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THE 2010 CONTRACT SETTLEMENT BETWEEN THE GROSSE POINTE PUBLIC SCHOOL SYSTEM AND THE GROSSE POINTE EDUCATION ASSOCIATION

A Narrative History

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Introduction

The May 2010 contract settlement between the Grosse Pointe Public School System and the local teachers union, the Grosse Pointe Education Association (GPEA) was one of the most significant events in the history of the district.

Having served on the Board of Education from August 2005 through March 2013, this document offers my perspective. As much as possible I have tried to avoid too much editorializing, but it would be impossible to treat this as an impartial history.

The time on the board at that time was intense and draining. The country was fundamentally changing in the aftermath of September 11, 2001 – an event that launched the State of Michigan into recession and ultimately a one state Depression. As the Michigan economy melted down with massive job loss, state revenues began to drop.

Since the state provides the majority of local school funding and state law prohibited school districts from raising their own operational tax levies, something – many things – were going to have to give. In a community like Grosse Pointe that is resistant to change, this was a difficult path to navigate.

This document attempts to recount the more narrow financial aspects of that journey. Focusing on the economics, however, removes some of the color of the time, which was decidedly tense, anxious and quite angry.

All of the data referenced here is publicly available, mostly still available on the GPPSS website. As readers come across references in the document, or on any matter that may raise question, I welcome contact via my website.

Some will undoubtedly question my motive for writing this piece. The honest answer is, as difficult and demanding as this time was, I enjoyed the ride and think it is a history worth capturing and sharing. Only wonks like me may find it as interesting, but it should be instructive to others who serve on school boards in Grosse Pointe or elsewhere in the future or others who like more detail on past events.

Getting to know The Formula Clause

The contract (available here) is complex and the events leading up to its ratification even more so. School finance and employee compensation can be emotional topics.

The most discussed element of the contract is often called "the formula clause," contained on p. 69, Appendix C of the above linked contract, but there was much more to it than that.

The contract took signed on May 18, 2010 with retroactive effect to September 1, 2009.

The formula clause established that two years after the contract was signed, beginning in the 2012-13 school year, teacher salary schedule, that will be discussed below, would be automatically adjusted up or down in relation to the district's General Fund equity, referred to commonly as fund equity, fund balance or fund surplus.

Defining Fund Equity

Fund equity is a district's accumulation of cash on hand, accounts receivable, inventory and pre-paid assets. It can be authorized for use by the Board for nearly any one-time or ongoing expense. A large portion is accounts receivable as state aid payments, the largest source of revenue to the general fund, lag the start of the school year.

Districts in Michigan receive guidance from the Michigan School Business Officials to keep fund equity levels somewhere between 15% and 20% of the district's annual expenditures. In GPPSS' case, annual expenditures have averaged around $100 million for the last ten years. So fund equity between $10 and $15 million has long been the goal of the various boards. Fund equity is one of a school district's few protections against unanticipated revenue loss or cost increases – which would prove to be the story from 2007 to 2011 as the Michigan economy descended into Depression.

This graph shows actual ending general fund equity for the ten years from 2003-4 to 2013-14 and current district projections through 2016-17. Since the general fund budget has been typically close to $100M, the numbers are reasonably close to a fund equity percentage.

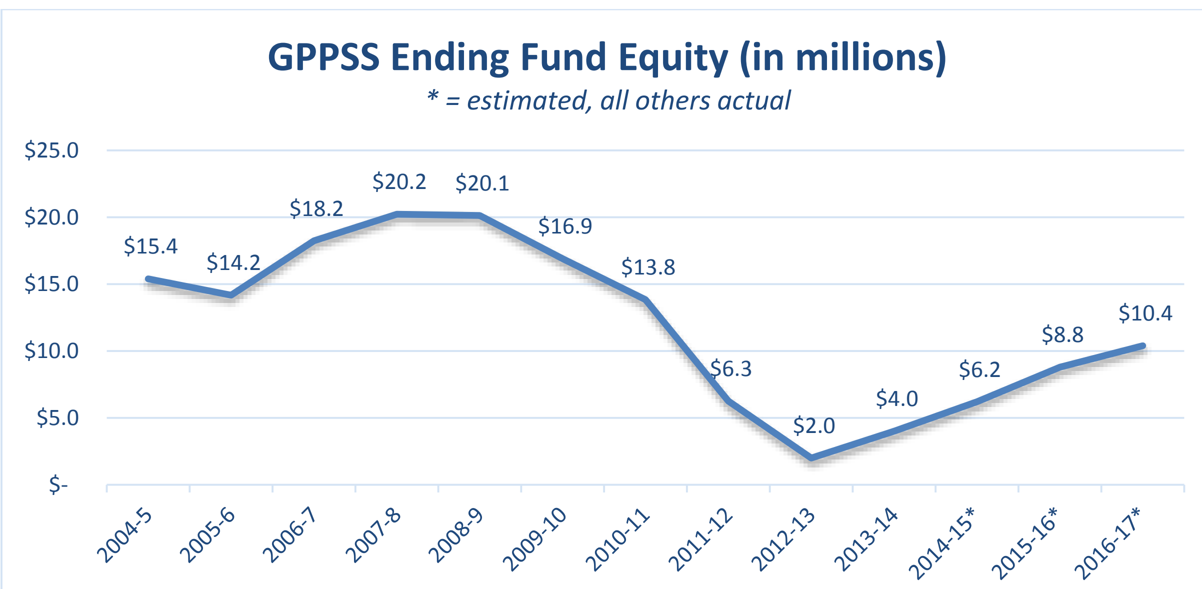


Figure 1: GPPSS ending fund equity

The contract formula and fund equity

The formula clause established that upon conclusion of the annual independent financial audit of the 2011-12 school year that if fund equity went below 10% of total district expenditures then the employee bargaining units' direct compensation would be reduced in proportion to how much each bargaining units' total compensation consumed of the total budget in order to return fund equity to 10%. The same language would apply in successive years.

In total, all the employee bargaining units consume about 85% of the General Fund budget. The teachers consume about 66% of the 85%. Eight other bargaining units consume the rest. Non-human resources costs have consumed the remaining 15% or so.

The chart below shows a distribution of employee bargaining units as a percentage of the total general fund expenditure as projected at the November 22, 2012 board meeting.

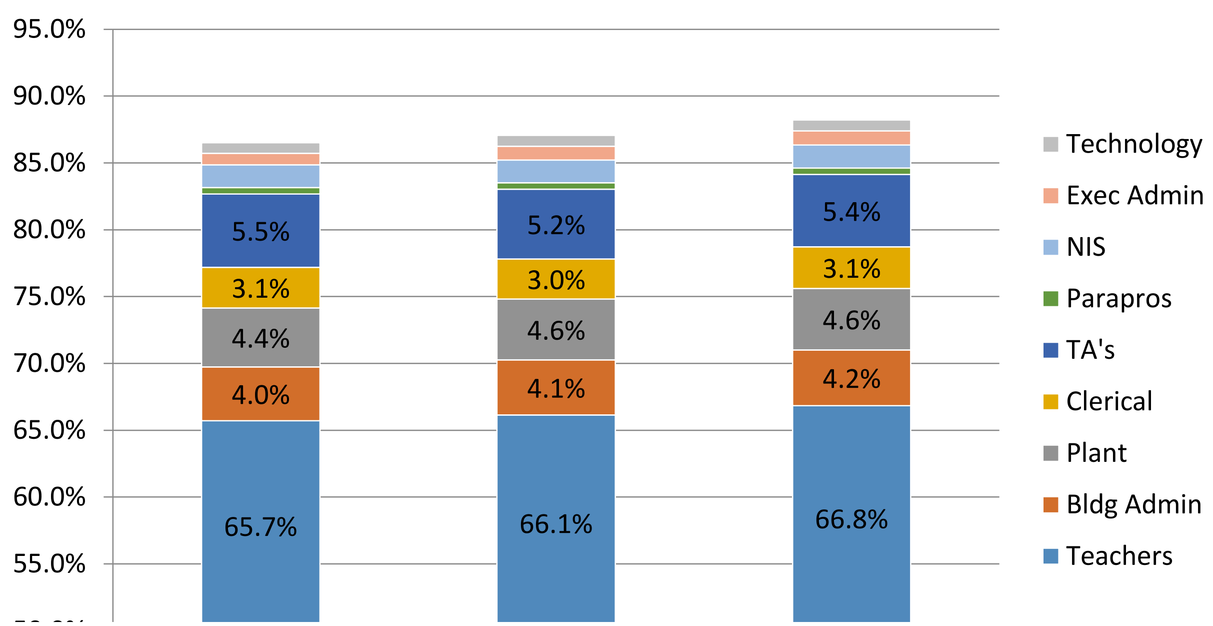


Figure 2: GPPSS bargaining unit costs as a % of total expenditures

The formula also allowed that if the 2011-12 audit showed fund equity had exceeded 15%, half of the excess would be returned to employees as "off-schedule" salary increases – again in proportion to their budget allocation. At the time the contract was signed, the district's fund equity was thought to be about 20%. In actuality, it was about 17%. The difference between originally adopted budgets and what the audits would later show is a key part to this story and will be treated thoroughly in this narrative.

Contract effect on the salary grid

The formula clause has gotten so much attention, quite rightly, that it is easy to forget the many other changes the same contract brought – such as the addition of three steps to the teacher salary grid. For a technical explanation of a salary grid, please review this article I published in January, 2010.

