

Turning Your Long-Term Financial Plan into Financial Policy

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Overview

- Purpose & Structure of a Long-Term Financial Plan
- Developing Economic Context
- Preparing a Baseline Forecast
- Developing & Testing Financial Policy Options
- Conclusions

Why you don't want to do multi-year planning

“I’m one of only [X] people in my department and I’ve already got enough to do.”

“You can’t predict the future any way, so why worry about it?”

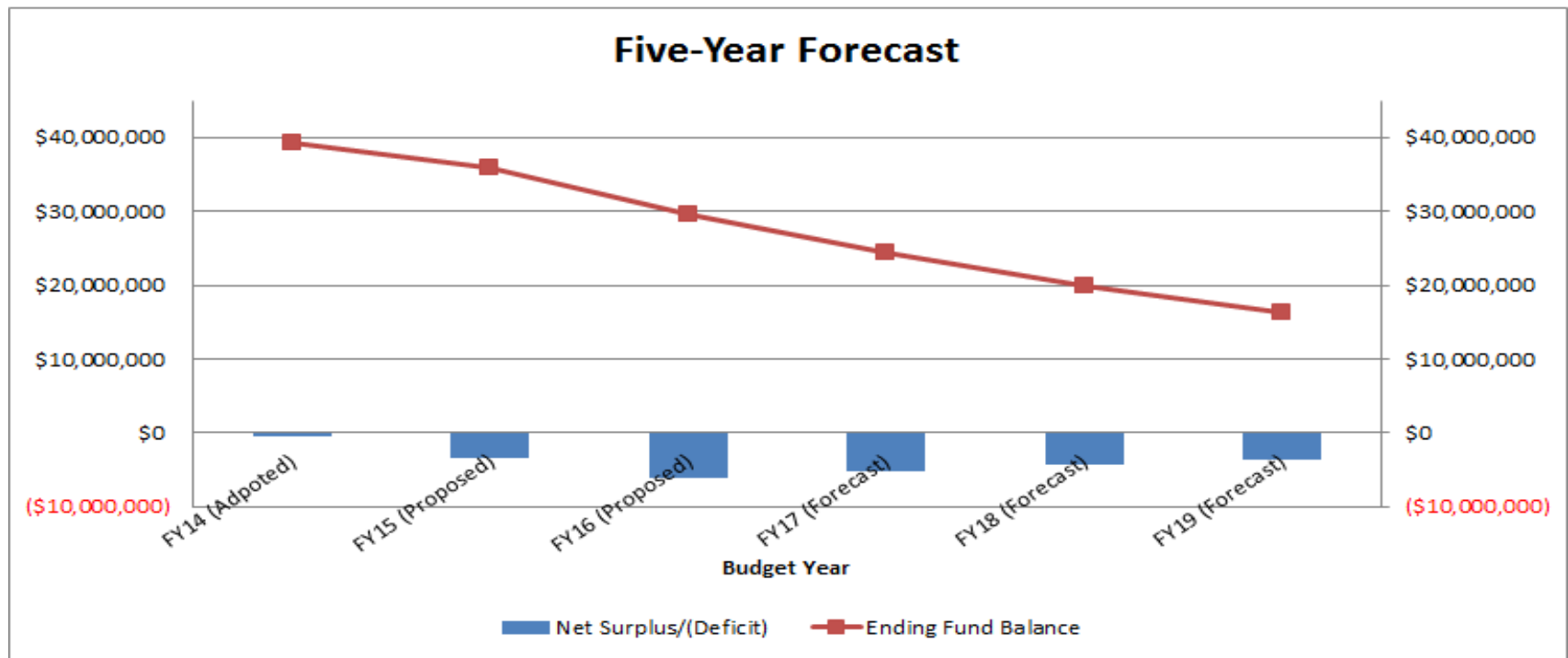
“If I put something out there and it’s wrong, then the plans cause more trouble than they’re worth.”

“We are focused on the next two years because that’s when we have another election.”

“Multi-year planning is something that bigger (or wealthier or poorer) governments do.”

A Common 5-Year Forecast

- Below are the results of a 5-year budget forecast as included in an adopted City budget
- While this projection is dire, there is no more information than the result. No policy, no fix, no “what happens to our reserves after FY19?”
- Furthermore, we don’t know what is not in the projection that may make this worse: funding of long-term liabilities, IT replacement costs, etc.



Sources: Budget published online by a northern California City.

Purpose & Structure of a LTFP

Purpose of Long-Range Planning

Strategic

Helps create a long-view for strategic decision making

Informs policy decisions, such as the impact on General Fund reserves

Projects impacts of policy changes in volatile economic environment

Financial

Identifies structural budget issues

Helps evaluate long-term impacts of current decisions

Helps understand major revenue and expense budget drivers

Who needs multi-year plans?



High Growth/Developing Growth/Developing

Tax base is growing

Rising demands for public services, recreation, green space

Significant or rising revenue related to development (impact fees, building permits)

Growth leading to infrastructure, and increased debt



Mature/Stable

Population and tax base growth has slowed or stopped

Development income is stagnant ("built out")

Costs of providing existing services are still rising

Re-aligning resources to priorities and addressing problems before they become crises



At-Risk/Declining

Old infrastructure and difficulty downsizing

Weak tax base with poverty, higher tax rates and low collections

Population shifting toward lower income and higher service needs

Long-term response to long-term problems

Four Views of Financial Stability

- Cash Position

- Having sufficient cash to pay immediate liabilities

- Budget Position

- Ability to generate sufficient revenues over the budgetary period to meet all expenditures and not incur deficits

- Structural Position

- Recurring revenues meet or exceed recurring expenses from year to year (e.g., no use of transfers, one-time revenue infusions, or reserves to “balance” budget)

- Community Goals

- The government is able deliver desired services over time and respond to changing needs and preferences of the community

