Ten-Year Fund Balance Outlook Under Various CPI Scenarios

District 64 Community Finance Committee

Financial Structure Study Group

Discussion with Committee of the Whole-Finance

November 9, 2009

Purpose

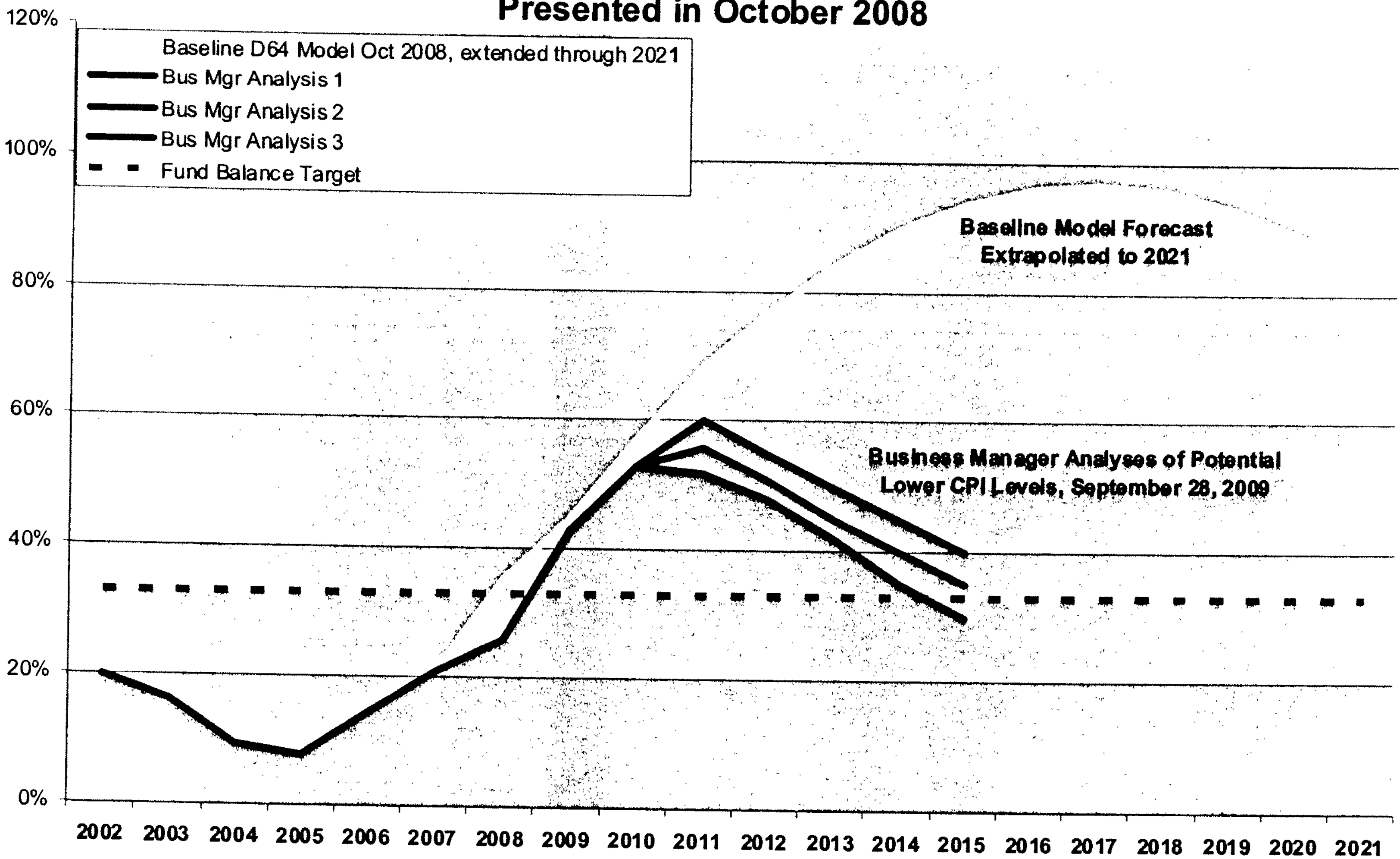
- **Provide an external perspective on the financial situation of D64 by calculating potential fund balance positions over the next ten years**
- **Identify potential variables and situations to monitor**
- **Suggest/confirm potential issue areas to evaluate alternative decisions that could be taken in the short term to avoid problems in the long term**
- **Members: Kent Bergren, Mike Callahan, Phil Eichman, Craig Elderkin, Jun Lim**
- **For today's meeting:**
  - Review our analysis approach and findings
  - Discuss implications and how to proceed