Here's the shorter version. A teacher salary grid is the schedule by which teachers' annual salary is established. The eleven steps in the GPEA contract leading into the 2009-10 negotiations increase pay based on years of service.

Teachers progress on lanes by getting post-graduate credits, Masters and Doctorate degrees. For example, the "BA+20" lane of the salary grid indicates teachers who have an undergraduate degree and 20 graduate course credits.

The salary grid embeds compensation increases in the contract. Any time a teacher moves up a step or over a lane, salary automatically increases. Raises, when discussed in the context of a contract, simply increase all the cells (step and lane position) of the salary schedule.

The 2009-10 distribution of teachers on the salary grid is shown in the first chart below. The cell with the highest number of teachers is "MA+60 on the 11th step, which has an annual salary of $91,472, as shown in the lower chart which is the salary schedule in 2009-10 before the new contract was established. 77.5 teacher FTE's held that position on the grid.

513, or 88%, of GPPSS teachers had Masters Degrees in 2010. 342, or 60% of teachers, occupied the top 7 highest paying positions of the 121 cells (11 steps times 11 lanes equals 121) on the salary grid.

2009-10 Teacher Distribution Across Salary Grid (Teachers per step/lane)											
	Lanes										
Steps	BA	BA+20	BA+30	MA	MA+10	MA+20	MA+30	MA+40	MA+50	MA+60	Dr
1	0.00	0.00	1.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00
2	3.70	1.00	0.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00
3	1.70	2.00	2.00	3.00	1.00	1.50	1.00	0.00	0.00	0.00	0.00
4	2.40	2.00	2.00	13.00	1.50	0.00	3.60	0.00	0.00	0.00	0.00
5	1.00	0.00	3.00	1.00	2.00	3.60	5.00	0.00	2.00	2.00	0.00
6	0.00	0.00	2.00	2.00	4.50	6.80	1.00	0.00	0.00	2.00	0.00
7	0.00	1.80	1.00	10.90	5.00	4.00	4.00	0.00	1.00	2.00	0.00
8	1.00	1.00	3.00	4.00	2.00	1.00	1.00	2.00	0.00	1.00	0.00
9	0.00	4.00	1.14	3.20	11.00	6.00	2.00	5.00	5.00	1.00	0.00
10	0.00	1.00	0.00	10.00	7.00	7.50	8.00	5.70	1.00	3.00	0.00
11	2.00	6.80	19.58	14.20	46.33	72.50	54.90	46.40	26.20	77.50	4.00

2009-10 Teacher Salary Grid (Annual Salaries)											
	Lanes										
Steps	BA	BA+20	BA+30	MA	MA+10	MA+20	MA+30	MA+40	MA+50	MA+60	Dr
1	$41,839	$43,852	$44,858	$50,202	$51,204	$52,215	$53,217	$54,227	$55,222	$56,233	$57,737
2	$44,769	$46,781	$47,777	$53,297	$54,305	$55,310	$56,310	$57,313	$58,319	$59,324	$60,836
3	$47,702	$49,703	$50,703	$56,401	$57,412	$58,408	$59,414	$60,418	$61,421	$62,429	$63,933
4	$50,372	$52,384	$53,387	$59,156	$60,166	$61,170	$62,171	$63,174	$64,181	$65,186	$66,692
5	$53,055	$55,067	$56,070	$62,298	$63,303	$64,308	$65,311	$66,325	$67,318	$68,323	$69,836
6	$55,727	$57,737	$58,745	$65,066	$66,067	$67,066	$68,075	$69,075	$70,084	$71,087	$72,594
7	$58,408	$60,418	$61,421	$67,832	$68,828	$69,836	$70,664	$71,840	$72,853	$73,851	$75,359
8	$60,970	$63,102	$64,100	$70,966	$71,967	$72,970	$73,978	$74,974	$75,980	$76,990	$78,499
9	$64,146	$66,144	$67,158	$73,721	$74,728	$75,724	$76,735	$77,741	$78,744	$79,740	$81,255
10	$67,985	$69,993	$71,011	$77,880	$78,885	$79,892	$80,901	$81,912	$82,907	$83,912	$85,417
11	$74,899	$76,915	$77,917	$85,452	$86,456	$87,451	$88,453	$89,465	$90,472	$91,472	$92,986

Figure 3: GPEA salary grid in 2009-10

Not noted in the salary grid are Longevity Payments. The contract had three levels of longevity payments of $1,690, $2,536 and $3,380 – each an annually recurring payment (direct compensation) for once a teacher had achieved 10, 18 and 25 years of service in the GPPSS.

Adding steps to the salary grid was particularly significant in 2010 since it gave raises to the 64% of teachers who were on the 11th and highest step. The May 2010 added three steps - a 12th, 13th and 14th. Using the most populated cell as an example, the new salary schedule would have the following effect:

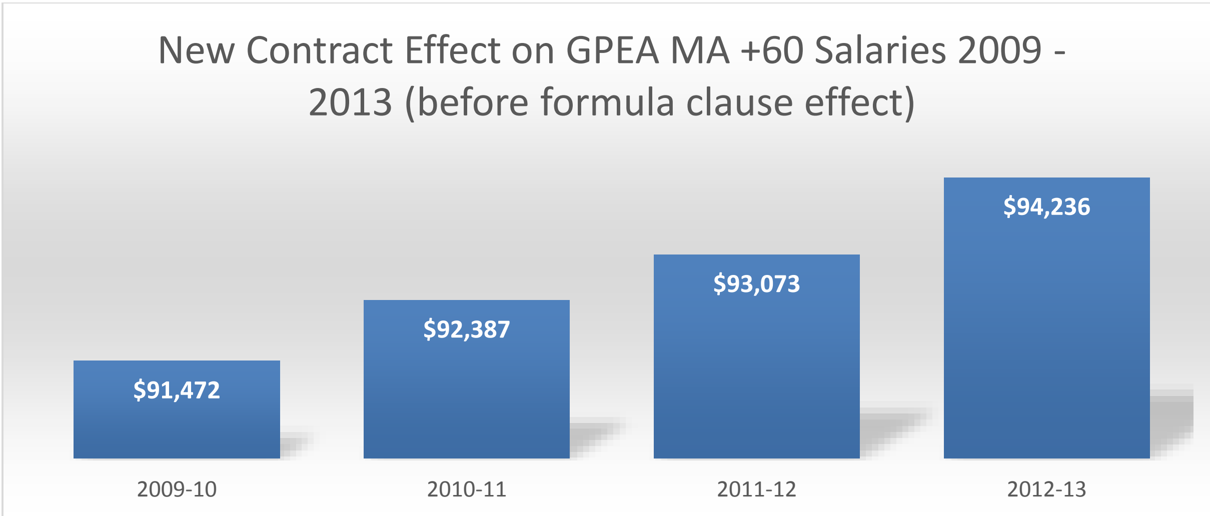


Figure 4: Effect of new contract on MA +60 salaries

The new contract's 12th step would be in effect in the 2010-11 school year, the 13th in 2011-12 and the 14th in 2012-13. In total, the net change to the salary grid would be a 3% total increase in salary payments.

That would of course be pending the results of the 2011-12 audit which would serve as the basis of the formula clause. If fund equity were to come in below 10% after the 2011-12 school year, the salary grid would be adjusted down. We now know, of course, that that did happen – the net effect of the increases of 2010 through 2012 will be analyzed later.

Another key salary grid change in the May 2010 deal was the creation of a second salary schedule that would be used for teachers hired after the ratification of the contract. The second schedule differs from the first in two ways. It added yet another two steps (up the 16) and reduced the number of lanes from 11 to 7.

The step changes meant that it would take newly hired teachers two years longer to get to the highest salary level within a lane. With fewer lanes, it created less of an opportunity for salary progression. The aggregate effect is the slowing down of salary increases.

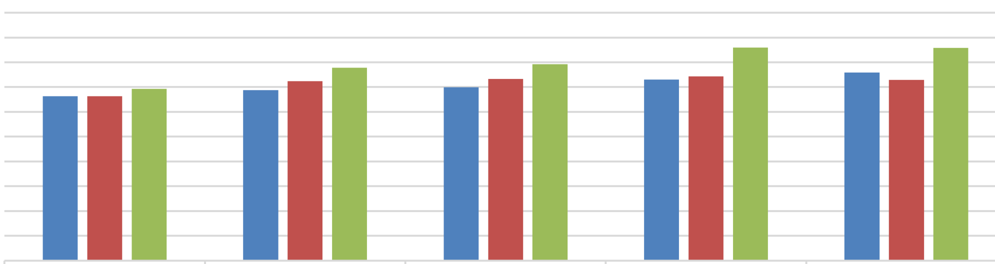
This came from research that compared the GPPSS salary grid to other districts, such as Birmingham and Bloomfield – both of which had (and still have) even fewer lanes and the average salary figures compared among them showed that the more lanes a district had, the higher the average total teacher direct compensation.

The chart below provides a snapshot of GPPSS in relation to Birmingham and Bloomfield in the years leading up to the new contract.

Readers should not presume that from 2004 to 2009 that GPEA members got raises that average $16,000 in this time. The average salary increase is at least partly attributable to the reduction of teachers over this time.

About 25 teaching jobs were cut at this time as the district braced for the financial storm. Teachers who lost their jobs were those with the least seniority and thus the lowest paid. Reducing the lowest paid teachers would drive the average salary figure higher.