Typical Project Overview

I. Economic Overview - Assessment

- Context
- Lingering recession impacts
- Informs revenue and expense forecasts

II. Baseline Forecast - Diagnosis

- The “status quo” approach without corrective action
- Incorporate known expenses where applicable

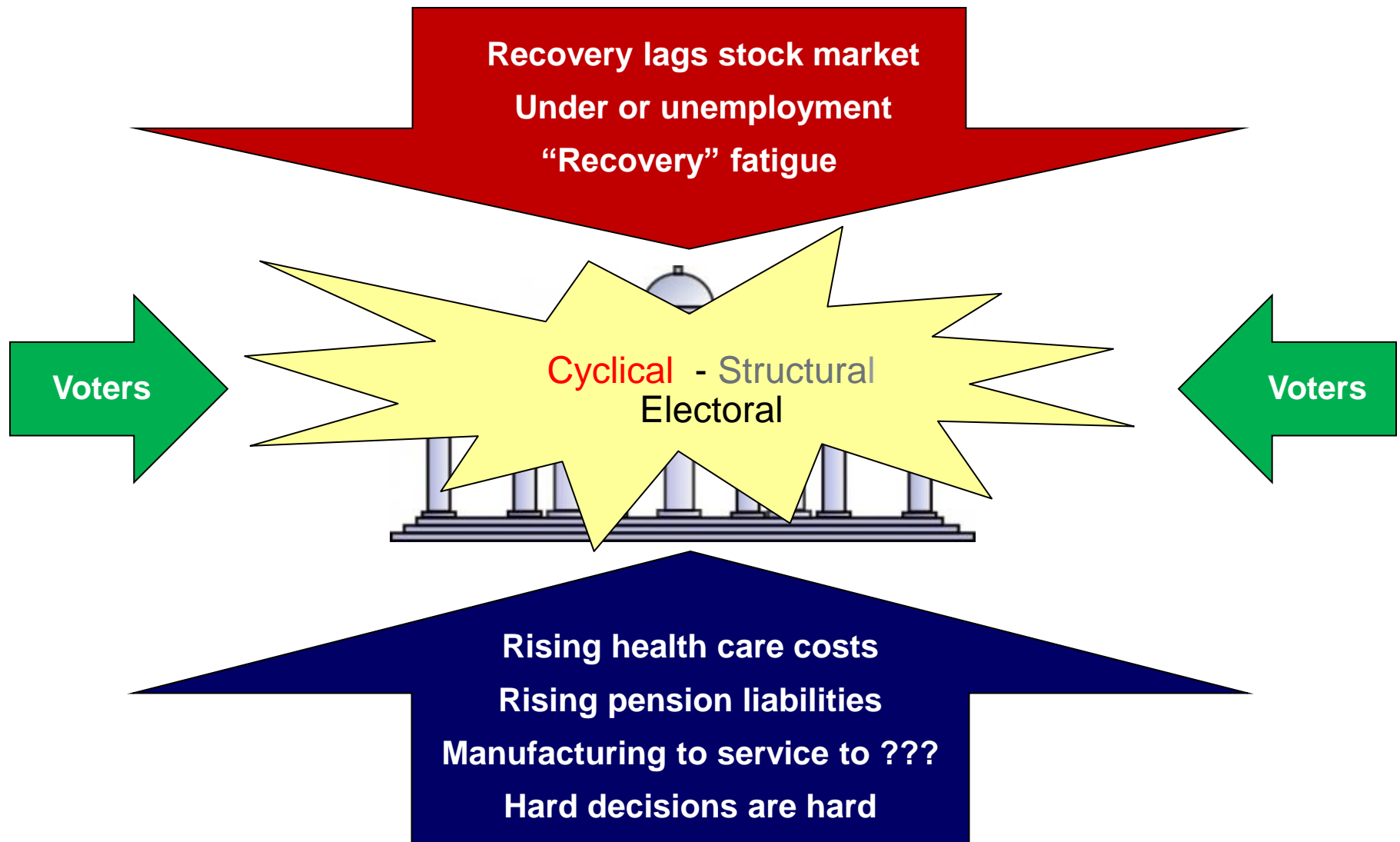
III. Alternative Budget Outcomes - Treatment

- Changes to the Baseline Forecast
 - Optimistic & pessimistic revenue scenarios
 - City actions to control costs or increase revenues
- Initiatives to address **financial policy outcomes**



Developing Economic Context

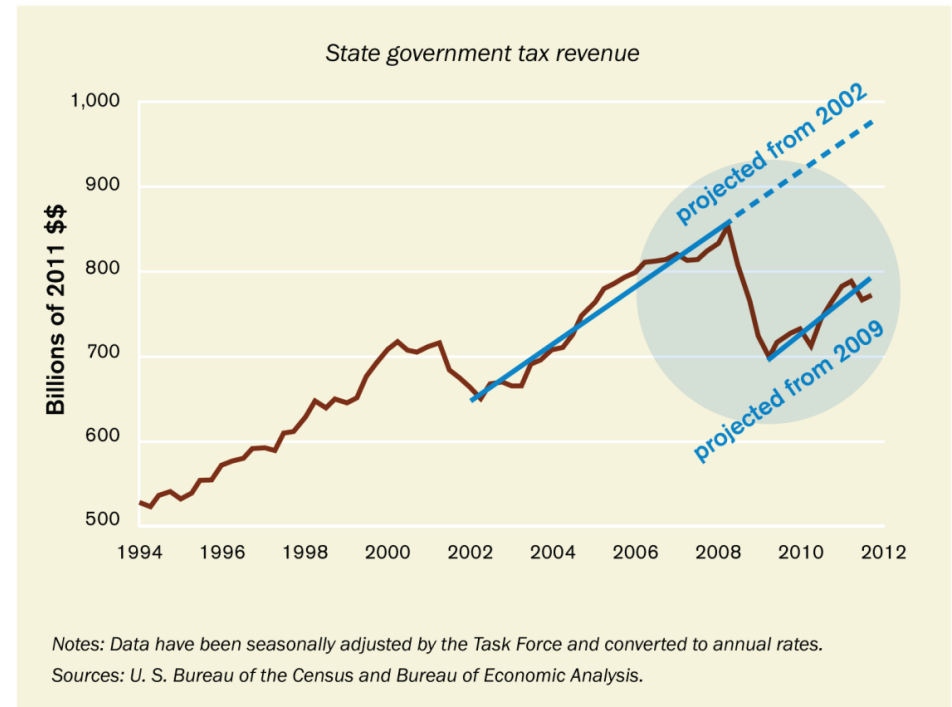
Local Governments Remain Under Pressure



Public Sector Revenue Impacts

- While U.S. state and local government tax receipts have begun to grow again, revenues remain significantly below where they would have been had revenues risen at a constant rate from pre-recession levels instead of “ratcheting down” with the economic contraction