Building on the D64 Ten-Year Model

- **In its current form, the model was designed to help estimate the desired limiting rate for the 2007 referendum**
  - Maintain fund balance over 33% for at least ten years
  - Raise taxes as little as possible
- **The model is based on assumptions about critical property tax behavior/rules/trends and historical trends of key revenue and expense items**
  - The D64 model is not a "ten-year budget"
  - It has been used as an aid to test/evaluate some key financial decisions in last 12 months
- **The CFC wants to build on the D64 ten-year model to understand the impact of:**
  - Inflation rates different from historical trend
  - Staff additions and retirements
  - The impact on property tax revenues and Illinois state funding caused by the historically-severe economic contraction

A Point on Language

- **There is one *model* to project future fund balances, which is maintained by D64**
- **CFC copied the *spreadsheet* of the model (as of October 2008) and made two sets of changes:**
  - Subdivided some existing categories/line items in the model without changing the concepts in order to better calculate projections
  - Substituted *values* for future years in the District's model with alternate values based on CFC analysis
- **The CFC spreadsheet follows the logic of D64's model with alternate values for future years**
- **Also, recall that in September 2009, the Board reviewed a fund balance ratio analysis conducted by the Business Manager to gauge the impact of much lower CPI rates**



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Assumptions

- **CFC's assumptions of spreadsheet values for future years were of four types:**
  - Historical D64 cost trends, estimating growth rates over inflation (CPI), such as salaries, supplies, and services
  - External forecasts of CPI, energy costs, commodity costs, and health insurance premiums from academic and business sources
  - Historical D64 revenue and expenditure trends less likely to be affected by inflation, such as federal aid and tuition paid
  - Reasoned assumptions about future behavior of "dislocated" revenue items
    - New Property and triennial reassessment rates, driven by significant changes in property values
    - Illinois state funding sources, driven by an extended recession and Illinois financial constraints
- **Except for the last item, all assumptions are based on analyses of historical trends and external forecasts**
- **Note that the calculated CFC projections are extrapolations and do not attempt to model management decisions, e.g., change spending to avoid annual deficits**

CFC Projections of Property Tax Components

Spreadsheet Variable	8-Year Historical Trend	D64 Value	CFC Projection
EAV Growth	7.9%	Five-year rolling average bases on triennial year; year 1: 17.07%, year 2: 4.63%, year 3: -0.15%	FY12 EAV down by 15% compared to D64 model, FY15 EAV down by 10% compared to D64, then applies triennial averages
New Property Growth	10.6%	Five year rolling average % of EAV	Tax Year 2009 is ½ of TY 2007, then increases by rolling 5-year average of New Property to EAV
% Taxes Collected	--	98.5%	98.5%
Property Tax Refunds	17.4%	Constant $463,000	$500,000 during first triennial, then increase 10% each subsequent triennial

CFC Projections for Other Revenues

Spreadsheet Variable	8-Year Historical Trend	D64 Value	CFC Projection
Corporate and Personal Property Replacement Tax	8.2%	3%	Flat in 2011, then CPI
Local Fees	--	3%	Weighted average of categories: CPI+1.6% to CPI+1.8%; Transportation 2%
Investment Interest Income	-0.8%	3%	1.0% in FY2011 due to Fed actions, then increase by CPI
TIF Payments	--	Specific schedule	Apply the schedule
General State Aid	2.5%	3%	Overall flat due to fiscal constraints and slowly declining enrollment
Categorical State Grants	7.8%	3%	Assume 1/2 CPI due to fiscal constraints
Federal Grants	10.2%	3%	Does not vary with inflation, use 8-year CAGR of 10.2%; adjust for ARRA and airplane noise abatement funds

