

***Park Ridge - Niles
Community
Consolidated
School District 64***

***Ten Year Financial Projections
February 2011 Update***

***Prepared by:
Lawrence Heidemann
StratPlan Consulting & Modeling***

File Copy

FINANCIAL PROJECTIONS

Recent History

Park Ridge-Niles School District has a history of thoughtful strategic planning and responsible financial management. At the turn of the century, an operating tax rate of \$3.32 (in FY99) was adequate to sustain ongoing operations even though the combination of federal and state support continued to provide only about 10% of the budget. As the decade progressed, however, it was becoming apparent that finances were under stress as the tax cap continued to nibble away at the property tax rate. By the 2007 school year that operating rate had been reduced to \$2.31. As fund balances continued to drop and cash flows turned negative, expense cuts were initiated and class sizes increased. In the spring of 2007, however, voters approved a tax increase to reinstate part of that rate. The operating tax rate for 2008 was restored to \$2.75 with the promise not to approach voters again before at least 2017, absent any dire economic developments.

Against that backdrop, the economy did take some dramatic turns in 2008 and 2009 and *StratPlan© Consulting* was enlisted in 2009 to evaluate District 64's financial outlook, to help investigate the sustainability of current operations in the emerging economic climate, and to consider whether the recent referendum would in fact accomplish its stated purpose in the new economic environment.

That study recognized the evolving economic climate with reduced tax rates and flat revenue growth, and investigated variations on an evolving economy and District 64 planning options for the future.

The general conclusions were that Park Ridge-Niles had in fact positioned itself with solid fund balances, positive cash flows, considerable flexibility, and a bright future. Those fund balances should provide to time and flexibility to enable thoughtful strategic consideration of such things as discretionary educational projects, class size considerations, additional facility improvements, or simple contingency to ward off the proverbial “Murphy” should he prove even more capricious.

Furthermore, the existence of its ongoing strategic planning process, and tools such as *StratPlan*, should enable the district to monitor economic developments and provide adequate early warnings of the need for proactive adjustments.

Looking Ahead

With that background and after another troubling year in the economy, *StratPlan* has again been enlisted to update previous projections, and to help keep a watchful eye on the financial horizon for the district. This update reflects current economic data, and incorporates another year of actual audited financial results for the last fiscal year and a new budget for the current year. Assumptions about the future and the economy are updated with the district's best estimates and a new base case is developed.

Variables & Assumptions

The outlook has not changed dramatically over the last year, but several factors or assumptions about the economy have changed enough to alter projected trends somewhat. The overall basis for this study is the current actual situation, with the following updated considerations and assumptions:

General

- **Inflation/CPI** - Inflation, as measured by the government's Consumer Price Index (CPI), is a critical variable as the current sluggish economy struggles to recover, since it is the primary revenue driver in a tax capped district. After the known 2.7% for FY12 and 1.5% for FY13, CPI is projected to fluctuate between 1.5% and 2.0% thereafter.
- **Enrollment** - Enrollment is expected to be relatively stable with only modest fluctuations over time. Demographic data supplied by Kasarda has been incorporated in this development.
- **Class Size and New Programs** - Class size guidelines range from 22 at the lower grades to 28 in the upper grades. Current averages are in the 23-24 range and are assumed to remain at those levels.

Revenue

- **CPI** - as noted above
- **Equalized Assessed Valuation – EAV.**
 - **New Construction EAV** - is assumed to increase gradually over a few years from current flat levels to a more historical level of about 1.5% growth per year.
 - **Existing EAV** - is forecast to resume the historical sawtooth patterns of triennial increases followed by no to slow increases. The base case assumes that after this flat year, the pattern will be moderated to a recurring progression of 10%, 1%, -3%, 10%, 1%, -3%.
- **Tax Rates** - Tax rates will comply with the PTELL (tax cap) calculations. Tax rates generally move inversely to the reassessments in existing EAVs and will thus result in a similar but inverse sawtooth pattern to EAV reassessments over time.
- **Stable State and Federal Funding.** As a base case, state and federal funding are assumed to be stable at current rates. Federal funding (at less than 1% of budget) is negligible in any case. State funding (at only about 6-7% of the budget) continues to be hard to predict given the budget woes in Springfield, but can be adjusted in the model as it evolves from Springfield; given its relatively small proportion, however, even significant changes are unlikely to have an appreciable effect on District 64. No additional stimulus funds are anticipated.
- **Impact Fees.** Impact fees are generally modest and are included in ongoing O&M background revenue.
- **Other Funding.** There are several current sources of one-time/project related funding including the recent federal "stimulus" dollars, and the current sound abatement project. Those funds, amounting to about \$8 million in total, are expended as they are received and do not have any long term carryover effect.

Expenses

- **Salary and Benefit (S&B) Escalations.** The PREA current contract obligations are incorporated into the base case model using a 2.5% base salary adjustment and an average step increase of 2%. Thereafter the base salary will be adjusted using the CPI-U factor for that year plus the 2% average step increase. Benefits are projected to increase at about 5%, or about 3-4% over that CPI-U factor. This will of course be very dependent upon the overall economy and competitive pressures in the area as the situation evolves, but is a *critical* strategic factor in the district's future.
- **Debt Retirement.** Debt retirement is modeled according to the currently scheduled commitments, at payments of \$2.5-3.0 million/yr. The debt is scheduled to be retired in 2017.
- **Project Expenses.** There are a variety of current projects underway and some longer term potential projects that are included in these cases. Those include the current project for sound abatement and an ongoing commitment for miscellaneous projects that have been estimated at about \$1.5 million for this year and next, and then averaging about \$1 million/yr thereafter.
- **Other Costs.** O&M, Transportation, and other costs are assumed to escalate from current levels with CPI.

Any of these assumptions can be easily changed but these are used as the default basis. Sensitivities are investigated in a subsequent section.

CURRENT BASE CASE

General Conclusions

The outlook in this update is marginally poorer in the out years (5-10 years) than in previous estimates, due primarily to the compounding effects of conservative assumptions about lower/slower growth in the EAV tax base and slightly lower CPI-driven revenues. The short term, however, (3-5 years, or until the 2017 target window) appears to be fairly stable. Previous solid planning efforts should now allow the flexibility to continue to watch the evolution in the economy and the environment, without the need to take any dramatic near term actions other than the ongoing prudent control of operating expenses. There is ample time, flexibility, and resources to monitor the situation as it evolves over the next several years.

The major *strategic* factors on the respective sides of the ledger during that time frame continue to be:

Salary and Benefit Escalations. As outlined in previous work, with the tax cap law limiting revenue increases to the CPI, expenses must generally be controlled to that same level. With S&B constituting 70-80% of operating expenses, those are the primary costs that must be controlled within that same general range. Other overhead type costs such as utilities and maintenance, at 20-30% of the budget, tend to be either fixed or difficult to control.

Evolution of the Tax Base. The evolution of the EAV tax base is the only major factor with the potential to have any significant impact on available revenues. Over the last decade, a modest amount of new construction and/or some "tear down/rebuilds" has gradually expanded the tax base enough to cope with expenses that were increasing faster than the CPI. With reduced to flat expansions now projected, that emphasizes the need to match ongoing expenses to expected CPI revenue increases.