Figure 1 | States are limping up from the bottom of a cliff

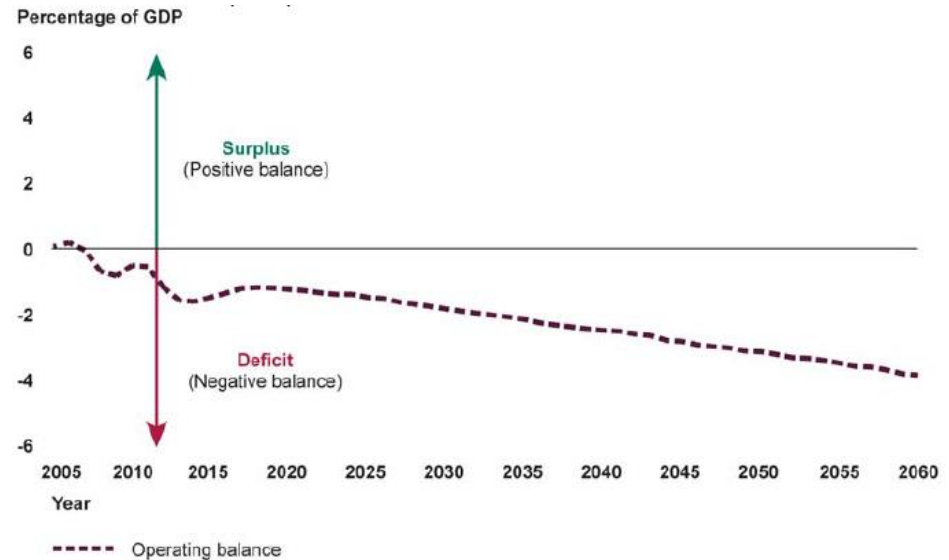


Source: Report of the State Budget Crisis Task Force July 31, 2012)

Structural Fiscal Challenges

- The U.S. Government Accountability Office (GAO) has developed a simulation model for the state and local sector as an entirety, projecting significant fiscal gaps absent corrective action, due largely to:
 - Flat revenues as % of GDP
 - Healthcare and retiree costs rising faster than the overall economy
- GAO calculated that closing the structural fiscal gap would require action equivalent to a **18% reduction** in state and local government recurring expenditures

State and Local Operating Balance Measure, as a Percentage of Gross Domestic Product (GDP)

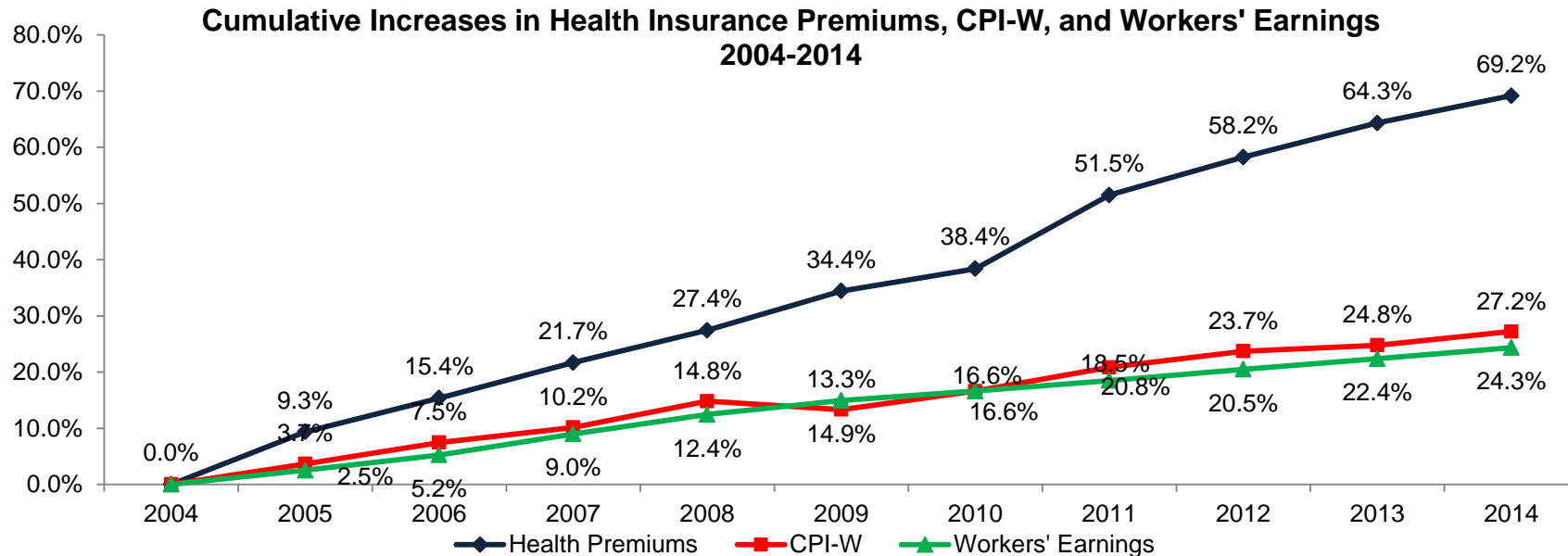


Source: GAO simulations, updated April 2013.