CFC Salary Formula Varies with CPI

- **The D64 model assumes an annual 4.5% increase in total salary**
- **CFC derived a simple formula to forecast salary rate changes using publicly available information that could vary with different inflation forecasts**
  - Before staffing changes, such as retirements or net new hires
  - Assumes PREA negotiations set the salary growth pattern for the other staff groups
  - This formula does not purport to document how salary negotiations are ***actually*** carried out
- **Part one of the formula for annual salary rate changes: 2% Step plus Forecasted CPI (annualized over the contract period) plus a Negotiated Adjustment**
  - CPI plus Negotiated Adjustment approximates the "annual increase to base salary" negotiated by PREA and BOE
  - Estimated Negotiated Adjustment, before CPI, using the prior contract period is 0.8% based on current PREA mix
  - The prediction for the new contract period range from Step plus 2.4% to 4.3% depending on CPI forecasts, compared to the Step plus 2.5% actually achieved
- **The second part of the formula is that some proportion of PREA will advance one Lane**
  - The estimated average salary increase due to a Lane advance is 4.6%
  - Estimated proportion of PREA members advancing one Lane is 10% annually, for overall 0.5% impact
- **The total CFC formula for forecasting salary rate changes before staffing changes is Annualized Forecasted CPI + 3.3%**
- **Caveat**
  - Estimates are overstated since the impact of staff with greater than 20 years experience is not modeled

CFC Projections of Staff Changes

- **The D64 model does not explicitly project net staff changes**
- **History**
  - Referendum passed in 2007, class size limits were restored, additional teachers to be hired
  - 2008: Add one EIS/RTI Director, six student-facing staff
  - 2009: Add three administrators, three student facing staff, seven retirees/departures
  - 2010: Some staff will retire
- **Based on recent history plus typical patterns, CFC projections assume:**
  - Adding net new staff: one senior coordinator, three mid-level experienced certified staff as specialists annually, in response to unforeseen mandates or circumstances
  - Retirements (replacing highly-compensated staff with less expensive staff)
    - Contract year 1: 5, as PREA members wait to see new contract terms and incentives
    - Contract year 2: 20
    - Contract year 3: 5
    - CFC projections assume 20-year MA+48 retiring teacher replaced with 4-year BA+12
    - Non-teaching staff – assume relatively small incremental salary changes, so not modeled
  - Reductions in positions:
    - Sections decrease once every two years
    - No net changes in other staff

CFC Projections of Non-Salary Expenditures

Spreadsheet Variable	8-Year Historical Trend	D64 Value	CFC Projection
Employee Benefits	7.7%	12%	11% regardless of inflation, plus $8,000 (extended at same rate) for net new staff
Purchased Services	4.5%	3%	Weighted average of Transportation (2%), Technology (7%), Energy (CPI+2%), and Food Services (CPI: CPI+2%)
Supplies	4.0%	3%	8 year CAGR: CPI+1.5%
Tuition Paid	11.0%	10%	Varies by need not by inflation - use historical trend of 11%
Capital Outlay	15.9%	3%	Adjust for airplane noise reduction and ARRA projects, then CPI
Other Expenses	27.5%	3%	CPI

CFC Spreadsheet Incorporated Four CPI Scenarios

	Spreadsheet Values 2011-2019	Source
D64 Model	3.0%	
Historical Trend	2.5%	8-year average and median
Blue Chip Consensus	Range 1.9% to 2.7%	Congressional Budget Office and private forecasters polled by the Fed
Low-Inflation	0.1%, 1%, 2%, 2.5%, hold at 3%	Discussion with Becky Allard
High-Inflation	2.5% rising to 4.0% to 5.0%	First Trust Portfolios, Brian Wesbury

Differences between Baseline Projection and CFC Projections

Historically-severe economic contraction affects 2010 and 2011, which reduces the starting-point