The very dynamic of responding to financial contraction by cutting teachers and other staff is extremely important to the narrative. Responding to revenue loss by cutting programs and raising class sizes (both of which drive teacher job loss) then the district was relying on a financial strategy that would only degrade services. This was one of the main drivers of the formula.



	2004-5	2005-6	2006-7	2007-8	2008-9
Birmingham	$66,282	$68,736	$69,902	$73,025	$75,890
Bloomfield	$66,268	$72,371	$73,352	$74,340	$72,966
GPPSS	$69,348	$77,843	$79,284	$85,985	$85,828

Figure 5: GPPSS teacher salaries compared to Birmingham, Bloomfield Hills

The Early Retirement Incentive

The construction of the new salary schedules went hand in hand with another major component of the 2010 agreement with the GPEA – the offer of an Early Retirement Incentive, or ERI.

ERI's are designed to give teachers at the high end of the grid incentive to retire so younger, lower cost teachers could take their place. The ERI offered $40,000 to any retirement eligible teacher at the end of the 2009-10 school year. It was a one time offer.

With the new contract, a starting teacher in 2010 would join the new salary schedule that would pay a BA on step 1 $39,366. Recall now the most populated cell on the legacy salary schedule – the MA +60 –paid $91,472 in base salary plus (in all likelihood) a Longevity payment of $3,380.

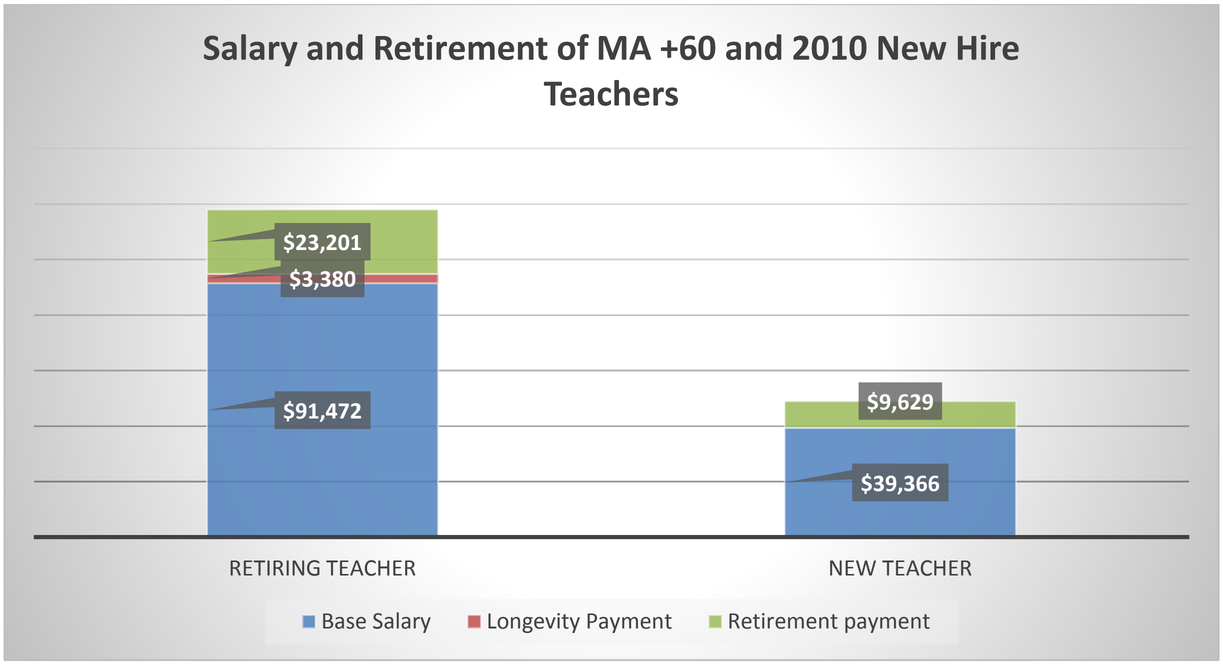


Figure 6: GPPSS new and MA +60 teacher salary and retirement cost comparison

In total, the effect of a retiring MA +60 teacher replaced by a teacher newly hired in 2010 was a $70,000 cost reduction. If this scenario happened just 30 times (a reasonable assumption) the total cost reduction would be $2.1 million in the first year.

The ERI, though, would have to be funded. The GPEA wanted $40,000 for each retiring teacher. The board had estimated that as many as 60 teachers would take the deal, which would cost $2.4 million. The ERI would be a direct hit to fund equity, but the bet is that those funds will be replenished by the lower teacher salary and retirement costs over time.

The concern was always whether the step and lane increases that would follow consume that cost benefit too quickly?

ERI's were well known to the district. Two had been offered in the previous several years and they proved to never really deliver permanent budget stabilization – as evidenced by the events leading into the 2010 agreement. Data from the aftermath of the settlement proves so again.

But the GPEA wanted the ERI badly. I was skeptical of the strategy and apparently the GPEA knew that. A long-standing and well respected GPEA member even asked to meet with me privately to lobby me on the ERI. It was the last thing the board would agree to in order to close the new deal.

Time would tell if the ERI delivered any significant long-term financial benefit. As this narrative is being written with fund equity rebounding from a low of 2%, the answer is not a great mystery.

Summary

As a brief summary, the most salient characteristics of the four year (2009 to 2013) contract between the GPPSS Board of Education and the GPEA that was enacted on May 18, 2010 were:

- The teacher salary grid that previously had 11 steps had three steps added to it that would deliver a 3% total increase to the majority of teachers who were employed by the district at time of the contract signing. The grid continued to have 11 lanes.
- A second teacher salary grid for teachers who would be hired by the GPPSS after the contract was signed. This grid was different from the legacy grid because it had 7 lanes and 16 steps which meant pay increases would be more gradual.
- A formula was established that would affect teacher pay in the 2012-13 school year based on the independent financial audit of 2011-12. If the audit showed the General Fund equity below 10%, teacher pay would be reduced. The clause would remain in effect in subsequent years to ensure fund equity would remain at least 10% of annual expenditures.
- Teachers were offered an Early Retirement incentive that paid $40,000 to teachers who retired at the end of 2009-10.

It's far easier to summarize the aspects of what became the final deal than it was to get there. The weeks and months leading up to the May 2010 agreement were tumultuous. People were angry, suspicious and anxious – not what would be expected of a district with $20 million of fund equity, but that was oddly one of our problems.

A different kind of fund equity problem

In the spring of 2010, the board was in a terrible bargaining posture and we knew it. Fund equity had increased (Figure 1) from 2005 to 2009 - from $13 million to $20 million. Despite this growth, the board was still uneasy – particularly in the aftermath of the October 2009 cuts made by Michigan Gov. Jennifer Granholm, which will be discussed below.

The board also knew it could not use fund equity to finance salary increases while also staving off rapidly rising retirement costs. Fund equity was of little protection against the threats that loomed. The board wanted a permanent solution to the annual budgeting challenges that were tearing the community apart. Using fund equity was not a long-term solution.

The GPEA stoked the angry flames of their membership by telling them that the growth in fund equity was a direct result of their concessions. This explanation may have helped the GPEA galvanize the support of membership, but it was hardly an accurate claim.

The unpleasant increase of fund equity

The ride to that $20 million fund equity position was far from pleasant and most certainly did not mean times were good.

Taxes were increased with the Sinking Fund in 2003 – a move that allowed the district to reduce general fund spending by $3 million and repurpose it mainly for employee compensation. Fund equity growth was at least partially attributable to that, which was not a teacher concession, but rather a taxpayer concession.

Pay for play sports was introduced, an action (among others) that led to a recall campaign against 5 board members in 2005. The recall was later dismissed. The GPEA continued to call for increases in pay to play sports, as did some community members, but certainly not a majority of them.

Cafeteria services were outsourced in 2005 as well and many had expected the custodians to follow. Indeed that option was seriously evaluated by the board, which itself incited the anger of many citizens and staff. Ultimately the custodians were not outsourced, but they took significant concessions.

The middle school day was reduced from 7 to 6 periods in a move that reduced 10 teachers. Looking back on my board service, this was the budget decision I came to regret the most. The bitterness of having to make this cut was a major driver for me to find a better solution. It bothered me that budget contraction was being solved by firing people. Why couldn't every sacrifice a little rather than asking a small percentage to sacrifice all their pay?

Because that is what was happening. Jobs were being slashed.