Source: United States Government Accountability Office, "State and Local Governments' Fiscal Outlook: April 2013 Update"

Expenditure Pressures: Health Benefits

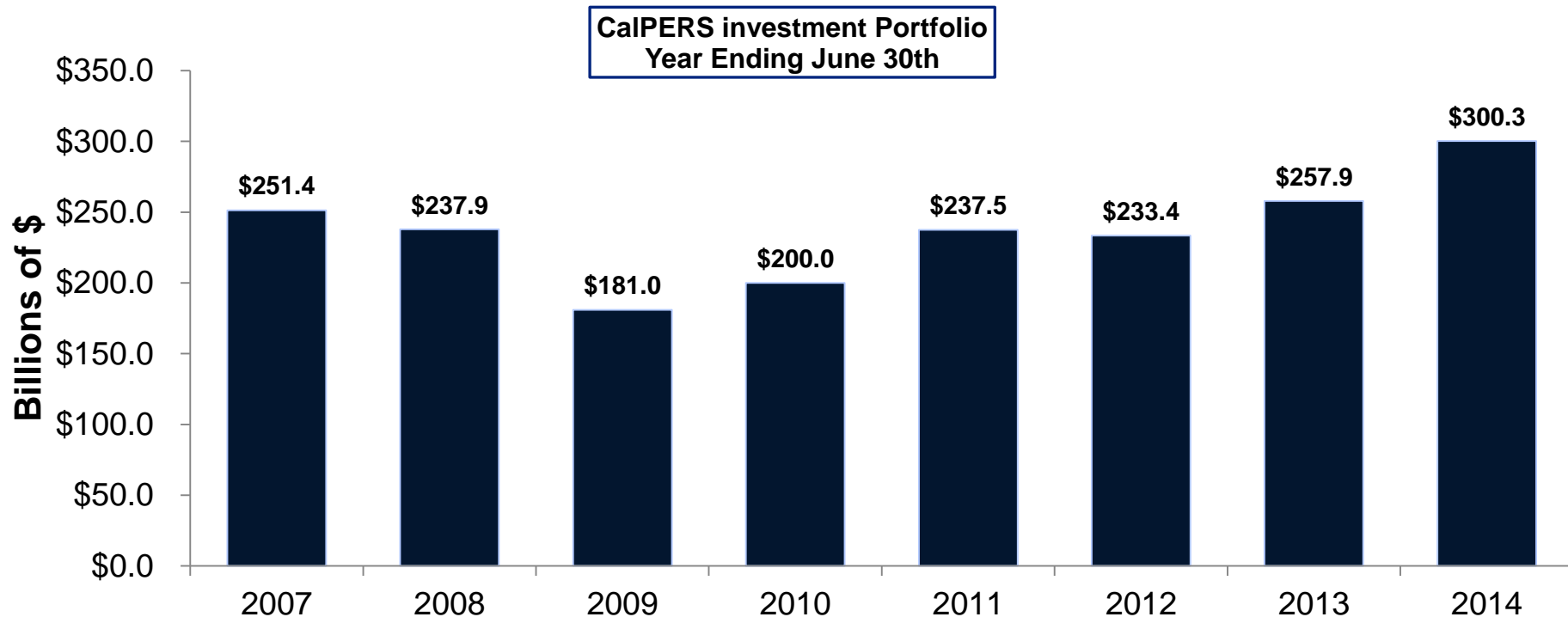
- As shown in the chart below, growth in health premiums nationally have significantly outpaced workers' earnings and inflation over the last 10 years
- From 2004 to 2014, Bay Area PEMHCA premiums for single coverage in the Kaiser plan increased from **\$3,665** to **\$8,913**, an increase of **143%**



Sources: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2003-2013. Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation (April to April), 2003-2013; Bureau of Labor Statistics, Seasonally Adjusted Data from the Employment Cost Index (Q1 to Q1)

CalPERS Holdings and Total Returns

- CalPERS investments have only recently exceeded June 30, 2007 levels
- While recent returns have been good, longer term total returns have been below the 7.5% target:
 - Fiscal Year to date ended 10/31/2014 (0.5%)
 - 3 years for period ended 10/31/2014 11.2%
 - 5 years for period ended 10/31/2014 10.7%
 - 10 years for period ended 10/31/2014 6.8%