Many Other Factors can of course affect long term planning. All have been included in this development and changes can be easily modeled. Most, however, are generally of smaller import and can either be accommodated in ongoing operations or are generally masked by larger issues.

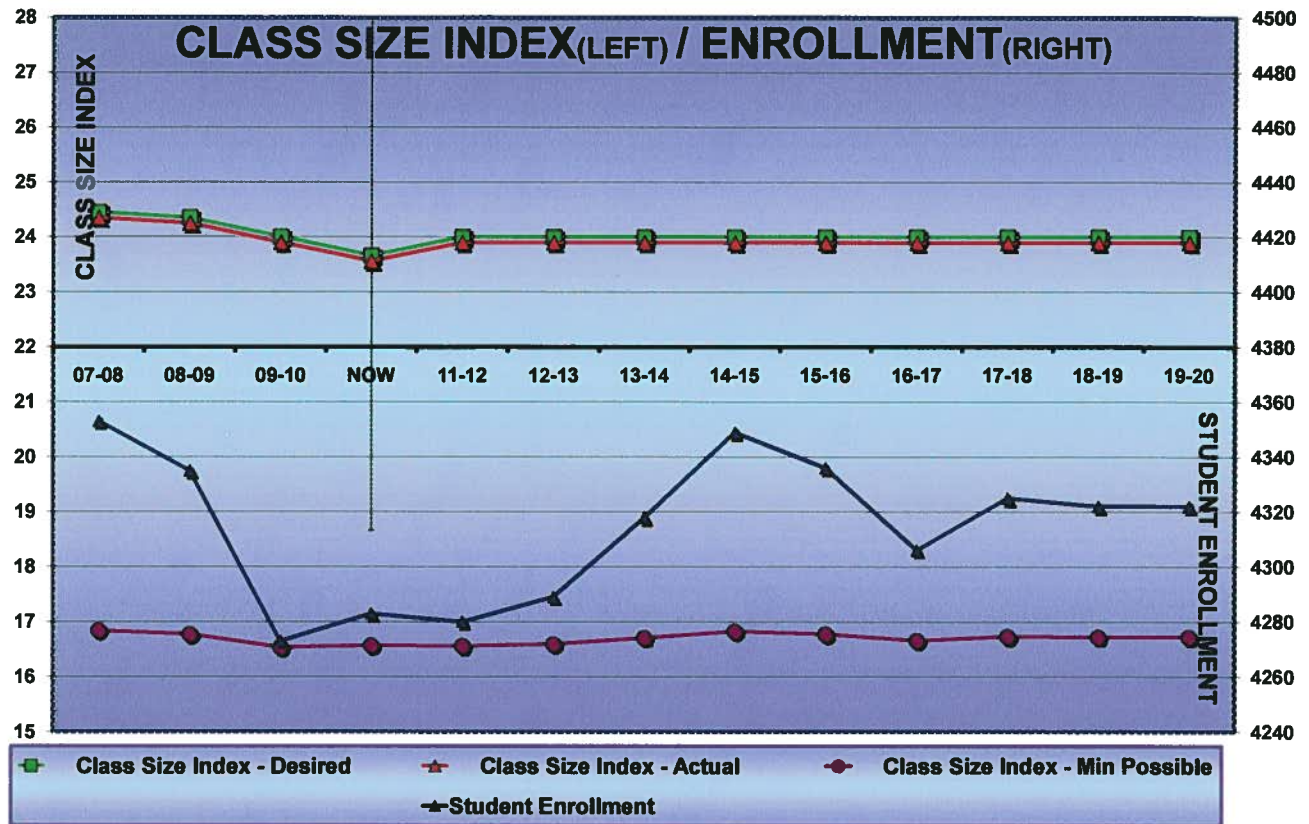
Overall, previous conclusions are still generally applicable:

"Park Ridge-Niles has in fact positioned itself with solid fund balances, positive cash flows, considerable flexibility, and a bright future. Those fund balances and that flexibility will enable thoughtful strategic consideration of such things as discretionary educational projects, class size considerations, additional facility improvements, or simple contingency to ward off the proverbial 'Murphy' should he arrive."

That analysis does, however, come with the caveat to be constantly vigilant in the near term.

The following charts illustrate that overall position.

Updated Base Case - February 2011

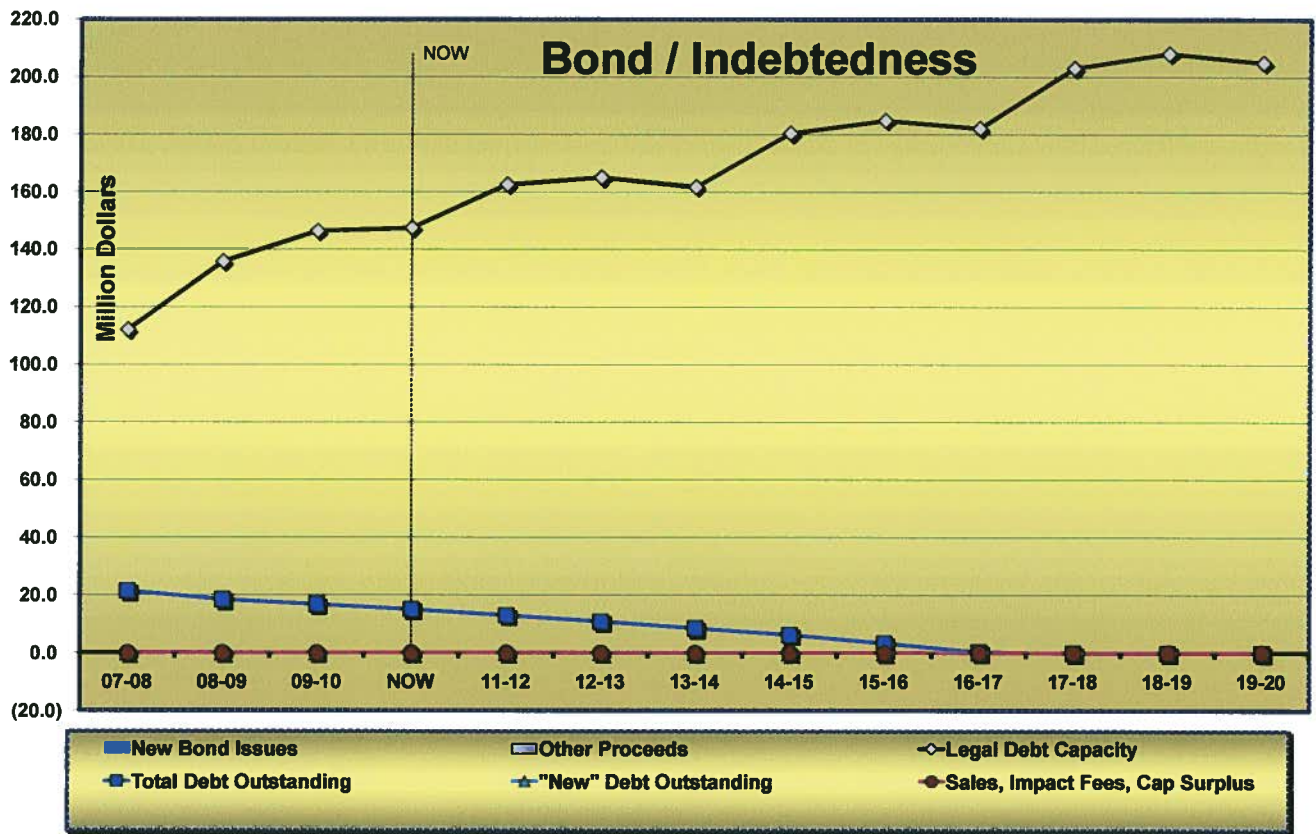


Current guidelines for class sizes range from the low 20s in the lower grades to the upper 20s in the upper grades and most schools have average class sizes below those target guidelines. Sixth day enrollment and October 30 attendance data indicate an **overall** district average in the 23-24 range (red/green - left scale), recognizing of course that averages can be deceptive given the planned difference between grades and the general variations between schools.