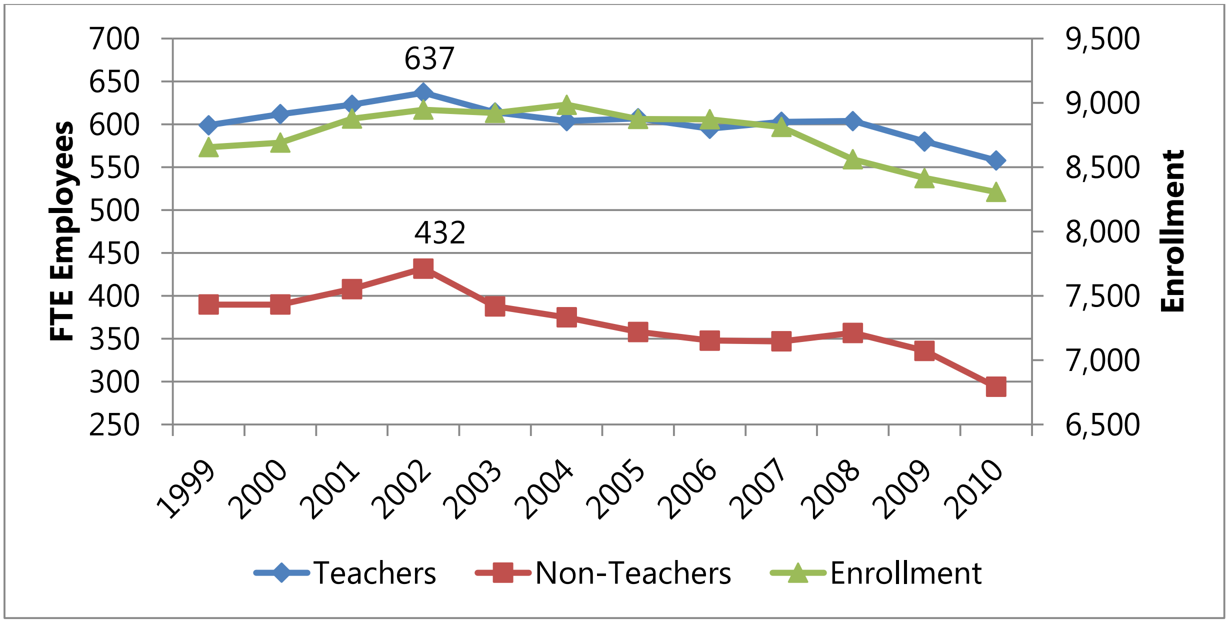


Figure 7: GPPSS FTE employees and enrollment from 1999 to 2010

In 2002, the district had 432 non-teaching full time equivalent staff. By 2010 nearly a third would be gone, plummeting to 294. That was most definitely not a teacher concession.

Teacher FTE's also fell, but not as precipitously as non-teacher ranks. In 2002, the district had 637 teachers. In 2010 we had 570, a 10.5% reduction while enrollment had fallen only 7%.

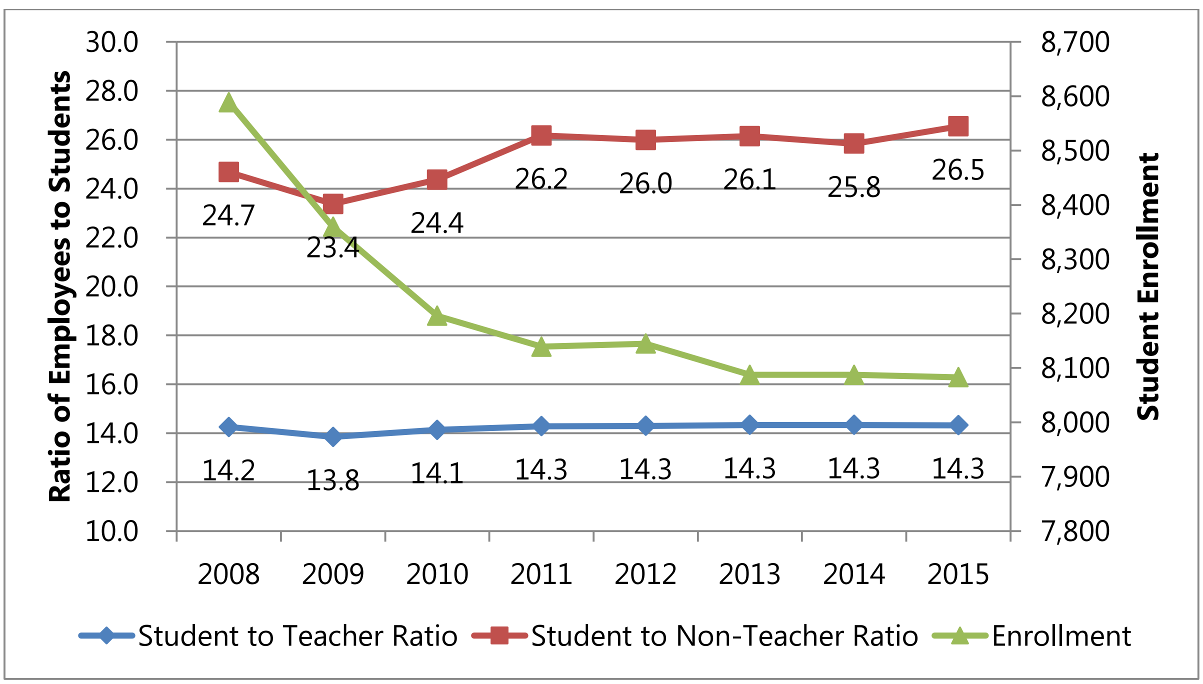


Figure 8: Ratios of teaching and non-teaching staff to enrollment

Figure 8 above makes it clear that the district adjusted teaching staff levels in reasonably consistent proportion to student enrollment.

Sadly the same was not true for non-teaching staff – particularly secretaries and custodians.

All of this brought major strife to the community and was the prologue to the GPEA negotiations in 2009 and 2010. Fund equity had increased, but at a huge price to student services, jobs, and community anxiety. The higher fund equity would prove valuable in the end, but not as people had expected.

The budgeting challenge

Another important backdrop to the contract settlement was the difficulty in building an accurate budget. The challenge of defining all the variables required to build the budget contributed to the rising – and later rapidly decreasing – fund equity.

For the ten year period from 2004 to 2014, the district budgeted – in aggregate – very accurately. But in any given year, even small misses could add up. A 1% budget miss is equal to about $1 million in the GPPSS budget.

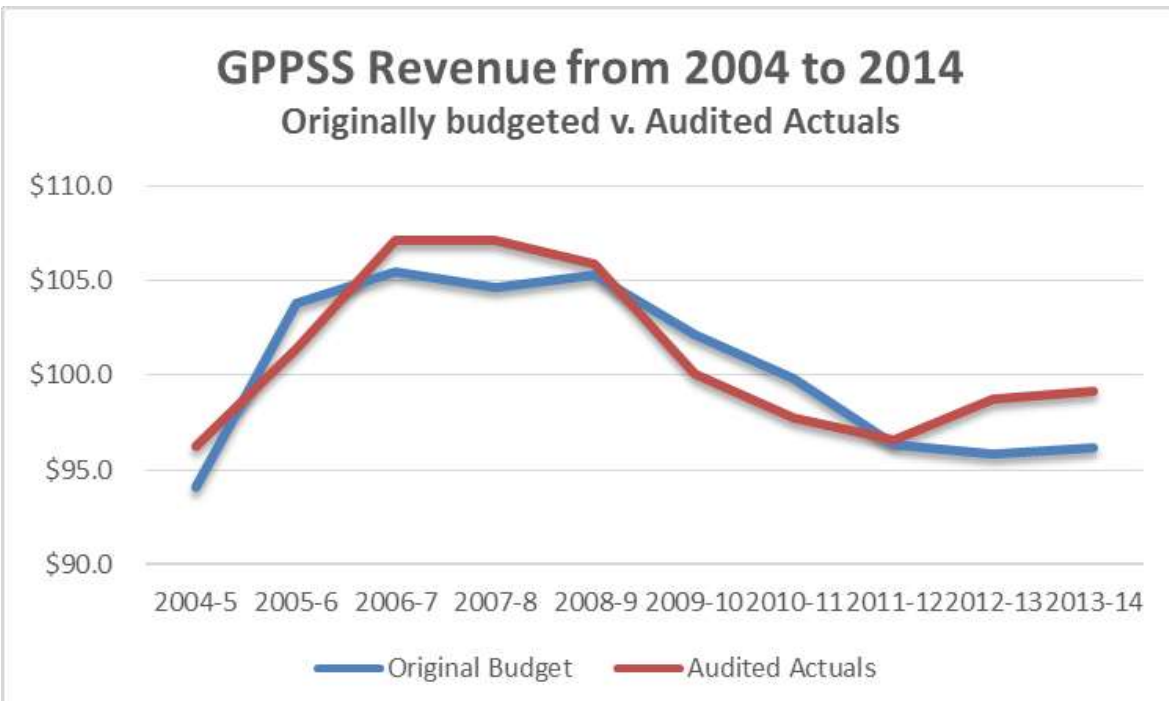


Figure 9: GPPSS revenue from 2004 to 2014

Figure 9 above shows that audited actual revenue came in higher most years from 2004 to 2009. The underestimated revenue forecasts from 2004-5 through 2008-9 totaled $4.4 million. This was a major contributor to that rising fund equity.

The pendulum later swung back. Revenue was overestimated in 2010 and 2011 - $4.2 million in total – contributed to a $6.3 million reduction in fund equity in that time. Revenue forecasting from local, county, state and federal sources was always a challenge and will be discussed below.

The enrollment issue

Enrollment was the biggest driver, both up and down, to forecasting revenue – and it was a massive wildcard. On average each student delivers about $10,000 of revenue to the district. It is no coincidence that Schools of Choice participation skyrocketed in this time as districts competed for this revenue. GPPSS of course consistently eschewed schools of choice participation.

Student enrollment trends were bad for GPPSS at the time the contract was signed and it remains a problem even as of this writing.

In 2008-9, enrollment dropped by nearly 300 more students than had been projected at time of budget approval – an unanticipated $3 million shortfall. That was the biggest drop of this ten year period, but enrollment loss was a headwind during this whole period.