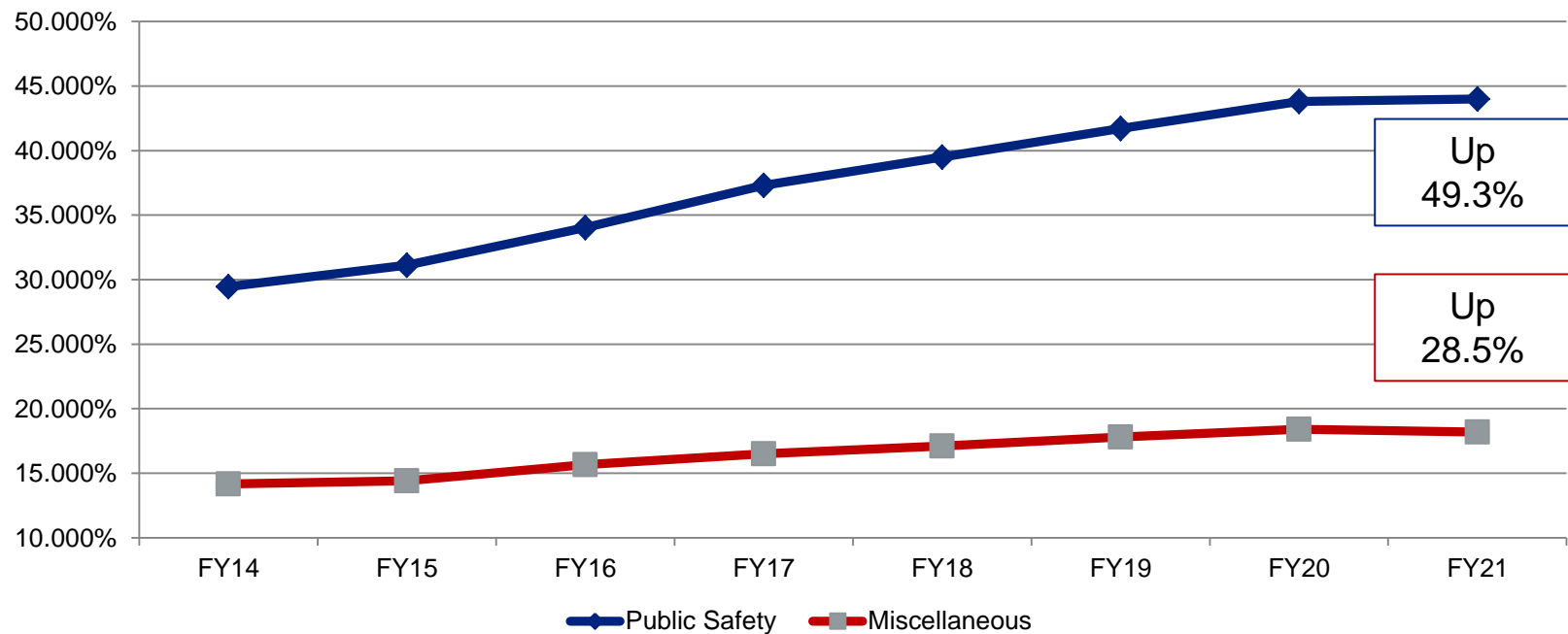
Source: CalPERS "Facts At A Glance," February 2015

General Fund Expenses

CalPERS Cost Increases

- Employer PERS rates are expected to rise significantly over the next several years as a result of actuarial changes approved by the CalPERS board and mortality improvements

Employer PERS Rates (EXAMPLE)



Forecast Employer PERS rates will have a significant impact on most City's finances over the next 6 years

Preparing a Baseline Forecast

Baseline Assessment

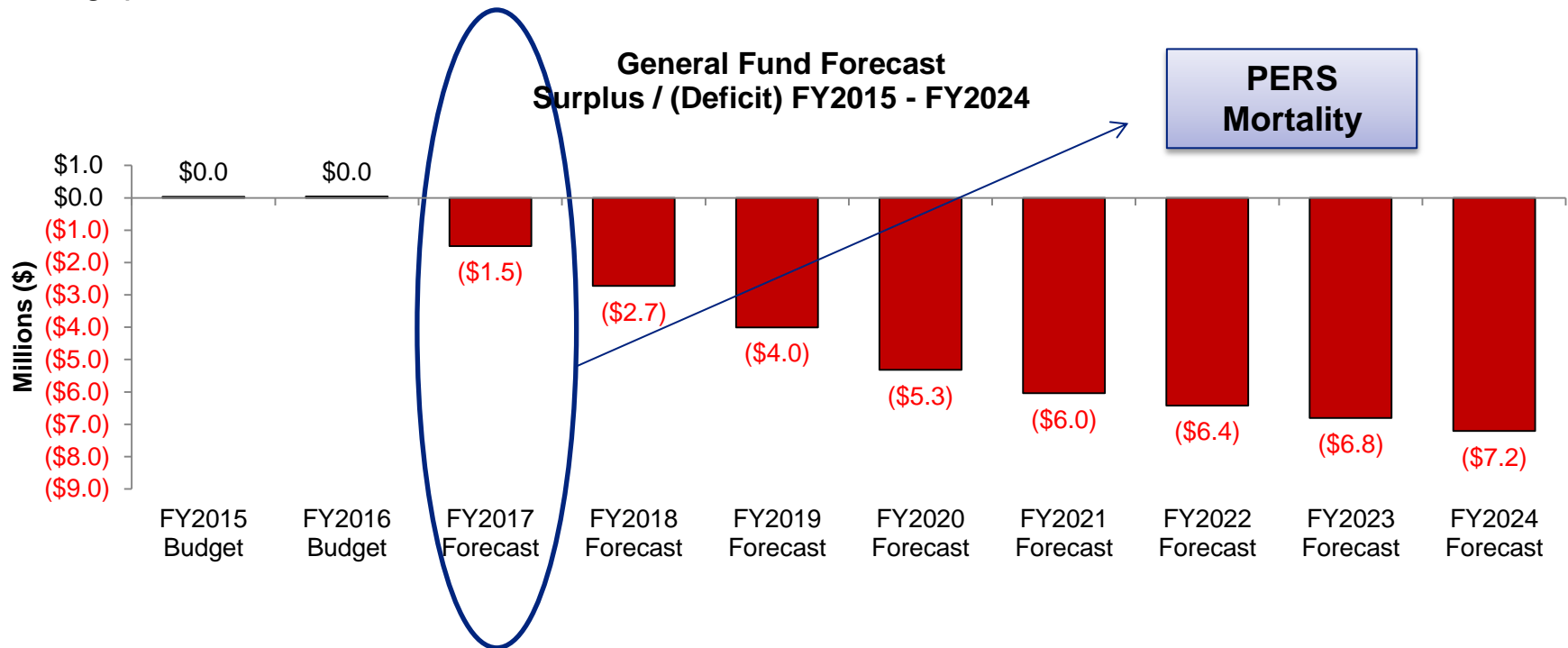
Guiding question: What is the financial condition of the government now and what is the condition likely to be in the future **if no policy changes or corrective actions are made?**

- Even if the you have a good understanding of your finances, the same may not be true of other important stakeholders. Forming and evaluating a baseline assessment will help you:
 - Communicate a clearer picture of your government's financial strengths and weaknesses to others
 - Identify hidden and emerging problems
 - Introduce long-range considerations into budget discussions

