes growth in wage and benefit costs, as well as growth in pension costs, which are growing on an accelerated basis. PSERS expenditures, which are set by the Commonwealth to fund the state-run system, will constitute the following percentages of payroll over the planning period: 12.36 percent in FY 2013, 16.75 percent in FY 2014, 21.25 percent in FY 2015, 25.56 percent in FY 2016, and 26.26 percent in FY 2017, by which time the net expenditures on PSERS payments equals nearly $63 million.
  - SDP leadership intends to negotiate with its labor partners to achieve savings of between approximately $167 and $180 million per year over the course of the planning horizon, when compared to expenditure levels and contractual terms in place as of FY 2012. There are a number of ways these savings can be achieved, from wage and benefit restructuring to work rule changes. This Financial Plan does not presume any particular set of options, but rather sets a baseline savings level that must be achieved.
  - Workers in SEIU 32BJ agreed to a new contract in July 2012 that provided over $100 million in savings via direct contributions from members to the education

program – a figure representing as much as 10% of compensation over the term of the contract.

- **Operations**: Additional efficiencies will generate savings in Personal Services, Property, Transportation, and Books Supplies, and Equipment categories of expenses due to operational changes.
  - The bulk of these savings come from the SDP's building portfolio. The SDP's buildings are currently only 67% utilized – well below national best practices of 85%-95%. This underutilization costs the SDP money for maintenance, utilities, and additional staff that could otherwise go into teaching and learning. Moving to an 85%-95% utilization – which would require the closure of approximately 40 buildings, though that number could move up or down depending on the size and current utilization of the buildings actually selected for closure – is projected to save the SDP approximately $33 million annually beginning in FY 2014 (and more in later years if additional buildings are closed over time to maintain or raise utilization levels). A Facilities Master Planning process to manage these closures will proceed throughout the fall, with extensive community input on the criteria by which a closure strategy would be designed as an initial step.
  - Along with building closures, additional operating efficiencies are anticipated from more modern scheduling of bus routes, utilities savings due to lighting and boiler replacements in some of the SDP's oldest facilities, and other savings from more streamlined procurement for basic goods like office supplies and textbooks.

- **Debt Service:** Debt service assumptions include adequate funds for the maintenance of a) the SDP's existing long term debt, b) new debt for maintaining capital expenditure for each year of the planning horizon, and c) the debt service costs for the anticipated deficit borrowing discussed above.

- **Non-Public School Services:** This line item contains funds passed through SDP from the state to support state-mandated services to high-need students attending private or parochial institutions. The expenditures are projected to be relatively flat over the planning horizon.

- **Payments to Other Educational Entities:** These expenditures are primarily for Philadelphia students who are placed by the courts and City Departments of Health and Human Services in facilities located outside the City. Also included in this expenditure category are payments for alternative education schools and programs operated and managed by private contractors. The expenditures are projected to be relatively flat over the planning horizon.

- **Charter Schools**: Projections in this line item – with the exception of projections for cyber charter schools, which the SDP is responsible for paying but does not authorize – are based on anticipated expenditures for charter seats currently authorized (some of which are not authorized until future years, or are authorized but not yet filled).
  - State charter per pupil funding formulas presently dictate that charter payments rise and fall with district spending. Therefore, as the SDP trims its expenditures, charter per pupil payments will be reduced as well. The Financial Plan assumes that regular per pupil payments fall by approximately 7% in FY 2013 and then grow only 4.3% in total between FY 2013 and FY 2017 – reflecting the cuts of the last fiscal year and the minimal growth in the SDP's overall operating budget projected for that period.
  - Currently, so-called "cyber charters" are a rapidly growing expense. These charters, which are authorized by the Commonwealth, not the SRC, are able to scale up quickly and receive the same per pupil payment as their brick and mortar counterparts – approximately 38% of which is attributable to local revenues. Other districts across the region and country have developed successful models for district-run cyber schools that are much less expensive for districts' bottom lines than cyber charters. The SDP expects to develop this in-house online option for students and anticipates that it will reduce the number of students migrating to cyber charter schools versus the current projections for cyber charter growth, in which cyber charter seats are projected to grow from about 5,900 in FY 2013 to 10,750 in FY 2017. In this manner, it is projected that an SDP-run cyber school would save $14 million over the five year planning period.

<u>Limited Opportunity for New Investment in High Quality Seats</u>

Even with all the revenue and expenditure adjustments noted above, the funding currently available for investment in new high quality seats over the five year planning horizon is extremely limited. In this Financial Plan, only $194 million over five years is available for this work - substantially less than SDP leadership believes is necessary. In light of lower than anticipated recurring revenues, and the commitment to maintain already-reduced services at the school level, this is simply what is possible at this moment.

There are many scenarios for how such limitations could impact the SDP's investment strategy, affecting, among other items, the ultimate mix of new Promise Academy, Renaissance Charter, freestanding, lottery-based charter, and any other investments authorized over the period of the Plan to meet the SRC's objectives. Under any scenario, management will continually seek solutions to reduce the marginal cost of new investments and target those investments to the highest need, highest impact opportunities. This will ensure that the funds available stretch as far as possible.

The ultimate decisions about the mix of new investments, which are yet to be made, will be the result of many factors, including ongoing changes in state legislation, the performance and demonstrated cost-effectiveness of different options over time, and the policy direction set by the SRC. At this point, therefore, the level of funding available cannot be correlated with any specific investment program or number of seats to be created. What is clear, however, is that unless there is a significant change to the fiscal environment in which the SDP is operating – in particular, new sources of revenue – the funds available for making any investments in high performing seats beyond current levels will be inadequate.

Conclusion

Only with the implementation of *all* of the measures listed above – or others identified at a later date offering similar levels of savings and/or revenues –is the Five Year Financial Plan balanced. This has two clear implications:

First, any shortfall in one area of this Financial Plan magnifies the requirement on other areas.

Second, if revenues or savings beyond these levels are realized, the first priority will be to increase funding to investments in growing the availability of high quality seats. Recognizing the limit on the funding levels available for this activity was the most difficult element of preparing this Financial Plan. As such, it will also be the first place funding is restored if conditions improve – a reflection of the commitment of this organization to placing teaching and learning first.

Importantly, public engagement on the issues in this Financial Plan will continue for some time to come. While the Financial Plan calls for the enactment of general initiatives within specific periods of time, like the closure of buildings to achieve a certain utilization and savings level, it does not determine *how* those initiatives will be implemented. Nor does the Financial Plan determine or adopt any organizational and/or governance changes – like the previously proposed Achievement Networks - that may be considered separately as the SDP adapts to best deliver educational services over the planning period. As is consistent with the commitment of the SRC to meaningful and extended public engagement, initiatives that directly impact members of the school community will move forward only after dedicated and specific outreach to arrive at the best approach.