In 2004, enrollment was just under 9,000 students. By 2014, it had dropped by nearly 900 students – an annual revenue loss of nearly $9 million.

The State revenue problem

The state of Michigan accounts for about two-thirds of GPPSS' annual revenue. (For more background on how Michigan schools are funded, please review this presentation.) State revenue comes in the form of the Foundation Allowance that, as covered above, is based on enrollment. So state revenue variability is based on not just enrollment, but also Foundation Allowance levels. One of the major budgeting issues every year was guessing what the Foundation Allowance would be.

The local school budgeting process was really out of step with state practices. The state required local schools to adopt a budget by the end of June. To do so meant that enrollment, Foundation Allowance, and state mandated retirement rates had to be projected.

The Granholm administration was notorious to the board at the time for not establishing the state variables before the budget was adopted. The mid-year cuts of October 2009, were even worse – a topic that will be discussed later.

Figure 10 below really tells the story.

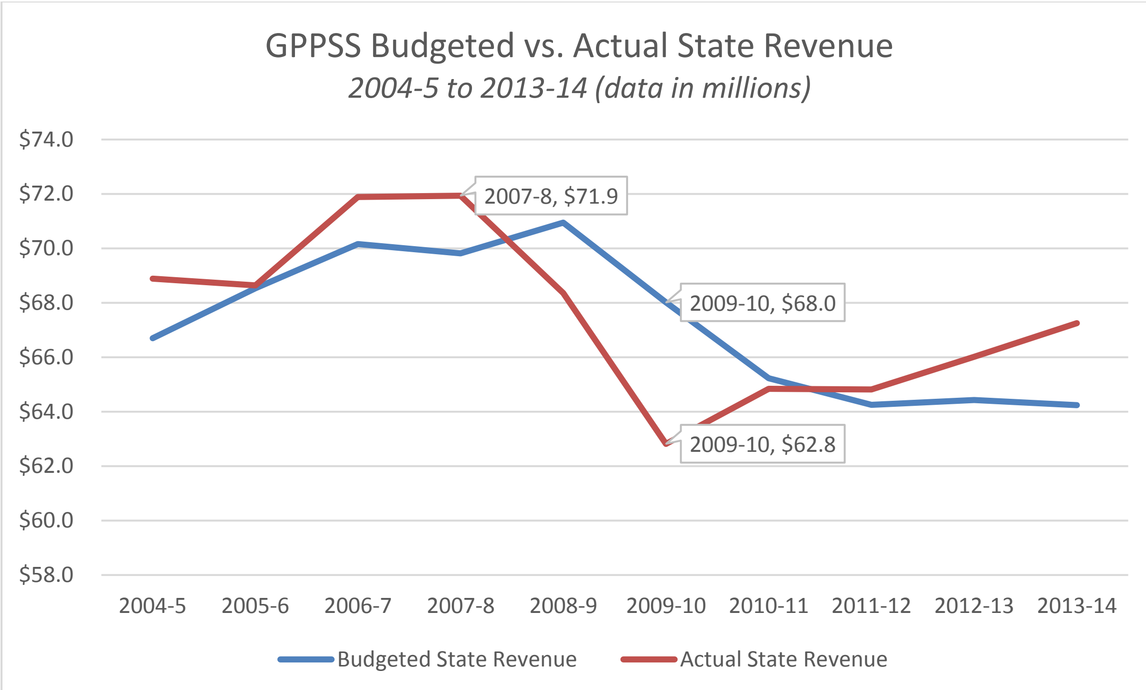


Figure 10: GPPSS Budgeted vs. Actual State Revenue

2007-8 was the high water mark of state revenue, $71.9 million. Even better than that, in the same year, revenue was nearly $2 million higher than budgeted.

But the story got much worse over the next three years as state revenue plummeted by $9.1 million over 2008-9 and 2009-10. In those two years alone, the board overestimated state revenue by $6.3 million.

So back to the rise of fund equity, the chart shows the conservative budgeting in the years preceding the contract negotiations – the acts of a board that was waiting for the bad news to hit – which it ultimately did.

Even last year, state revenue is still $4.3 million below the high water mark, but it is at least trending up.

The County revenue problem

County revenue, almost exclusively related to special education services, lagged the time when the services were delivered by at least a year. I won't do the explanation complete justice, but basically special education revenue is based on the services we are required to deliver. The accounting of those funds lags by a year and the variance in services required is significant.

It was part of a broader and consistent problem budgeting for special education services. It was, and probably remains, ten times harder than general education budgeting. Nevertheless, special education teacher and teacher assistants' costs accounted for an average of 15% of general fund revenues from 2004 to 2014.

The variance of these county revenue misses were massive in this time – from a $2.3 million revenue miss in 2010-11 to an equal revenue overrun two years later. In total though, county revenue was overestimated by $3.5 million from 2004 to 2014.

Expense forecasting challenges

A review of Figure 3 is helpful to understand the challenge of estimating teacher salaries. How many would retire from the time the budget was approved in June to the coming fall? How many have earned a Masters degree over the summer? What will the state retirement rate be? Will we have a catastrophic health care event as a self-insured employer? Nearly impossible to estimate.

From 2004 to 2014, the district underestimated our total teacher costs by $9.5 million. A staggering $8.5 million of that occurred after the May 2010 contract agreement – plagued by the variability of the new salary grid and rising retirement costs. Recall this $8.5 million underestimation later when we examine where the fund equity went following the agreement. Short answer, it went to maintaining teacher levels and teacher compensation.

Figure 11 below presents a snapshot of the variance between budgeted expenses versus actuals. The story is familiar. Budget misses in the years leading to the agreement were generally to the good – that is expenses came in lower than budget. From 2009-10 even through last year, actual expenses came in above budget, particularly in 2011-12 – the year preceding the contract clause activation.

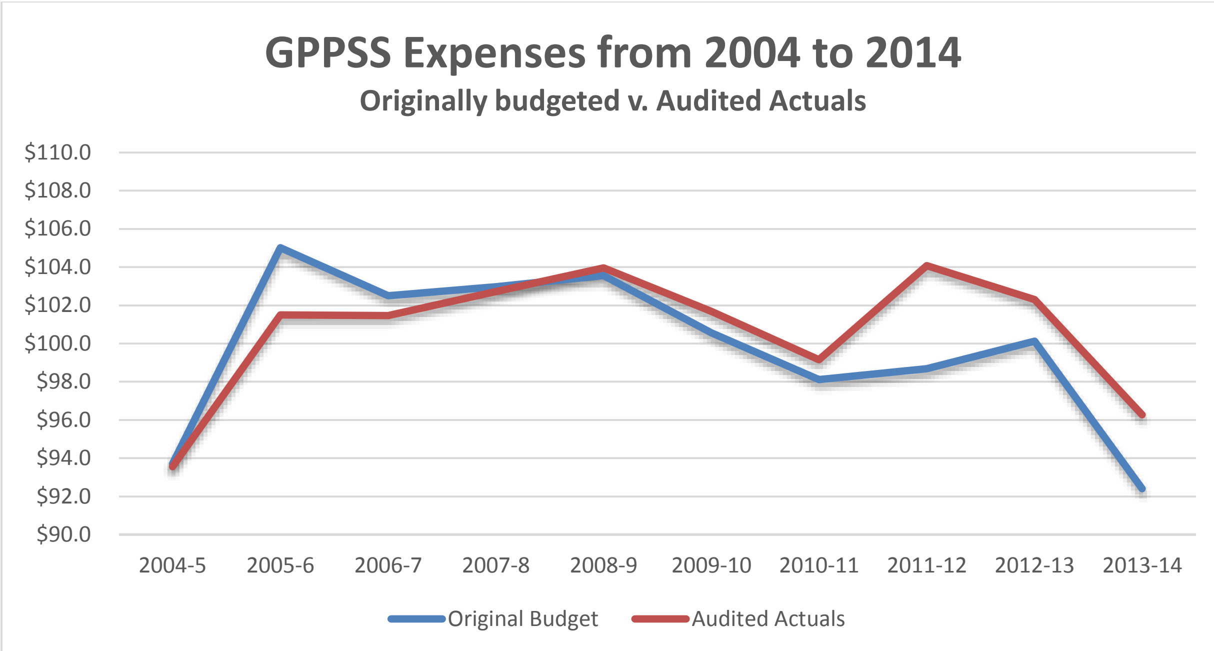


Figure 11: GPPSS originally budgeted expenses versus actuals

The Granholm cuts of October 2009

From 2003 to 2009, bad things were happening economically in Michigan and it was inevitable that the state's largest expense, K-12 education, was going to be affected in a major way. Everyone had been anxious up to this point, but the big blow had not been landed.

Anxiety became reality in October 2009, the fall preceding the contentious negotiations of the ensuing winter and spring.

Michigan's economic nadir followed shortly after General Motors declared bankruptcy in June of 2009. On October 19, 2009, after months of brinkmanship politics between the Democratic executive office and the Republican legislature and four months after the district had passed its budget, Gov. Granholm cut GPPSS' 20J funds and reduced the Foundation Allowance, by $165 per pupil.

In total, these moves cost the GPPSS a permanent loss of another $3 million annually on top of the $3 million in lost enrollment revenue the previous year – neither of which had been budgeted.

