



**TO:** Member of the Board of Education  
Dr. Jennifer Cheatham, Superintendent

**FROM:** Mike Barry

**DATE:** January 26, 2017

**RE:** Financial Analysis - IMA as an Instrumentality Charter School

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If IMA were an instrumentality charter, MMSD *resident* students attending IMA would be included in the district's 3<sup>rd</sup> Friday September count and Revenue Limit. Under the Revenue Limit formula, each *additional resident* student adds approximately \$11,500 of revenue authority to the district's revenue total.

On the expenditure side, new MMSD charters are expected to hold per-student expenditures to an amount not-to-exceed the Open Enrollment transfer amount, or approximately \$7,000 per student.

Thus, the initial look at the financials appears to be quite favorable for chartering IMA, given the potential for \$11,500 of revenue versus (\$7,000) of expenditure per each student added to MMSD's enrollment count, or a net positive margin of \$4,500 per student. However, closer examination of the following factors is necessary to get a more complete and accurate view of the financial impact of IMA on MMSD:

#### Who Gets Counted?

The IMA head count must be adjusted to exclude 3-year olds, since the Revenue Limit formula does not include that age group in the K-12 count. (Special grant programs may be available.) Also, 4-year olds can be counted at no more than 0.60 FTE, since the state will fund part-time, but not full-time 4K. Finally, MMSD can count only resident students, which excludes students who live outside MMSD boundary.

#### Revenue Limit 3-Year Phase In

The Revenue Limit formula uses a three-year rolling average of enrollment, which is intended to smooth out changes in year-to-year enrollment. Therefore, it will be three years before the district can realize the full per-student revenue associated with the additional students. Since the revenue limit formula uses a 3-year rolling average, we can expect revenues to trail expenditures until year three.

#### Vacuum Effect and the Lottery

If IMA enrolls students who are transferring from other MMSD schools, and therefore already included in the MMSD 3<sup>rd</sup> Friday count, there is no overall Revenue Limit increase for MMSD. Our financial modeling indicates that a 50/50 split for student enrollment (half being new to MMSD and half being transfers of existing students) would be necessary for the proposal to be budget neutral to MMSD by year three. (See table).

For students transferring from other MMSD schools, there may be a cost reduction in the schools from which the transfer occurred. However, this difficult to model, since it is a step-variable cost. We will assume a cost reduction of \$1,500 per student who transfers out. While this might not hold true on a specific grade/school level, it may hold true on a macro level across the district.

As an instrumentality charter, the initial enrollment of IMA would be determined with preference given only for residence within the attendance area, then residence within MMSD generally. If applicants exceed seats, then an initial general lottery would determine the award. We assume no preference for prior IMA attendance (no grandfathering) in the initial lottery, which could mean current IMA students are displaced through the lottery process if applicants exceed seats.

In theory, if all seats awarded through a lottery went to ‘new to MMSD students’ then MMSD would have minimal financial risk, since each *additional resident* student adds approximately \$11,500 of revenue authority to the district’s revenue total, and the expenditure per student is approximately \$7,000.

On the other hand, if all seats awarded through a lottery went to ‘existing MMSD students’ then MMSD would have significant financial risk, since students transferring from other MMSD schools are already included in the MMSD 3<sup>rd</sup> Friday count, resulting in no overall Revenue Limit increase for MMSD, while the expenditure per student is approximately \$7,000.

The charter contract can specify the attendance area and annual enrollment goal per grade, which can help control the financial risk associated with the vacuum effect.

Expenditures and Standards

Existing MMSD charters (two middle schools, one elementary) have per student expenditures greater than \$11,000 per student. Per MMSD rules, IMA’s expenditure target is approximately \$7,000 per student. Can the school meet MMSD standards at this expenditure level? (Note: 2X charter rules allow approximately \$8,100 per student).

Tax Levy and Equalization Aid Impact

If IMA were an instrumentality charter, there would be an increase the local tax levy in each of the first the first three years. However, starting year two, additional state aid would be awarded to MMSD, a portion of the tax levy impact (see table). The aid impact is difficult to model due to the many other factors which affect it.

Net of Revenues and Expenditures

We would expect revenues to trail expenditures in years 1 and 2, before nearly breaking even in year three. The key factor will be the vacuum effect. See chart.

*These Three Enrollment Scenarios Demonstrate How the Financial Results are Dictated by the Overall Enrollment and Extent to which Students Enrolled in an IMA Charter are New-to-MMSD or are Existing MMSD Students who Transfer to IMA*

<b>If All Students Enrolled at IMA Charter are New to MMSD</b>	Various Student Enrollment Levels at IMA	IMA Expenditures at \$7,000 per Student	Possible Expenditure Reduction at Existing MMSD Schools	Revenues if All Students are New to MMSD	Net Revenue to Expenditure Impact based on Enrollment
	75	(525,000)	DNA	900,000	375,000
	100	(700,000)	DNA	1,200,000	500,000
	125	(875,000)	DNA	1,500,000	625,000
	150	(1,050,000)	DNA	1,800,000	750,000
	175	(1,225,000)	DNA	2,100,000	875,000
<b>If Half of Students Enrolled at IMA Charter are New to MMSD</b>	Various Student Enrollment Levels at IMA	IMA Expenditures at \$7,000 per Student	Possible Expenditure Reduction at Existing MMSD Schools	Revenues if Half of Students are New to MMSD	Net Revenue to Expenditure Impact based on Enrollment
	75	(525,000)	45,000	450,000	(30,000)
	100	(700,000)	60,000	600,000	(40,000)
	125	(875,000)	75,000	750,000	(50,000)
	150	(1,050,000)	90,000	900,000	(60,000)
	175	(1,225,000)	105,000	1,050,000	(70,000)
<b>If No Students Enrolled at IMA Charter are New to MMSD</b>	Various Student Enrollment Levels at IMA	IMA Expenditures at \$7,000 per Student	Possible Expenditure Reduction at Existing MMSD Schools	Revenues if No Students are New to MMSD	Net Revenue to Expenditure Impact based on Enrollment
	75	(525,000)	90,000	0	(435,000)
	100	(700,000)	120,000	0	(580,000)
	125	(875,000)	150,000	0	(725,000)
	150	(1,050,000)	180,000	0	(870,000)
	175	(1,225,000)	210,000	0	(1,015,000)

Table Notes:

- 1) The table above illustrates the wide range of possible financial outcomes for MMSD depending on the overall enrollment of an IMA charter and whether those enrolled are existing MMSD students or

are new-to-the-district. The risk exposure can be managed by narrowing the attendance area, limiting the number of seats per grade, better defining the rules of the lottery process and even the grade range for the school. These issues surfaced during the Charter Review Team meetings and would need to be finalized in a contract document.

- 2) The attached document models the scenario “If half of students enrolled at IMA Charter are new to MMSD” in more detail.

### **IMA as a 2x Independent Charter School**

The revenue mechanics are essentially the same whether IMA is chartered as an instrumentality by MMSD or as an independent 2x charter by the OEO. In either case, MMSD resident students are added to MMSD’s membership count and increase the MMSD Revenue Limit by approximately \$11,500 per student. However, if IMA became an independent 2X charter, MMSD would have no means of managing the growth and vacuum effect of the school, which could have a negative impact on MMSD. If IMA were a 2X charter, the cost to MMSD would be \$8,188 per year under current law. Under the 2x rules, we would expect revenues to trail expenditures in years 1 and 2, before nearly breaking even in year three. The key factor will be the vacuum effect.