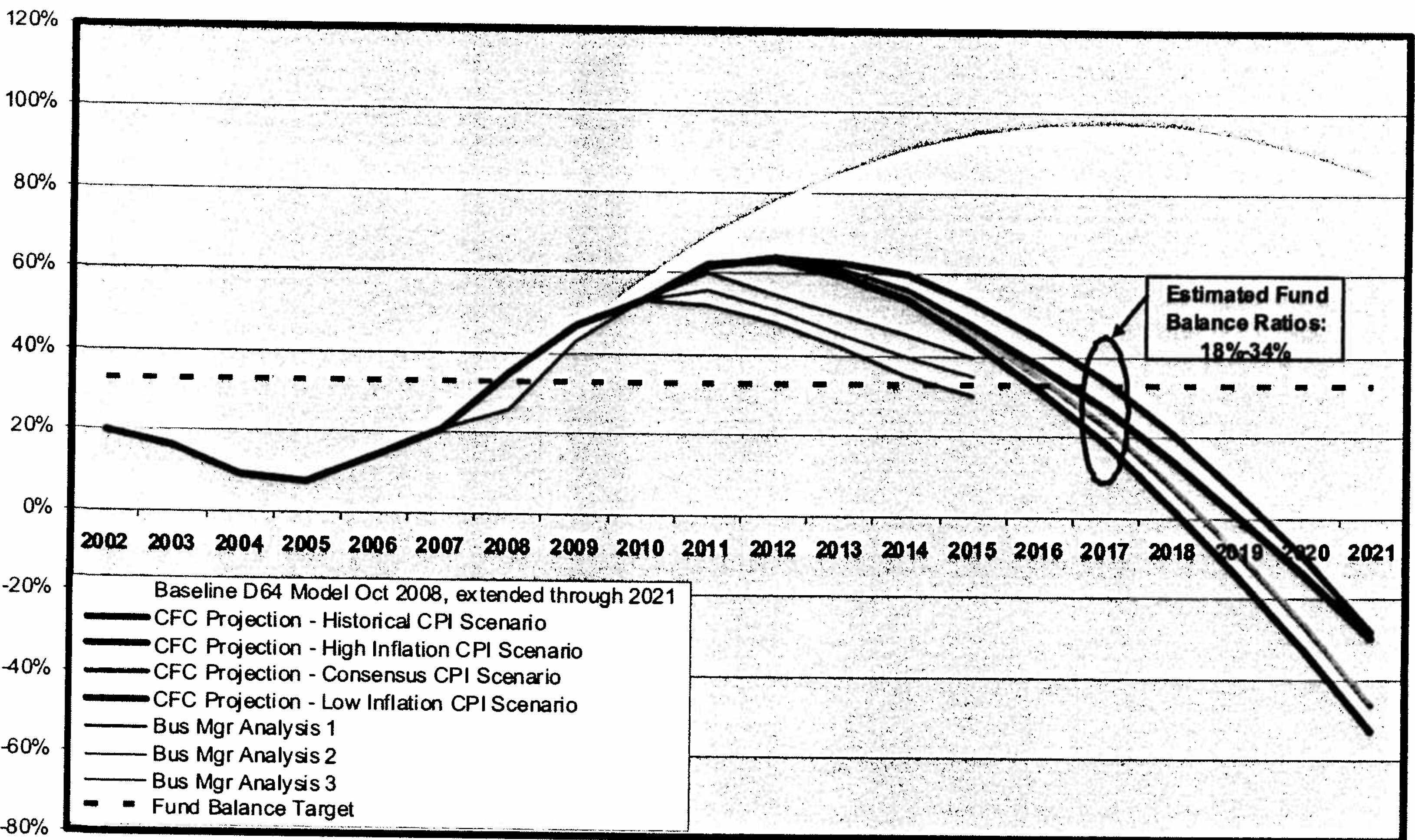
- Lower CPI in 2010-2012 versus smooth 3% CPI assumed in October 2008 Baseline
- Decline in property values, resulting in decline of the value and projected growth of New Property
- CPPRT down two-thirds due to reduced revenues from Illinois businesses
- State aid down two-thirds due to reduced tax collections and political turmoil at the State level