Miles apart

This was the fitting setting for the GPEA negotiations. Despite the previous seven years of economic turmoil and a 10% drop in their own ranks, the GPEA thought the board was posturing – even after the Granholm cuts. Rising fund equity was their proof. From their perspective, the money was there for raises, more steps and an ERI.

For the board's part, having overseen several years of economic turmoil and a fresh new $6 million hole in the budget, the general feeling was that the current path was unsustainable – economically, educationally and for the good of the community. Raises were completely out of the question. Closed session discussions centered more around how much of a salary reduction did we need out of the employees.

At the January 25, 2010 meeting (minutes here), the treasurer's report stated that without corrective action the district's fund balance would be negative within two years. We were projecting a $7.3 million budget shortfall in 2010-11 alone. Figure 12 below was shared at that meeting.

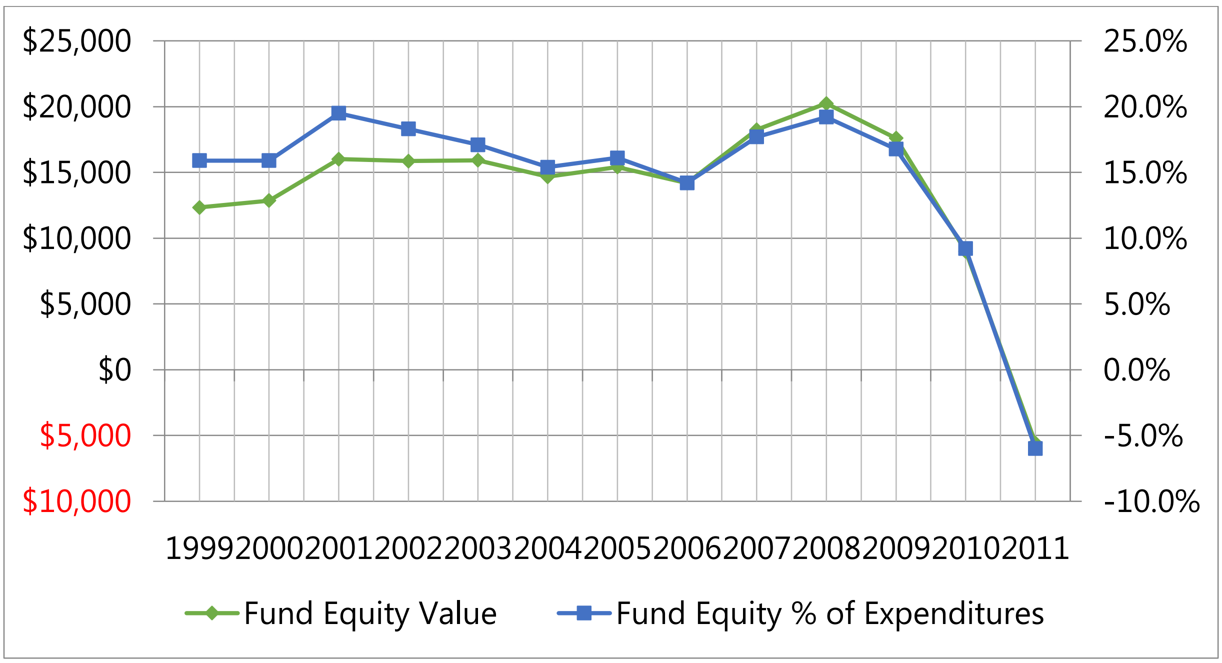


Figure 12: Fund equity projections from GPPSS Board on Jan. 25, 2010

In a fiery and contentious March 22, 2010 meeting that actually ended at 2am the next day, Assistant Superintendent of Human Resources Tom Harwood, publicly reported that the two sides were $11 million apart in their respective economic positions.

We saw it getting worse. In April 2010, just a month before the new contract was to be approved, Board members debated whether to expect another $268 per pupil cut and the potential reduction of another 70 staff members.

The GPEA's perspective was quite different. In a January 2010 bargaining update to its members, the GPEA stated:

> *"What we would like for the Board to go back to a reasonable fund surplus (FS) of 7 to 10%. If the district were to spend down its FS [fund surplus or fund equity] at the rate that would give the bargaining unit employees a fair and equitable contract, it would be able to stay in the black for another 10-15 years in the current climate."*

Of course the GPEA saw the new steps and raises as fair and equitable.

That was the impasse in a nutshell and the genesis of the formula clause. The Board and GPEA vastly disagreed on what the future would hold as far as state aid, retirement costs and the like. However both sides agreed that fund equity around 10% was reasonable. The Board would have liked 15% and the GPEA would have gone as low as 7%. Soon 10% would be the mutual target and the new center of negotiations.

The work behind the scenes was feverish. Complicated economic modeling and intricate spreadsheets were created. The negotiations turned to basically modeling in the GPEA's financial components and then settling on the trigger method that the lead negotiators from both sides had agreed to analyze.

In hindsight, the deal came together quickly because it was indeed fair. The board's offer basically said to the GPEA, "If you believe what you're saying to us and your membership, then there is little risk in this deal. The GPEA believes your economic proposal is viable if the board is prepared for fund equity to drop to $10 million or 10%."

For the board's part, we heeded the loudest complaint lobbed at us: fund equity was bloated and should be used to resolve the dispute that had teachers picketing every Friday before reporting to their classrooms.

But we could not abide to use fund equity without mitigating the massive risk of more economic turmoil. It was a very finite resource, as the models shared at public meetings showed. Furthermore, the board and community was resolute that cutting or outsourcing staff and reducing programs was not the way forward either.

The formula clause bound all that sentiment together and would be properly voted upon by both the GPEA and board. That is a fair and equitable settlement no matter what was to come.

The rancor, anger, demonstrations and vitriol that marked the early winter of 2010 thawed with the spring almost solely on the basis of the clause. There would have been no deal without it. In May 2010 a new 4 year contract was approved by the teachers by an overwhelming margin and unanimously by the Board. It officially started on May 18, 2010 with retroactive effect to the previous year. It was scheduled to expire in August of 2013.

A year by year analysis

We know the end of this story in terms of fund equity. It plummeted from that $20 million peak to a low of $2 million in three years and it has started its climb back, projected to return above 10% by 2016-17. Let's take a closer look at how that happened in the one year preceding and years following the contract settlement.

2009-10: The year before the deal

The deal was signed in May of 2010 meaning that the financial audit of the 2009-10 school would come in November of 2010. Recall the 2009-10 budget was also the first one affected by the Granholm cut of 20J funds, the additional mid-year $165 per pupil reduction and the 300 student enrollment reduction.

The audit would show that all of those things delivered a loss of $5.5 million. County (special education) revenue also came in $1.3 million less than expected. However, this was the first of the federal ARRA funding. Federal revenue came in $4.7 million higher than budget. In total, revenue came in $2 million below budget projections.

On the expense side, the news was no better. Instructional expenses (money that went to teacher compensation) came in $3 million higher than budget, but all other expense were $2 million lower than projected.

The lower revenues, higher expenses and the first payment of the ERI, 2009-10 reduced fund equity by $3.25 million. It had fallen from $20 million to $16.9 million just two months after the contract was signed.

In 2009-10, the district had 580 full time equivalent teachers earning total compensation (salary and benefits) of $66.9 million, an average of $116,036.

2010-11: The first full year of the new contract

2010-11 budgeting was a massive challenge with all the moving parts of the new contract, especially the 81 retirements generated by the ERI, the new teacher salary steps and the second salary grid. It wouldn't help matters that the state raised the mandatory retirement assessment to nearly 21% from the previous years' 17%. (The retirement rate was applied to salary payments.) Despite having 36 fewer employees, retirement costs increased $1.4 million year over year. And it would get worse.

The 2010-11 budget had expected general education (teacher) expenses to be $51.5 million. In the end, after all the salary grid movement, new steps, retired and new teachers, the actual cost was $53.3 million – a $1.7 million miss to the bad. All other expenses came in about $670,000 better than expected.

81 teachers had taken the ERI, well more than we had ever expected. 70 new teachers were hired. The total salary costs, while still higher than what had been budgeted, did decrease by $2.7 million. After the $40,000 payout to 81 teachers (about $3.2 million), the ERI was $0.5 million to the bad. But the recurring lower salary costs (the $2.7 million) were supposed to outlast the upfront payment.

Fast forwarding to the financial audit of the 2010-11, state, local and federal revenue estimates were very almost dead on to budget. County revenue, again associated with special education services, came in at a whopping $2 million below projections.

The Board had expected to run a $1.7 million surplus when the budget was adopted, instead it ran a $1.4 million deficit. Meanwhile the second ERI payment of $1.6 million was due.

Total compensation per teacher dropped just slightly, from $116,036 to $114,935 – benefitting from the lower new teacher salary costs, but not as low as had been expected.

By the end of 2010-11, the fund equity that had been $20 million in 2008-9, then $16.9 million at the end of 2009-10, was now $13.8 million, or about 14% of expenditures. The next year the ending fund equity would activate the formula.

2011-12: Headed toward the formula year

In budget planning for 2011-12, the audits were proving that the contract's economics outside of the formula clause were having the negative effects the board had feared.

Revenue was flat, preferable to reductions, but salary and retirement costs continued their steady rise. The factors that prompted the need for the formula clause were rearing their ugly heads.

The board had a philosophical decision to make. Should we resume the layoffs and program cuts that eroded services, raised class sizes, and incited anger among the community in order to preserve fund equity? Or was that the very cycle the formula clause had intended to break?

