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AAPS and the Privatization of School Support Functions:
Lessons Learned from Food Service
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In these challenging economic times, public administrators must respond to shrinking public budgets. Current and projected budget shortfalls have prompted Ann Arbor Public Schools (AAPS) to explore whether the privatization of two school support services, bus transit and custodial-maintenance, will save the district money, presumably without jeopardizing service quality. Before the AAPS makes that decision, it seems prudent to evaluate and discuss what happened to food service, which was fully handed over to a private company, Chartwells, in FY 2007-08. The following report is based on an analysis of public data filed with the State of Michigan by AAPS, documents from AAPS, and interviews with food service personnel.[1]

Prior to the full Chartwells takeover, AAPS contracted with Chartwells for their food management services only, with a main responsibility for food procurement. For this role, Chartwells was paid about $2 million per year from FY 1003-04 to FY 2006-07. Public records do not detail how much of this amount covered food versus Chartwells' management expenses and corporate profits. However, since the initial 2001 agreement, Chartwells has operated under a flat fee basis for food service management. The fee was $0.07 per meal from 2001 to 2008 ($0.03 management fee and $0.04 administrative fee); as of 2008 this was increased to of $0.08 per meal ($0.05 administrative fee). AAPS also reimburses Chartwells for all operation costs, including inventory (food and beverage), all materials and service expenses, and the compensation for all involved Chartwells' employees.

The relationship between AAPS and Chartwells changed after FY 2006-07. Starting in FY 2007-08, the management-only service contract ended, and Chartwells became responsible for staffing. During this transition, AAPS food service workers had to accept employment with Chartwells to keep their jobs. Most accepted the offer of work, not out of gratitude but out of necessity: to refuse the job with Chartwells would have made them ineligible for unemployment benefits. Workers lost their state pension and union representation. A comparable health care benefit is offered by Chartwells, but the annual co-pay is over $3,000 – a fivefold increase from when these workers were AAPS employees.[2] The co-pay increase effectively priced many food service workers out of premium coverage. Further, as senior workers exit Chartwells' employ, new hires are brought in at slightly more than $9.00 per hour.
This brief report describes how this policy decision affected the AAPS food service budget and operations. Our intent is to draw lessons from this experience in order to anticipate the probable effects of privatization on bus transit and custodial services.
AAPS Total Budget

[1] State FID data can be found online at: http://www.michigan.gov/cepi. The FID data was incorrect for FY 2006-07, the year before the service transitioned to Chartwells. Corrected budget figures for that year were provided by Robert Allen in a telephone conversation on January 14, 2010.

[2] The Network Choice – Blue Cross Blue Shield plan has a bi-weekly co-pay of $115.56.

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Given that the total budget is emphasized in the most recent contract between AAPS and Chartwells, this is where we begin. As the chart below illustrates, the AAPS food service operated at a deficit during the entire period, which steadily worsened from FY 2003-04 through FY 2006-07. After the transfer of control to Chartwells, we do see an improvement in the overall budget. In FY 2007-08, the deficit improved (declined) by approximately $340,000 to a level slightly below 2003-04; in FY 2008-09 the deficit became negligible. So what explains this improvement?

An impressive turnaround, but before we can credit the budget reversal to the new relationship with Chartwells, one must examine the changes in expenses and revenues over the period. I begin with expenses.

Expenses

Public records indicate that the initial effect was an expense reduction for AAPS. The graph below is for the total expenses of the AAPS food service function over the fiscal years 2003-04 to 2007-08. These figures are not adjusted for inflation.

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What is evident is an upward trend from FY 2003-04 to FY 2006-07, the period when AAPS covered the salary and benefit expenses of the food service workers. The complete transition to privatization occurred in FY 2007-08, and here we see an expense decrease of slightly less than $300,000 from the previous year. In FY 2008-09 expenses returned to FY 2006-07 levels.

It is important to first note that the cost escalation from FY 2003-04 to FY 2006-07 happened under Chartwells' management, and further, that the most significant driver of the cost increase from FY 2005-06 to FY 2006-07 was due to a $200,000 jump in "professional services," a FID category that includes the contract with Chartwells. Thus, the run-up in costs to the peak year of FY 2006-07 was not because of AAPS labor costs, but instead, an escalation in payments to Chartwells.

It therefore follows that eliminating the AAPS positions would have a minor effect on the budget. In this case, the improvement appears to be temporary. The FID line item labeled "mandatory benefit," which includes the state pension requirement, dropped by about $207,000 between FY 2006-07 and FY 2007-08, approximating the value of terminating the state pensions for AAPS food service workers. Yet as the graph illustrates, after the dip in expenses for FY 2007-08, the upward trend resumed. The largest expense increase in FY 2008-09 was for an item categorized as "miscellaneous" by the FID.

Instead, a closer look at the data reveals that the real drivers for the improvement in the overall budget are on the revenue end. We now turn to revenues.

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Revenues

The next two graphs below give the revenues for food sales across the FY 2003-04 to 2008-09 periods. First are sales to pupils:

Throughout the period under review, food service revenue has been in decline. However the pace clearly accelerated after FY 2006-07. Revenue from the sale of food to pupils declined by about 1% from FY 2005-06 to FY 2006-07, by approximately 8% from FY 2006-07 to FY 2007-08; and another 3% from FY 2007-08 to FY 2008-09. The reduction in revenue from pupil food sales between FY 2005-06 to FY 2008-09 is about $234,000.