Refined CFC forecasts for certain expenditure categories

- Salary growth of 6-8% versus 4.5%, partially driven by CPI-based formula
- Supplies growth of CPI+1.5% versus CPI
- Purchases Services growth of CPI+~2.2% versus CPI

Bottom line: CFC ten-year outlook models higher expense growth combined with a lower revenue starting-point compared to the October 2008 Baseline

CFC Projected Fund Balance Ratios Under Various CPI Scenarios



A Ten-Year View: Selected 2017 Findings

	CPI Scenario			
($ millions)	Historical CPI	Consensus CPI	Low Inflation	High Inflation
Fund Balance Ratio	34%	23%	18%	27%
Revenue Growth Rate	3%	2%	2%	4%
Expenditure Growth Rate	6%	5%	6%	7%
First Year of Projected Operating Fund Deficit	2015	2014	2014	2014
Salary Growth Rate	6%	6%	6%	7%
Benefits	$14.6	$14.6	$14.6	$14.6
vs. 2010 Budget	2.1x	2.1x	2.1x	2.1x
Tuition	$2.7	$2.7	$2.7	$2.7
vs. 2010 Budget	2.1x	2.1x	2.1x	2.1x
Cumulative 2010-2017 Compared to Baseline Scenario				
Tax Receipts from New Property	($9.3)	($11.8)	($12.3)	($2.9)
Total Tax Receipts	($41.4)	($53.3)	($56.0)	($25.9)

A Ten-Year View: Some Summary Conclusions

- **Based purely on extrapolation, it appears that D64 needs to act to avoid a referendum before 2017 as promised**
  - Current trends, regardless of CPI, will result in deficits in four or five years, which of course the District would not allow to happen
- **CPI growth can be a double-edged sword: higher-inflation scenarios can boost tax revenues but also deplete the fund balance almost as quickly as lower-CPI scenarios**
- **CFC believes salary growth will have a significant impact on the fund balance compared to earlier projections**
  - Adding non-classroom professionals will further strain projected fund balances
- **If trends continue, Health Benefits and Special Education Tuition costs will double**
  - Health Benefits can rise to as much as 15-16% of total expenditures compared to 11% today
  - Tuition will grow to become the third largest expenditure line item after Salaries and Benefits
- **Non-people expense growth trends will also pull down the fund balance ratio**
- **Constrained New Property growth on top of lower increases in CPI rates will have significant negative impact on tax revenues**

This Ten-Year Fund Balance Outlook Can be a Useful Analysis Tool

- **While ten-year projections are only approximations, this review can help the Board identify significant financial issue areas**
- **Study, identify, and evaluate alternatives, and begin to address over the next 18 to 24 months**
- **Act deliberatively to achieve long-term benefits while the fund balance is healthy**
- **For example, consider the following "what if"**
  - District 64 works through the spring of 2011 to evaluate and make decisions about specific issue areas
  - Beginning in the fall of 2011 – two years from now – implement programs to:
    - Slow salary expense growth by 1%
    - Slow Benefits and Tuition growth by 2%
    - Slow Supplies and Purchased Services growth by 1%
    - Identify a new income source to net $500,000 by 2017
  - The 2017 fund balance ratio would exceed 33% under the various CPI scenarios

Some Implications for Discussion

- Developing a holistic view about prioritizing, adding, and reducing professional activities can guide job design, net staff changes, and new-hire policies
- As relatively inflation-insensitive expenditure items with high growth trends, particular attention should be paid to Health Benefits and Special Education Tuition costs
- Many non-people expenses will grow significantly if CPI accelerates, suggesting continued attention should be paid to expense control and strategic sourcing
- Developing an alternative income stream, no matter how small it begins, may become an important strategic project for the Board
- While outside of Board control, careful attention should be paid to the property tax environment, particularly CPI and New Property
- In general, prepare now to plan and take actions – more revenue, slower spending, working cash financing, referendum