The district had cut over 80 jobs in the previous two years and the cost reduction options pursued previously (outsourcing, 6 period high school day, increased class sizes, school of choice, pay to play) elicited angry and even aggressive responses from district stakeholders.

In my view, that decision had already been made when we made the deal in 2010. The formula clause was designed to protect district taxpayers and students if the GPEA's economic projections proved faulty. After all, that was the impasse. The formula was the board's response to the impasse.

As proven by the audits, the structural deficit from the revenue losses combined with increasing salaries and benefits remained the problem. We were paying wages we could not afford and the definition of afford was established in the contract – the ability to maintain a 10% fund equity.

When adopting the 2011-12 budget, the board's answer to the philosophical question was a matter of public record. For the first time since 2005, the board approved a budget that anticipated an appreciable reduction of fund equity – a budgeted reduction of $4 million. That figure reflected the previous year's $3 million structural shortfall plus increasing compensation costs. Fund equity was headed below 10% for sure. The question was how far.

When the audit was presented in the fall of 2012, the one that would commence the formula clause process, it showed that revenue forecasting had again remained very accurate – within 0.3% of the forecasted budget.

Expenses were a different story. Basic Instruction (general education teachers) expense came in $1.8 million higher than expected. Added Needs Instruction (special education teachers) came in $1.5 million higher than budget.

The really bad news, as usual, was state mandatory teacher retirement cost increases. The chart below shows the history of the districts total retirement payments from 2007-8 through 2013.

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
GPPSS Retirement Costs (in millions)	$10.7	$10.8	$10.7	$12.0	$14.8	$14.6
Retirement Costs as % of Revenue	10.0%	10.1%	9.9%	11.2%	13.8%	13.6%

The sharp increases in retirement costs from 2010 to 2011 and then again to 2012 are most noteworthy. When adding FICA and healthcare, the story got worse. In 2009-10 total teacher indirect compensation costs were $18.6 million for 580 teachers – about $32,000 per teacher. A year later indirect compensation costs increased by $1.2 million and a year later, in 2011-12, by another $2 million.

The $1.2 million salary cost benefit of the ERI had been eclipsed and the primary economic characteristics of the May 2010 teacher contract in combination with other benefit increases (mainly in retirement) had blown another $2 million hole in the budget.

The $4 million reduction the board had projected when it passed the 2011-12 budget actually became a $7.6 million shortfall, equal to the structural deficit presented at the February 22, 2010 board meeting. The only difference now was fund equity was $14 million lighter.

At the board meeting on Nov. 26, 2012, following the review of the audit, fund equity projections were shared again

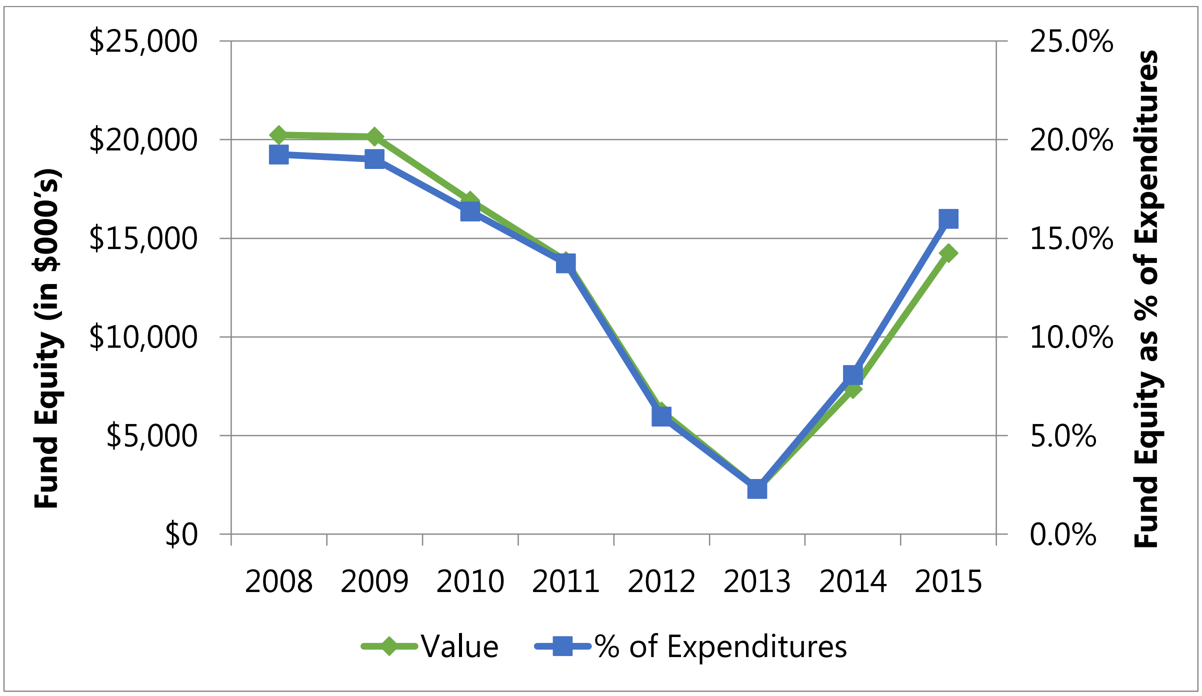


Figure 13: GPPSS Fund equity projections on Nov. 26, 2012

The district never reduced structural expenses after the Granholm cuts of October 2009, the higher retirement costs, and the significant loss of student enrollment. The federal ARRA funds of 2010 and 2011 merely masked the gap briefly or else it would have been much worse.

Leaving federal sources aside, 2011-12 revenues were almost $9 million below 2007-8 levels, yet 2011-12 expenses were less than $2 million below 2007-8 levels. That's the $7 million structural deficit and why the board had wanted to negotiate a salary reduction during the impasse with the teachers two years earlier.

The only thing protecting the district from financial disaster now was the formula clause.

2012-13: The formula clause takes effect

In 2012-13 the formula clause was activated for the first time, delivering a 3.34% salary reduction to all teachers. For those teachers that had previously been at the top of the salary grid (meaning highest paid) they would be giving back the 3% salary increase the new contract's added steps had given them. Some would have moved up in lanes as well.

Obviously other compensation elements mattered. Teachers were paying more for health care and retirement – due exclusively now to state law, not local choice. Retirement was always state mandated. Now state law also specified minimum levels of health care contributions for school employees.

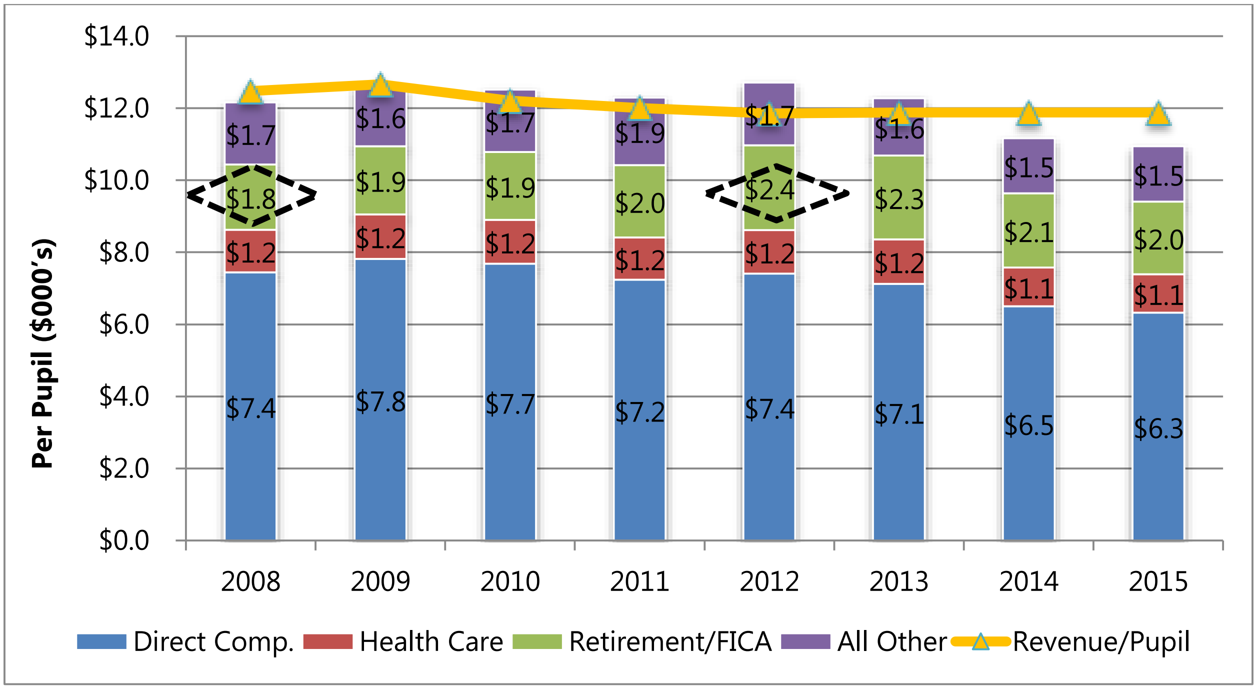


Figure 14: GPPSS per pupil costs as presented in November, 2012

Figure 14 above illustrates the issue well. How was the district supposed to account for retirement cost increases that had once consumed $1,800 of per pupil funding, but that in 2012 had consumed $2,400?