Baseline Forecast - City "A"

Operating Surplus / (Deficit)

- This city is projected to run a budget deficit beginning in FY2017 of **\$1.5 million** absent corrective action
 - Over the 10-year forecast period PFM's baseline forecast reflects a **\$39.9 million** cumulative gap



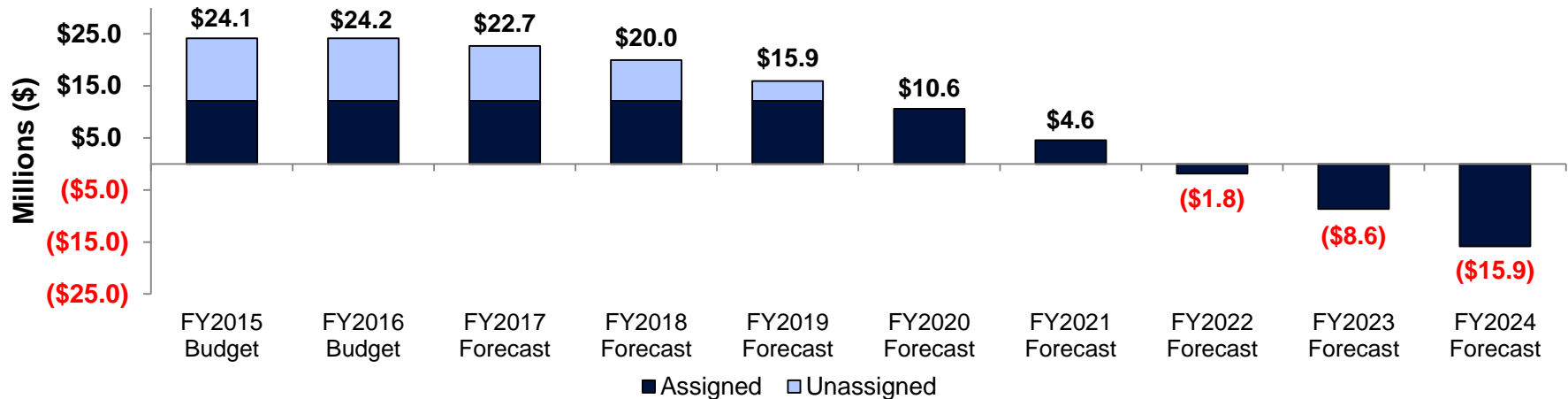
General Fund	FY2015 Budget	FY2016 Budget	FY2017 Forecast	FY2018 Forecast	FY2019 Forecast	FY2020 Forecast	FY2021 Forecast	FY2022 Forecast	FY2023 Forecast	FY2024 Forecast
Revenues	\$72.8	\$73.6	\$75.1	\$76.7	\$78.3	\$80.0	\$81.6	\$83.3	\$85.0	\$86.7
Expenditures	\$72.8	\$73.6	\$76.6	\$79.4	\$82.3	\$85.3	\$87.6	\$89.7	\$91.8	\$93.9
Surplus/Deficit	\$0.0	\$0.0	(\$1.5)	(\$2.7)	(\$4.0)	(\$5.3)	(\$6.0)	(\$6.4)	(\$6.8)	(\$7.2)

Baseline Forecast - City "A"

Impact of Budget Deficit on Fund Balance

- Based on the projected deficit, the City will be unable to keep a policy level 15% unassigned fund balance.
 - The unassigned fund balance would be completely depleted by FY2020 and the assigned fund balance would be completely depleted by FY2022