Various demographic studies in recent years have predicted enrollment in the 4,000-4,500 range. Kasarda has recently updated those studies and projections now suggest a stable enrollment in the relatively narrow range of 4,200-4,400 (blue - right scale).

The district has considerable capacity available if needed. Average class sizes (from a purely capacity standpoint) could in fact be lowered into the upper teens (purple - left scale) if educationally beneficial or financially acceptable. For purposes of this study, the targeted class size index is held constant at 24 - recognizing of course that "averages" can mask considerable variations between grades and between schools.

Updated Base Case - February 2011

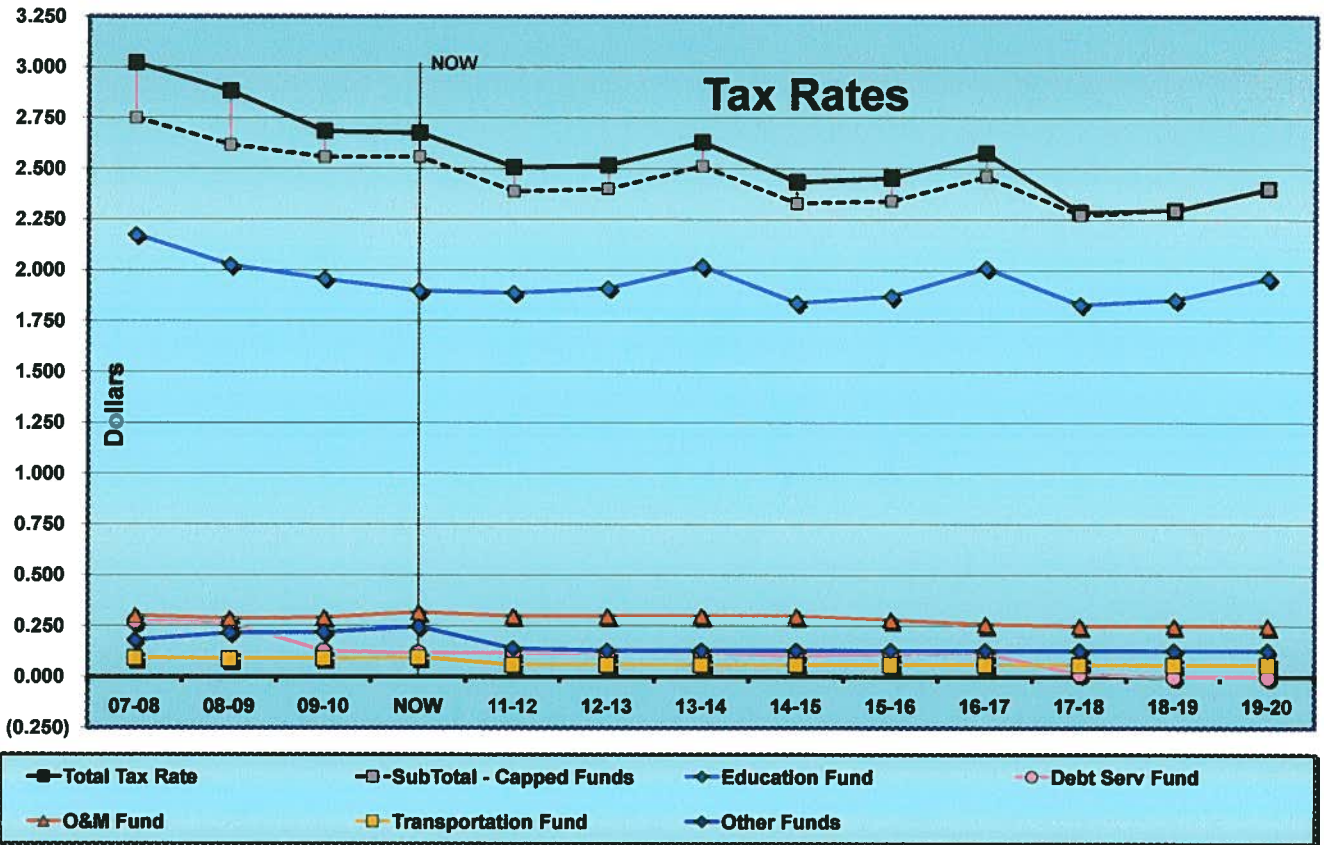


Debt is not a significant strategic issue for Park Ridge - Niles.

"Legal" debt capacity (black), as determined by EAV, is considerable and is not an issue. Actual debt (blue) is being steadily reduced and should be retired completely within a relatively few number of years.

*(Interestingly, if an operating referendum were eventually considered necessary, the timing would be at about the time debt is retired and the B&I levy would disappear from the tax bills. That could potentially allow a strategic referendum asking the voters to simply replace the expiring debt levy with a comparable operating levy - at **no net tax rate increase**. That strategy has occasionally been effective in other districts.)*