That is precisely what the formula clause aimed to do – adjust compensation elements within the districts control against expense and revenue elements out of our control.

2012-13: The historically low fund equity

The rising costs that had led to the fund equity reductions of the previous two years had a head of steam and it would take a couple of years, as we knew it would, for the salary adjustments to return fund equity to 10%. Even with the 3.34% salary reduction, the 2012-13 budget still showed expenses exceeding revenue by $5 million.

Nearly everyone was nervous. No one had ever seen fund equity levels this low. With a $5 million projected shortfall, fund equity was headed below 2% if the projections in the budget approved in June 2012 held. Employees would be taking a 10% pay cut following the 2012-13 year.

Never before had budget projections mattered so much. When the audit came in November 2013, local, state and federal revenues came in as expected – within 1% of the original budget. But once again, county (special education) revenues confounded, but this time to the good - $2.3 million above projections and finally a welcome surprise.

The district would need it. Expenses, employee compensation in particular, came in 2.2% above projections – about $1.1 million in total. The budget, in a roundabout way, came in as projected – even slightly better. Fund equity ended at $2 million – even with the 3.4% reduction. Employees appeared headed for a 10% additional reduction to bridge the $8 million fund equity gap.

Had that transpired, fund equity would have returned to 6% by the end of 2013-14 and to 16% by 2014-15. With a structural surplus at that point, teacher salary compensation would increase at that point.

Right to Work legislation influence

But another move was afoot. The Michigan legislature had passed the Right to Work legislation. The law was to take effect in April 2013. Many teacher unions were eager to cut deals to avoid the negative consequences of the new legislation, namely preserving union membership since locally bargained agreements would grandfather into the Right to Work era.

The GPEA wanted to bargain again.

The board had little incentive to do so, but there was legitimate concern among board members about the pending pay cuts. Despite what might be portrayed, the board was troubled by the cuts – myself included.

From the inception of the formula clause development, I was concerned that the steeper the descent below 10%, the harsher and more long-term the consequence of the formula clause. We had hoped to land more gently, gliding slightly below then back to 10%. Earlier financial models looked like it would do that. The steep retirement cost increases and the added steps destroyed the gentle landing.

One area I did see opportunity for all parties were teacher sick days and paid time off. The contract limited probationary teachers to ten sick days. Tenured teacher sick days, however, were unlimited. From 2007 through 2012, the district averaged $1.3 million in substitute teacher costs per year.

In 2009-10, substitute costs totaled $1.5 million for 580 teachers. The rough math showed that teachers were averaging between 4 and 5 weeks of absences – in all forms – per year. This was on top of the vacation schedule. Of course not every teacher took that much time off, but clearly something was wrong.

The public controversy on this topic was intense, but it intended to find a lever that would help preserve nearly $1 million annually that should not have to be funded with pay cuts. I viewed it as money that should be available to all teachers, particularly as pay was reduced. In my view, sick days were a poor form of compensation that happened to detrimental to the learning environment. The GPEA ultimately agreed.

The formula clause gets frozen

The new contract addressed the absence language and newly required teacher evaluation legislation. Most importantly it also suspended the formula clause until August 29, 2017 - the day before it would expire. This meant that the formula language would be active upon the contract's termination and thus remain in full effect unless and until a successor contract is bargained the language out.

Instead of a formula driven salary schedule, the contract established an immediate 4.9% pay reduction in 2013-14 – halving what would have been an automated 10% cut. The salary grid would remain frozen in 2014-15. But in the next two years, teacher pay would actually increase by 1% and 1.8%. The financial models showed that at that time, following the 2016-17 year, fund equity would return to 10% (as shown in Figure 1).

Instead of another pay cut, over the next three years, the new deal returned $7.9 million back to the employees in various forms of direct and indirect compensation. It was ratified on March 25, 2015 – just days before the Right to Work law took effect.

Summarizing the formula clause and its effect

Fund equity's return to 10% would be delayed by two years, from 2014-15 to 2016-17. At the previous pace, fund equity would have been nearly 18% by 2016-17. The delay also dramatically reduced the district's capacity to return investment to budget areas that had been plundered as human resources costs consumed more and more of the budget.

Near the top of this list was technology funding. The March 2013 contract then, indirectly, put the wheels in motion leading to the tech bond vote that was to fail less than a year later.

Had it been left to run its course, the formula clause would have delivered salary reductions closer to 15% from 2012 through 2015.

According to the district's published data, average teacher total compensation (salaries and benefits) in 2009-10, the year before the original contract was signed, was $116,036. By 2012-13, even with the salary grid reductions, total compensation actually rose to $117,779. In 2013-14, the district reported total compensation dropped to $111,584 – a 3% reduction from 2009-10.

Total compensation meant everything to the district, but something very different to employees. One day they will realize the benefit of their retirement pension and health care, but in the course of their working days, the retirement and FICA payments made by the district do not hit their bank accounts.

Understandably, salary is the main thing for the district employees. So with all of the various factors affecting salary – steps and lane changes, new salary grids, formula clauses and the most recent contract, let's look at the change in salary for two tracks of employees: the MA +60 legacy teacher and the new hire of 2010.

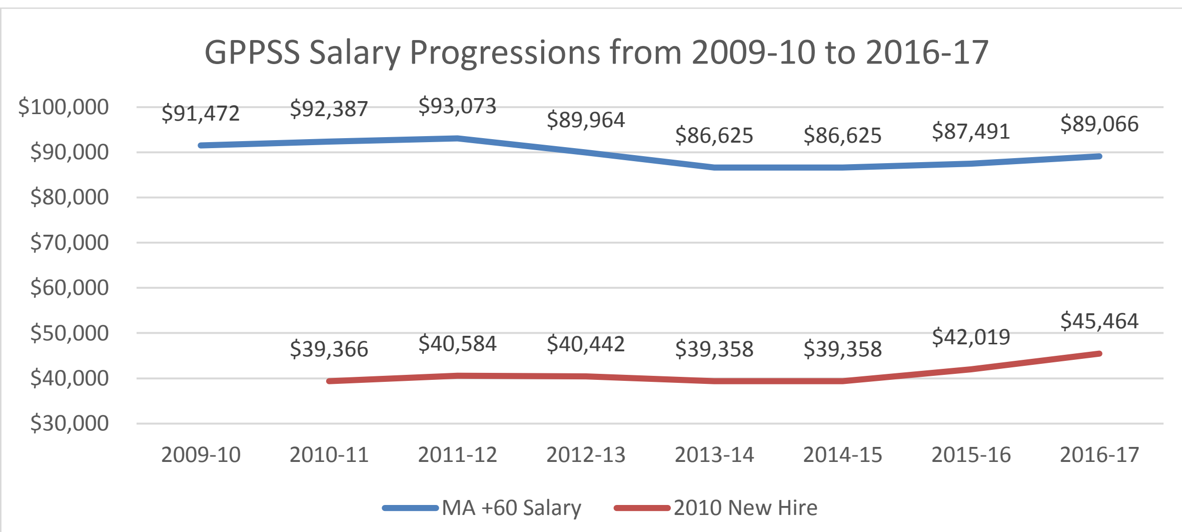


Figure 15: Representative GPPSS teacher salary progressions from 2010

The chart in Figure 15 shows how the effects of reduced funding ultimately reduced salary basically in a two year lag. The MA +60 teacher used in our original examples experienced a salary reduction peak of 6.9% from the high of 2011-12 to the two year lows of 2013-14 and 2014-15.

But recall that the rise up in salary from 2009-10 to 2011-12 was the result of the negotiated step increases the GPEA so badly wanted and that the board projected we could not afford. Unfortunately history showed we indeed could not afford them.

When the salaries progress to the 2016-17 levels, the MA +60 teacher salary will end up being just 2.6% less than the 2009-10 levels. The 2010 new hires will be 15.5% higher than their starting salary in 2016-17, which best illustrates the dramatic effect step and lane increases have on direct compensation.

Undoubtedly GPPSS teacher salaries will not only remain competitive, but near the top of state rankings. Meanwhile fund equity will return to 10%, ratios of students to teachers will remain flat, schools will not have been closed, massive job slashing stopped, as state funding recovers with the economy – as the data clearly shows it is – funding will likely increase and necessary investments in areas such as technology can happen – without further penalizing the taxpayer.

In short, the formula clause delivered exactly as it was intended and most importantly as agreed upon by the board and the GPEA. It was impractical that a salary reduction would have been agreed upon in 2010 and the formula clause that leveraged the strong fund equity position enabled the deal to happen.

The board ended up proving trustworthy to the GPEA as best evidenced by the new contract agreed upon in March of 2013 that prevented far worse cuts coming to employee salaries. It was a sign of good partnership and solid fiduciary action by the board.

Looking ahead

The formula clause sits frozen as of this writing. This narrative was intended to ensure the events leading up to its adoption were captured. It was certainly most unpleasant to have had to experience all of this, but as the trite saying goes, the past is prologue.

As citizens, employees, and future boards evaluate the formula clause, I hope they take the time to understand it in all its intricacies. Of course I am biased, but my service on the board and my efforts here are founded in a deep caring for the Grosse Pointe Public School System.

I will remain a vocal advocate for the retention of the formula clause in ensuing contracts. It did nothing less than save the district from financial ruin and preserve the programs and structure that made the Grosse Pointe Public School System what it is today.