Assigned + Unassigned Fund Balance
Impact of Budget Gap on General Fund Reserves

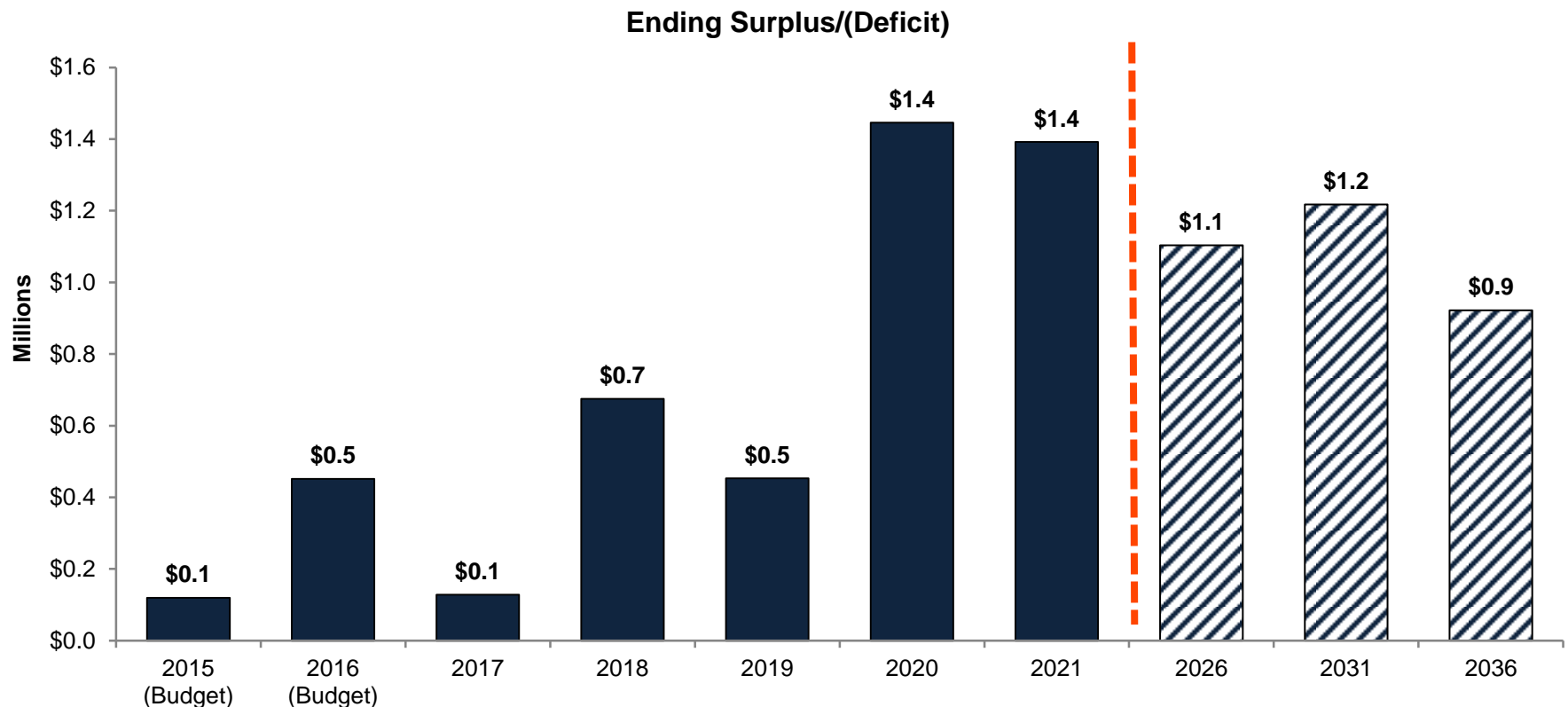


	FY2015 Budget	FY2016 Budget	FY2017 Forecast	FY2018 Forecast	FY2019 Forecast	FY2020 Forecast	FY2021 Forecast	FY2022 Forecast	FY2023 Forecast	FY2024 Forecast
Assigned	\$12.1	\$12.1	\$12.1	\$12.1	\$12.1	\$10.6	\$4.6	(\$1.8)	(\$8.6)	(\$15.9)
Unassigned	\$12.0	\$12.1	\$10.6	\$7.8	\$3.8	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Total	\$24.1	\$24.2	\$22.7	\$20.0	\$15.9	\$10.6	\$4.6	(\$1.8)	(\$8.6)	(\$15.9)
Unassigned Target	\$10.9	\$11.0	\$11.5	\$11.9	\$12.3	\$12.8	\$13.1	\$13.5	\$13.8	\$14.1

Baseline Forecast - City “B”

Operating Surplus / (Deficit)

- City’s annual revenues exceed expenses while meeting reserve requirements, creating a different set of potential issues:
 - What is your policy on using the surplus?
 - What are the competing demands?





Developing & Testing Financial Policy Options

What Will Change the Forecast?

The economy

- Changes to revenues (either up or down) will change the City's budget future
- PERS rates and the impacts of future market returns and actuarial assumptions

Council decisions on spending

- Total compensation (salaries, active and retiree health care, pension, leave, etc.)
- The number of staff needed to maintain service levels
- Funding of long-term obligations (e.g., OPEB)
- Long-term facilities maintenance (asset recapitalization)

Voter-approved taxes or assessments

- Local-option taxes must be approved by voters, and could include sales tax, hotel tax, utility users tax, or business license tax
- Assessments must be property-related and are subject to Prop. 218

Attraction of new or expanded businesses and retention of existing

- Expansion of retail and commercial properties in the City; Local economic development initiatives

Matching Financial Policies to Forecast Issues

1. Operations:

- Recurring revenues exceed recurring expenses
- Maintain policy reserve levels
- Use one-time monies for one-time expenses

2. Unfunded Liabilities:

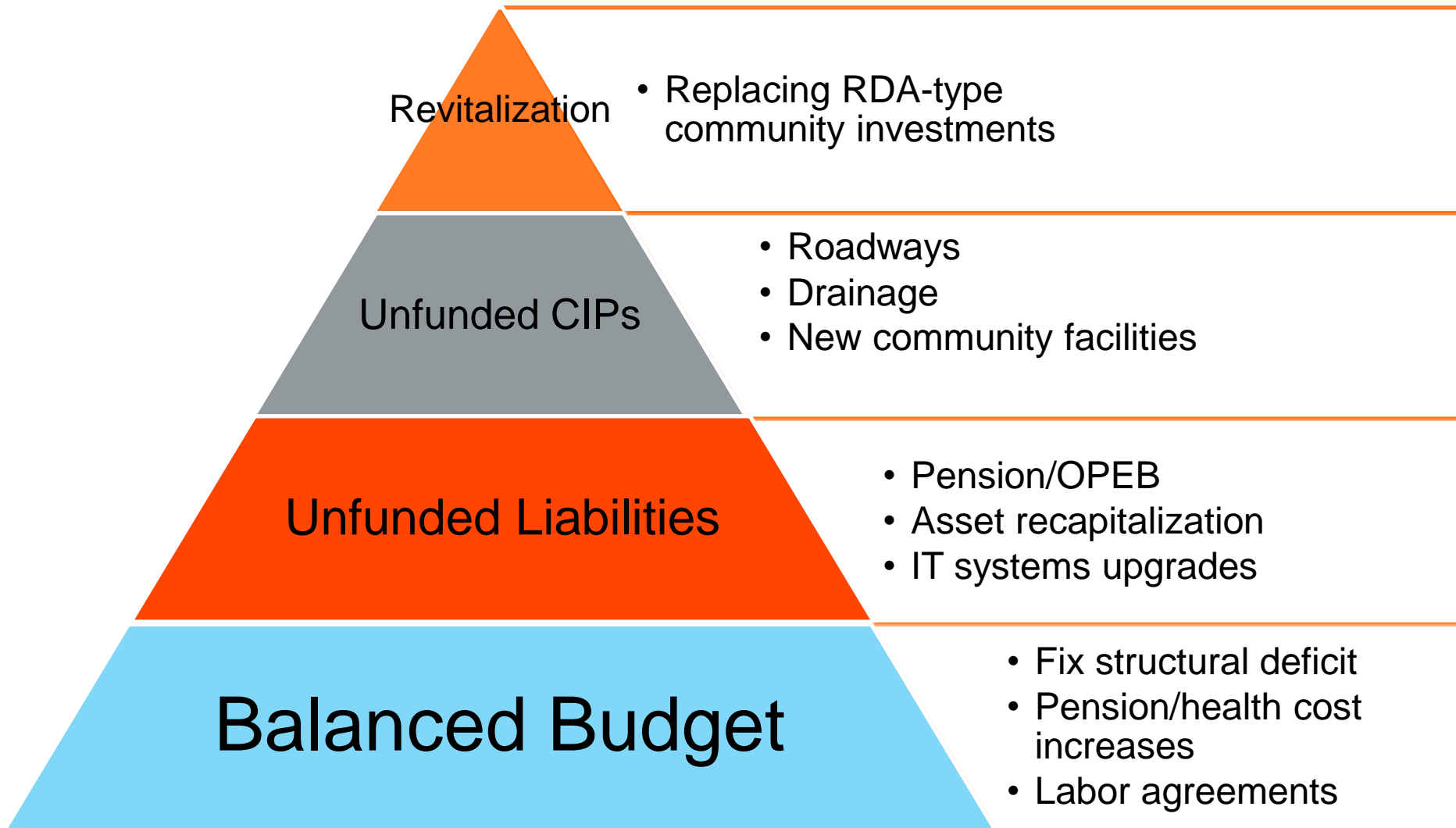
- Fully fund OPEB ARC
- Set-aside funding for asset recapitalization