Updated Base Case - February 2011



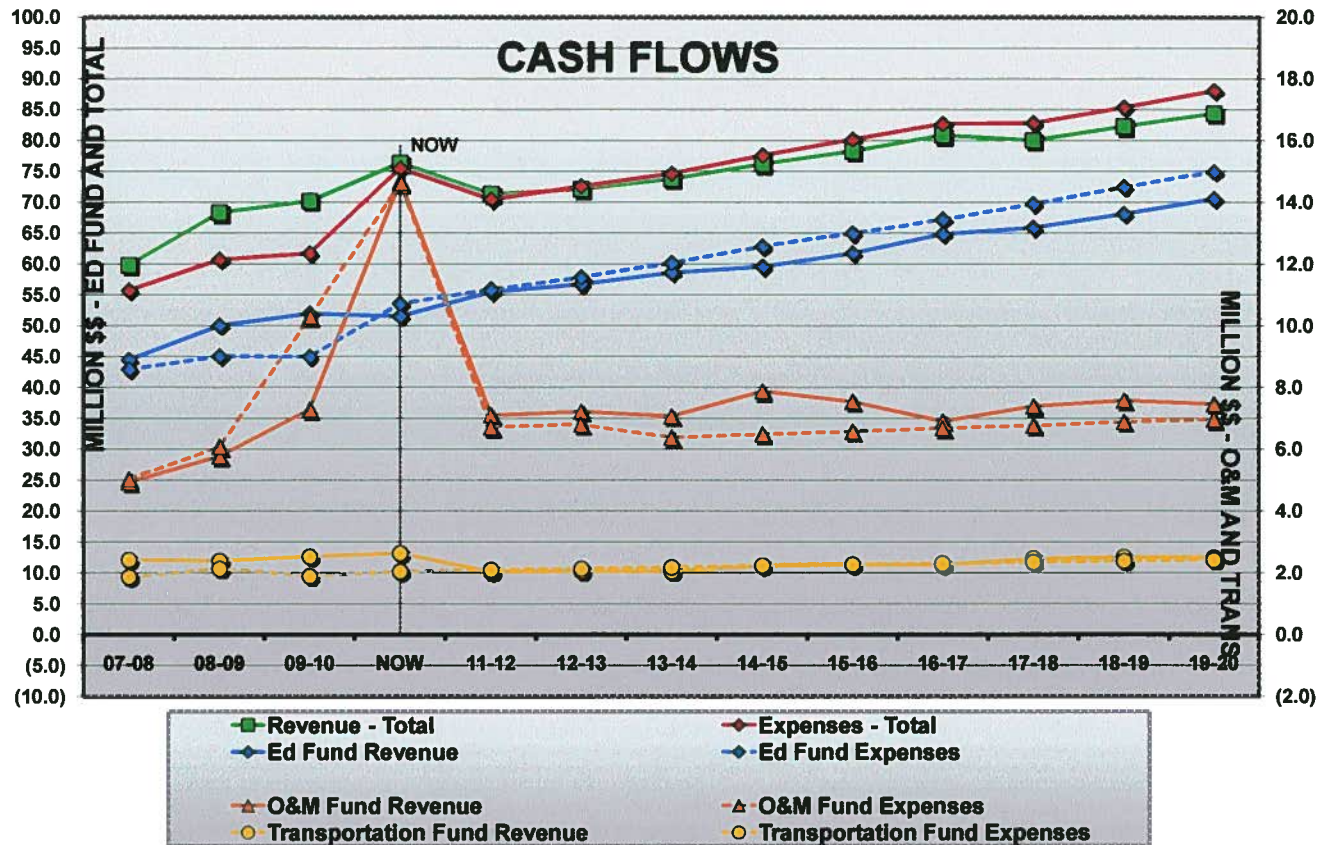
Operating tax rates are of course "capped" in District 64. That (gray) capped rate is the composite of all the individual rates below it, with the exception of the (pink) Debt Service rate which is not capped. That (pink) Debt wedge is added to the (gray) operating rate to yield the (black) total rate above it.

The "tri-ennial" re-assessment process in Cook County has historically created a sawtooth pattern for tax rates. When EAVs are reassessed upward in a given year, capped tax rates drop inversely to it and then are relatively flat to increasing in the subsequent two years.

Tax rates for the smaller funds have been held relatively flat to meet their ongoing obligations. The tax cap and tri-ennial variation are then absorbed in the larger Ed Fund (turquoise), which of course then translates into the same overall pattern for the Total (black) rate.

Note also that debt is retired in 2017 and the base line tax rate permanently drops 10-12 cents as that (pink) Debt Service wedge goes away.

Updated Base Case - February 2011



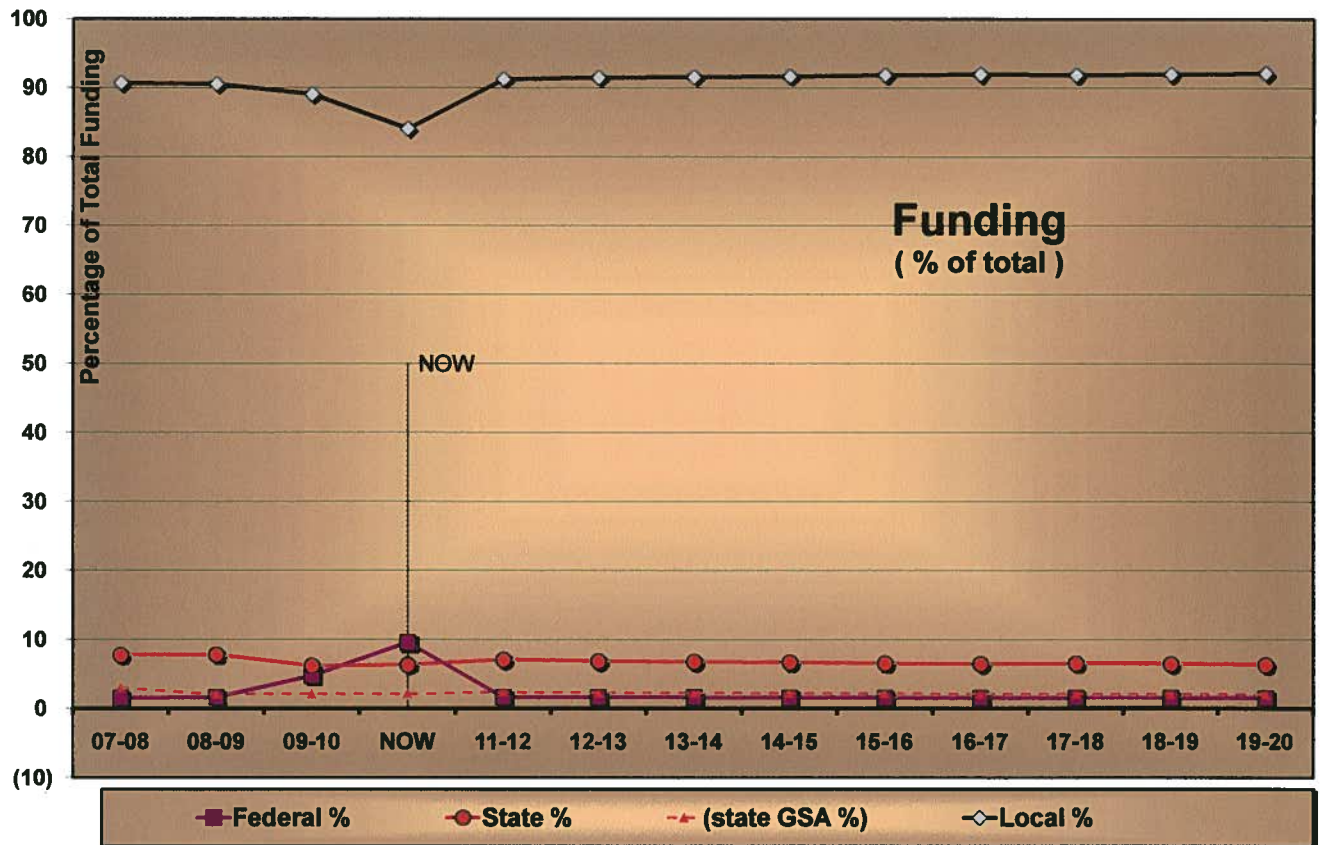
Cash flows for the major funds and total are reflected in this chart.

Cash flows for Transportation (yellow - smaller right scale), O&M (orange - smaller right scale), and Others (not shown) are kept in relative balance by adjusting the annual levy process. Revenues (solid) are in relative balance with expenses (dashed). The current blip in O&M (orange) is largely the result of abatement projects, funded primarily by extra federal dollars.