Although the revenue item is not as large in magnitude, food sales to patrons declined even more rapidly, off 19% from FY 2005-06 to FY 2006-07; 17% from FY 2006-07 to FY 2007-08; and 8% from FY 2007-08 to FY 2008-09. The reduction in revenue from patron food sales between FY 2005-06 to FY 2008-09 is about $33,000.

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There are two possible explanations for the decline in revenue from food sales. The first is that Chartwells is pocketing a larger share of total sales. The second is that fewer families are purchasing school lunches.

There are reasons to believe that much of this trend is due to the voluntary drop out of students and patrons from the food program.[3] One reason might be cost: the price of a school lunch is currently $2.60. Another might be quality: corn dogs, tater tots, hamburgers, chicken nuggets, Beef-a-Roni, and garlic cheezy bread, are food options for younger students. Parents concerned about the diets of their children might be wisely rejecting this fast-food fare.[4] It would seem that this service dimension should be factored in when evaluating the performance of Chartwells.

The major AAPS food service revenue categories that have increased in recent years are from federal sources. The two main sources are the free and reduced lunch program and the USDA commodity program, plotted below:

[3] These revenue declines may, of course, be related to other food service policy, such as restrictions on the operation of soda and snack machines. Such changes should show up in another FID category, “a-la-carte” sales. For a-la-carte, revenues have held relatively steady over the period.

[4] The trend toward fast food runs contrary to best practice. See: Newman, Constance, Joanne Guthrie, Lisa Mancino, Katherine Ralston, and Melissa Musiker. 2009. Meeting Total Fat Requirements for School Lunches: Influence of School Policies and Characteristics. Economic Research Report Number 87.

Washington, DC: United States Department of Agriculture. Online at:
http://www.ers.usda.gov/Publications/ERR87/ERR87.pdf

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The federal school lunch program is a need-based subsidy for low income families. The rise in revenue from this category of about $180,000 between FY 2006-07 to FY 2007-08 and $168,000 between FY 2007-08 to FY 2008-09 is due to recession. Enrollment in the federal school lunch program has accelerated nationwide, and there is no doubt that this revenue category would have increased without Chartwells.
The USDA commodity program is a rebate for purchasing surplus agricultural products, and would be available to AAPS with or without Chartwells. The increase in FY 2006-07 to FY 2007-08 revenues from the USDA program was approximately $98,000; which held fairly steady in FY 2008-09.

All totaled, money from these two federal sources grew roughly $280,000 between FY 2006-07 to 2007-08; and another $158,000 between FY 2007-08 to FY 2008-09. When one looks for explanations for the impressive budget turnaround during this time period (revisit the graph on page 3), it is clear that the gains in federal revenue sources were responsible for filling the AAPS food service deficit gap.

So what can we conclude about the success of school support privatization? Although it is impossible to know in advance how privatization will affect bus transit and custodial-maintenance, we should nonetheless strive to learn from the experience with food service, and hopefully improve policy decisions. This analysis yielded three general lessons from food services:

1. Projected savings from privatization fail to materialize.

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A year after staffing responsibility was shifted to Chartwells, AAPS experienced a budget improvement estimated at about $340,000, and a year later, the budget improved by an additional $95,000. It would be misleading, however, to credit this favorable trend to privatization.

Staffing expenses were indeed cut in the transition to Chartwells, and if this were all that happened, one could argue that the shift toward privatization aided the budget. Unfortunately, revenue from food sales also declined. Both of these budgetary changes are related to the transfer of operational control to Chartwells, and both effectively cancel each other out.

The most significant improvement in the budget was due to revenue categories that were beyond the control of Chartwells. Large revenue gains after FY 2006-07 came from the federal school lunch program, and to a lesser extent, the USDA commodity program. Without these additional revenues, the FY 2007-08 and FY

2008-09 budgets would show a deficit comparable to FY 2006-07.

2. Privatization produces an inferior service.
One persistent problem with privatization flows from the divergent interests between the public and the private contractor. Private contractors sign onto a deal to earn profits, and their methods for doing so often contradict the public good. With school food service, a nationwide pattern is evident. Private contractors purchase bulk commodity foods at a discounted rate, and in turn sell the food to children. There is nothing wrong with leveraging purchasing power, provided that the food is quality, nutritious fare. However, the lowest cost, most profitable food is inexpensive, processed, fast food.

The current service contract (July 1, 2008) between AAPS and Chartwells pressures Chartwells to reduce meal costs. As a result, Chartwells is incentivized to market snacks and menu items that are inexpensive to purchase and serve. The conversion of the food service toward a low-cost, high-profit, low-nutrition model is evident at AAPS, and may explain why parents are increasingly choosing other lunch options for their children. Such a model stands in contradiction to best practice.

3. Privatization degrades service jobs.
Low cost labor is a critical comparative advantage of private firms. By losing their AAPS employment status, food service workers lost their state pension benefits, had their health insurance co-pays skyrocket by 500%, and lost union representation. New employees are offered wages at about $9.00 per hour. There is no doubt that the food service jobs at AAPS have been degraded.