The recent referendum has provided the desired Ed Fund revenue (solid turquoise - larger left scale) to meet ongoing expenses (dashed turquoise - larger left scale) before a slight deficit begins to emerge. That slowly expanding deficit is the result of presumed contract escalations in salaries and benefits that continue to exceed the CPI-driven revenue increases.

In total, Revenues (green - left scale) are projected to adequately cover Expenses (red - left scale) for several years before the Ed Fund deficit begins to affect it.

Updated Base Case - February 2011



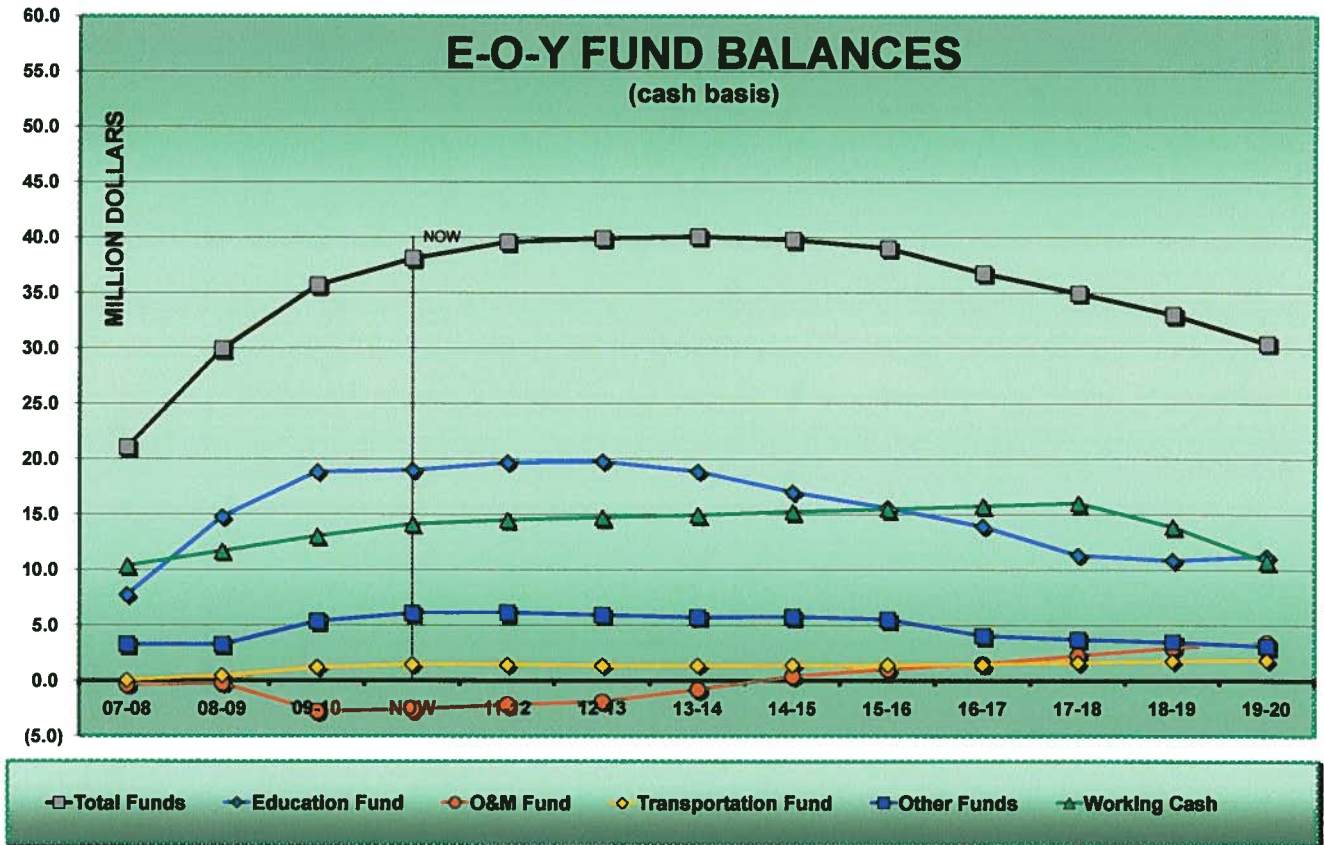
A significant feature of District 64's financial picture is the source of funding.

Federal revenue (purple) is minimal at about 1% of the budget, except for the temporary "stimulus" in 2009-11.

State support (red), including General State Aid, "Categoricals", and some transportation, typically total only 6-8% of the budget.

Essentially all of Park Ridge-Niles funding comes from local sources (black), primarily local property taxes.

Updated Base Case - February 2011



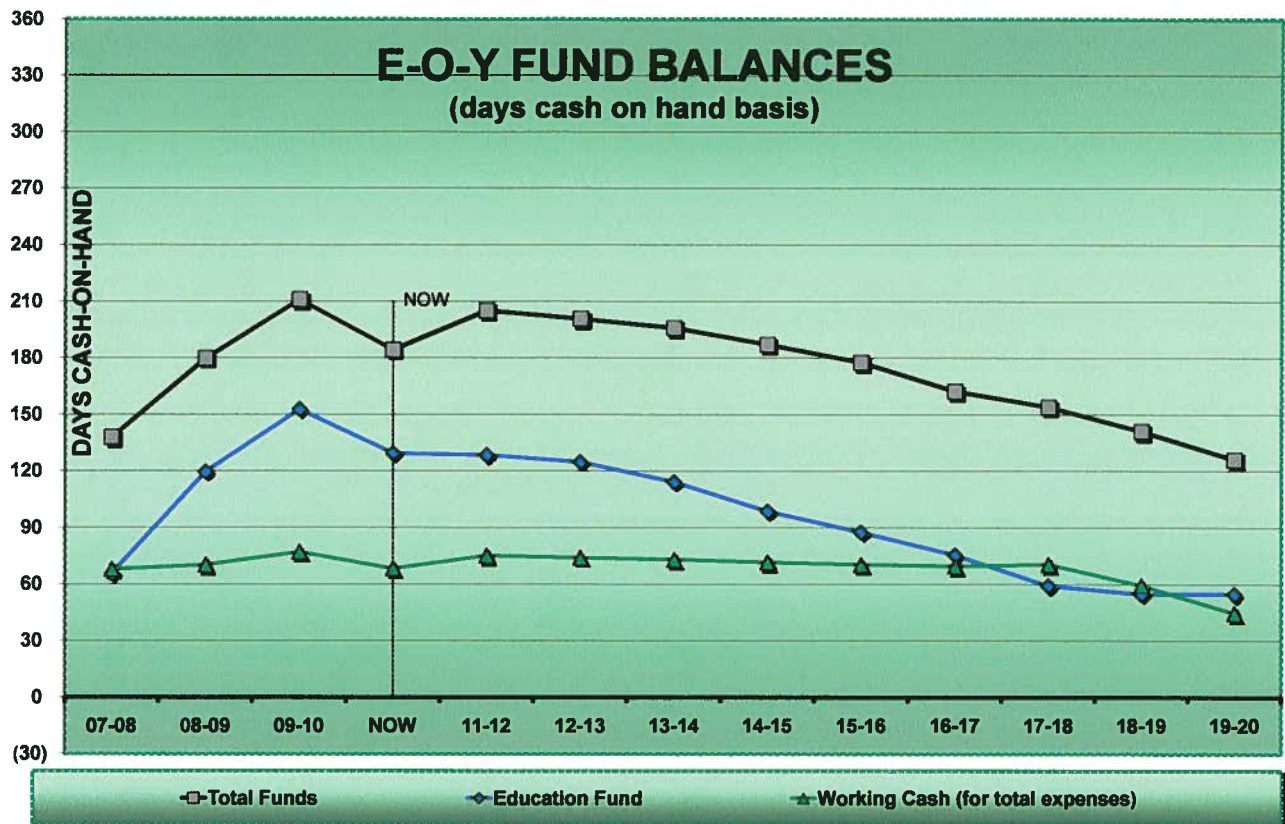
EAVs, tax rates, and cash flows result in these all important E-O-Y (end-of-year) Fund Balances.

The smaller funds are all anchored with solid fund balances as levies are assessed over time to meet their obligations. The larger Ed Fund usually absorbs any larger fluctuations.

As expected from previous tax and cash flow charts, Total Fund Balances (black) are stable for several years until the compounding effects of increasing salaries and benefits begin to turn the slope down. In particular the (turquoise) Ed Fund takes the brunt of the deficit. In this scenario, Working Cash (green) is eventually used to supplement the Ed Fund and keep it at a (somewhat arbitrary) working level.

There is considerable flexibility over time to adjust the fund balances of the smaller funds as needed via the levy process. In addition, the healthy balance in the (green) Working Cash Fund continues to provide an important strategic source of flexibility to support other funds on a temporary or as-needed basis (as illustrated here) as the environment evolves.

Updated Base Case - February 2011



An alternative way to look at fund balances is on a "days-cash-on-hand" basis. As future fund balances were changing on previous charts, so were expense obligations. This chart normalizes those effects and looks at how many days expenses can be paid without new cash infusions. Since tax receipts generally arrive in two major disbursements from the county, most districts target for a 3-6 month range in total. Park Ridge - Niles in fact targets for 4 months ($\frac{1}{3}$ year) and is projected in total to fall comfortably above or within that range well into the future.

This chart does suggest that there is probably little need for immediate concern about projections of eventually declining fund balances. That declining trend is very gradual for a number of years and is dependent in any case on the two-fold assumptions of increasing S&B escalations and a continued flat EAV tax base. Both of those longer term effect can be monitored over the next several years as long as potential concerns continue to be recognized this far in advance.

The Differences ?

It is instructive to compare previous projections to current estimates. The following pair of charts compares projections of fund balances made last year at this time to current estimates.

The primary differences are slightly lower CPI estimates and lower projections of new or expanding EAV tax bases - both resulting in marginally lower revenue receipts overall. The primary strategic differences in District 94's estimates are illustrated below:

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Prev CPI est	4.1	0.1	2.7	1.0	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Curr CPI est	4.1	0.1	2.7	1.5	1.5	2.0	1.5	2.0	1.5	2.0	1.5
Prev est M\$ new EAV	24	32	28	32	33	1.5% =>					
Curr est M\$ new EAV	1	14	7	12	24	1.5% =>					

As noted previously, there is probably little need to make any significant short term adjustments as long as the overall picture remains actively on the strategic radar screen. That strategic picture, however, is a good news / bad news story.

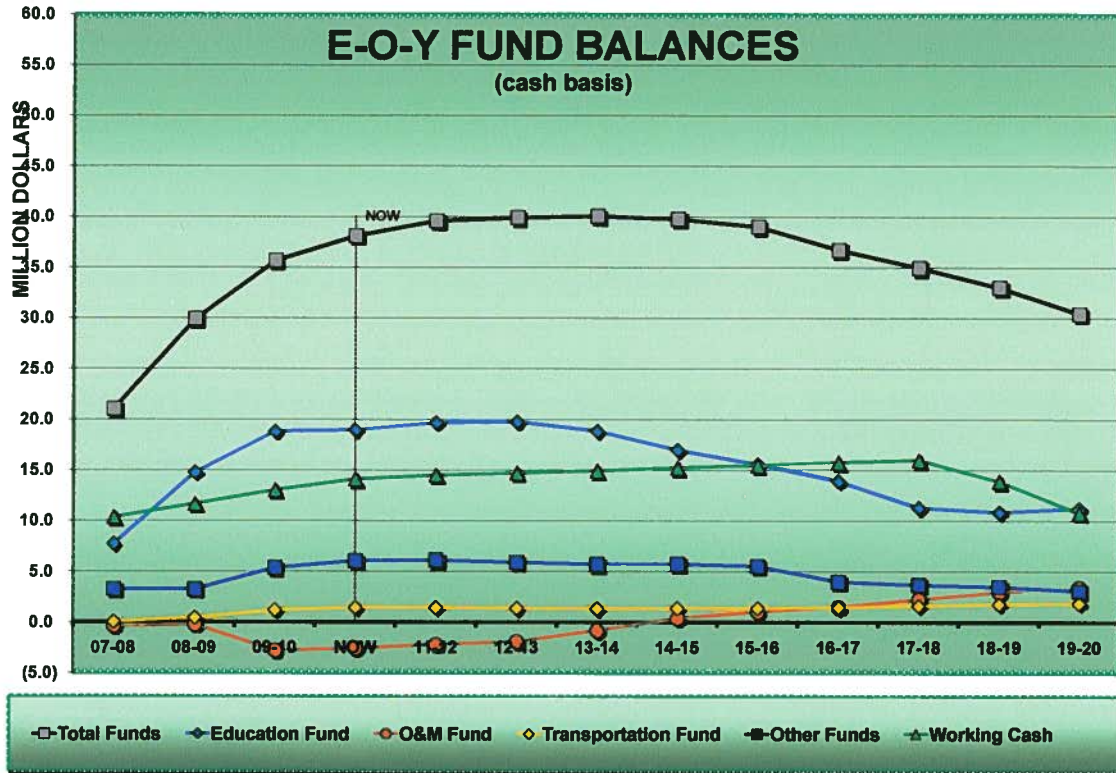
The good news is that the projected declines don't materialize for several years and are dependent in any case on the somewhat conservative two-fold assumptions of increasing S&B escalations and minimal increases in the EAV tax base - both of which can be monitored.

The bad news is that both are potential long term effects that are both compounding and permanent once institutionalized.

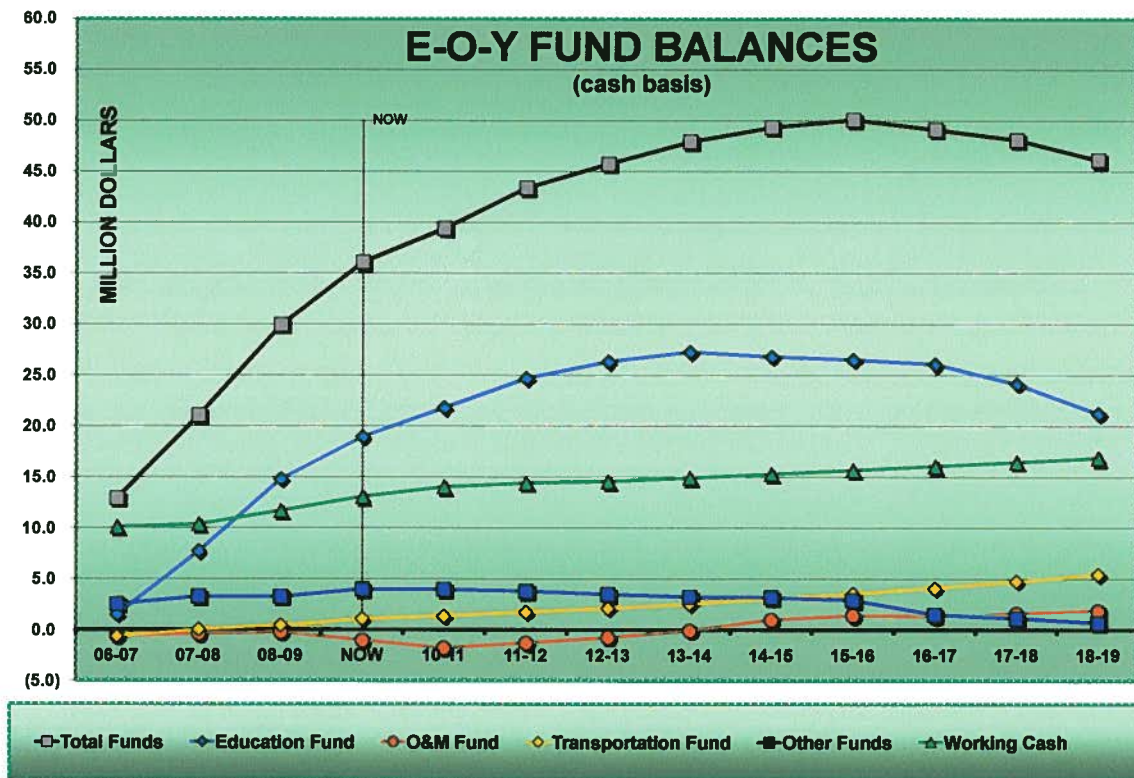
The comparison charts illustrate how very slight differences in ongoing assumptions can affect the long term with those compounding effects. The difference in **total** projected fund balances in 2019 is about \$13 million. While that is certainly not an insignificant amount, it does need to be considered in context - that is less than 2% of a total cash flow over the period of about three-quarters of a **billion** dollars.

As a further illustration, either as little as a 0.5% annual increase in new district EAVs over current assumptions, or 1% less salary and benefit escalations than is currently modeled for the next 3 year contract, would essentially flatten the fund balance projections and be comparable to or better than previous projections.

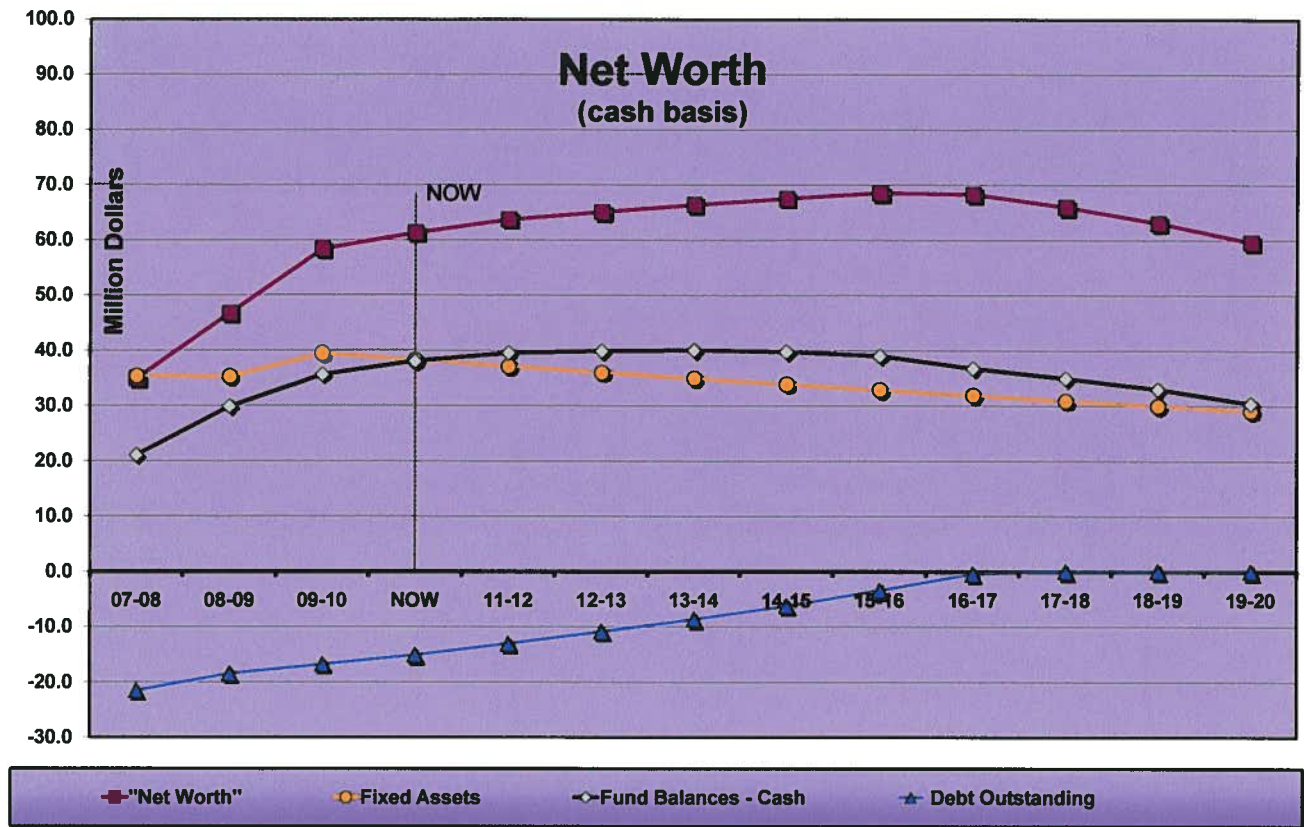
Updated Base Case - February 2011



February 2010 Projections



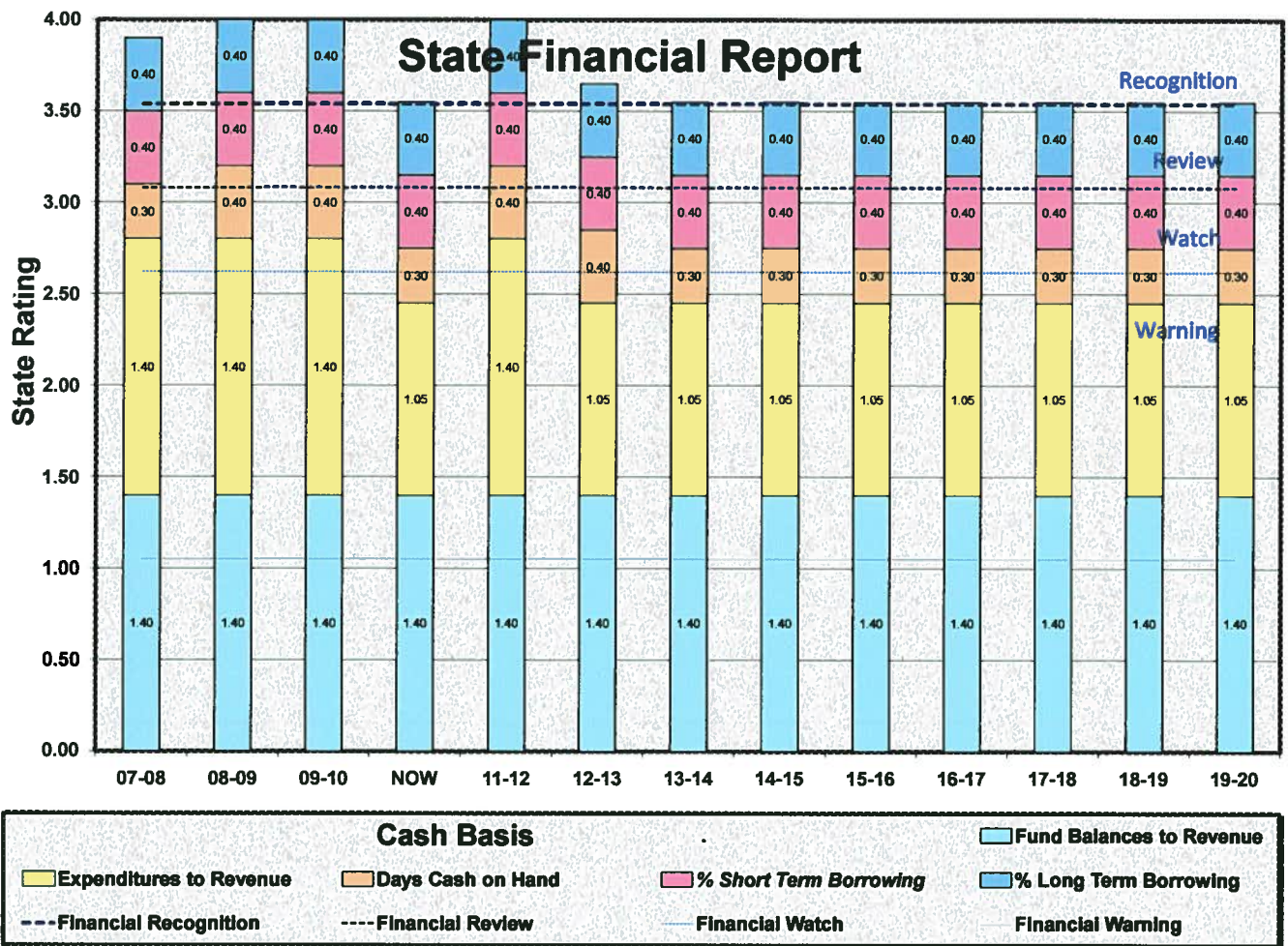
Updated Base Case - February 2011



Although public entities are not strictly analogous to private industry, Net Worth is still a reasonable metric to assess general stewardship. In its simplest form, Net Worth is the sum of Fixed Assets (orange) plus Cash Balances (black) less Debt (blue).

Net Worth (maroon) is relatively stable as declining debt partially offsets the effects of slowly declining fund balances and depreciating fixed assets.

Updated Base Case - February 2011



The state of Illinois of course has its own financial report card for school districts. The five parameters it measures result in a rating from 0 to 4. Park Ridge - Niles ratings have climbed into the top "Recognition" category after the recent referendum and are expected to remain in or around that level in the future.

SENSITIVITIES

Basis

It is virtually certain that whatever evolves, it ***will not*** be exactly as modeled in any of these cases. It is prudent, therefore, to investigate sensitivities. Literally dozens of “what-if?” cases were run in the model investigating variations of District 64 cases. Sensitivities were run to all of the variables presented in the variables/planning section. While all can of course change, and all will then have some subsequent effect, only a few of them are critical from a ***strategic*** point of view.

The major strategic factors in the Park Ridge Niles future include the evolution of the current struggling economy, with its effect on revenues and the recent referendum increases, the control of future salary and benefit escalations on the other side of the ledger, and the ability to implement potential educational enhancements. Other factors such as fluctuations in state/federal aid, or variations in Project or Life Safety work, can be (and have been) accurately modeled, but are generally of smaller import and can either be accommodated in ongoing operations or are generally masked by the larger issues.

Sensitivities are essentially as developed in previous projections with useful “Rules of Thumb” offered for use in scoping discussions.

Useful Rules of Thumb

There are a variety of approximate relationships that can be used for “what-if?” discussions of sensitivities. All are dependent to a degree on where and in which case they are applied and upon the timing, because of varying EAVs, tax rates, enrollment and other factors. All can (and should) be verified in detail within the model if they are under active consideration.

Nonetheless, they are useful for “back of the envelope” type discussions. Some useful approximate rules of thumb are:

	<u>is roughly equivalent to</u>
• each 1% change in CPI	5 cent tax rate
• each 1% salary & benefit escalation	2 cent tax rate
• each 1% spread between EAV/CPI	2 cent tax rate
• each 10% change in level of state/federal funding	3 cent tax rate
• each \$700k (~1%) in ongoing expenses or revenue	4 cent tax rate
• each class size increment of +/- 1	5 cent tax rate
• each two additional staff members	1 cent tax rate
• each \$10 million in new construction EAV	3 cent tax rate

Or, when considering tax rates, referenda, or tax cap consequences,

each 5 cent tax rate increment is roughly equivalent to:

- \$1M annual revenues
- 2-3% salaries/benefits
- Class size increment of +/- 1
- Additional 10 staff members

SUMMARY

Previous studies by StratPlan have evaluated the Park Ridge - Niles long range financial outlook. A particular focus was if the recent operating referendum would in fact stabilize District 64's finances as envisioned through about 2017, in light of the dramatic turn of events in the local, national, and worldwide economies. Several alternate scenarios investigated that same question and the effects on the quality of education and ongoing plans should either a faster or slower economic recovery evolve.

With now another year of economic doldrums, and another year of actual financial data and budgets, StratPlan has revisited the Park Ridge - Niles long-range outlook.

Given new, marginally worse, base case assumptions about the economic recovery and its impact, the district's financial outlook is also very marginally worse. This also highlights, however, how the compounding effects of very slight changes in assumptions, or certainly in the underlying economic environment itself, can easily begin to color long range trends.

Variations in previous studies investigating the effects of healthy versus anemic recoveries are still fairly applicable. Those increments can still be directionally superimposed on this base case update.

The overall conclusions for Park Ridge - Niles remains consistent. The District 64 is **basically stable** -certainly in the near term, and likely until the unofficial 2017 day of reckoning. Variations past that point are very dependent on long range assumptions and the compounding effects of smaller short range activities.

The suggested strategic course continues to be to watch the economy and the tax base evolve over the next year or two and to use that period for thoughtful discussions and evaluations of the range of future strategic options. Over that horizon, StratPlan can continue to be used to investigate variations on those themes, to evaluate the implications of periodic contract negotiations, to address unforeseen situations, or to consider any new initiatives that may arise.