3. Capital:

- Carve out percent of budget for City investment
- Limit debt as percent of budget (varies by type of fund)

“Making no decision is making a decision”

Matching Financial Policies to Budget Needs



Financial Policy Implementation

- Once you have a baseline projection and discuss the related challenges and opportunities, you can move to the next step – developing initiatives to change the projection and implement your financial policies

Guiding question: Given the baseline assessment and your organization's goals, what kind of response is necessary to implement your financial policies (on both the expenditure and revenue side)?

- Approaches to balancing a budget typically involve some (or all) of the following:
 - Management and productivity initiatives
 - Debt restructuring
 - Workforce strategy
 - Program prioritization
 - Cost recovery (fees and service charges)
 - Tax rate (voter approval) or base changes (economic development)
 - Funding of long-term liabilities

How Fast Can Your Policies be Implemented?

Short-term (less than a year)

- Lay-offs
- Reduced service levels and program funding
- Change in overtime or other work rules or policies (not explicit in a labor agreement)
- Debt restructuring
- Implement new or increased fees for service or increased fines

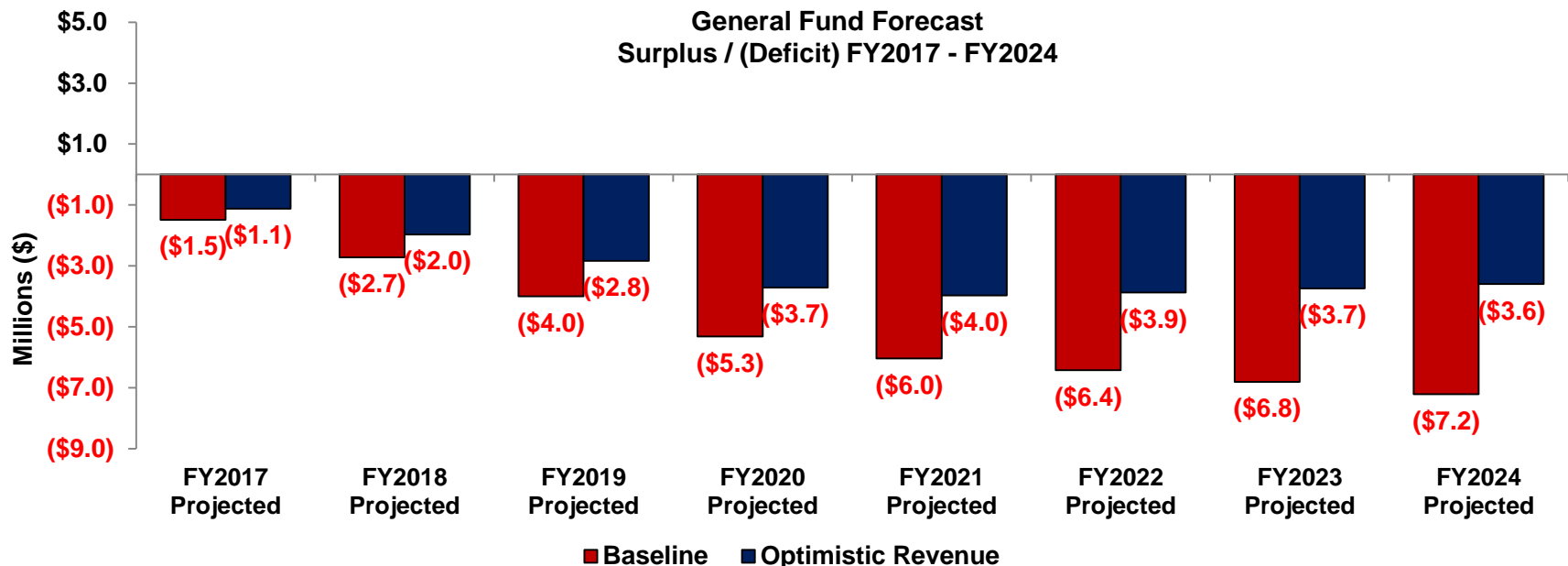
Longer-term (1-5 years)

- Increase existing/implement new tax rates
- Reduce compensation
 - Salaries
 - Health premiums
 - Work rules changes
- Economic development
 - Increased sales/prop tax
 - New retail, hotels, etc.
 - Increased jobs
 - Higher-value homes
- Reduce staff or increase contracting
- Wait for affects of lower PEPRA pension rates or side fund pay-offs

Policy Option – City “A”

Optimistic Revenue (“Hope for the Best”)

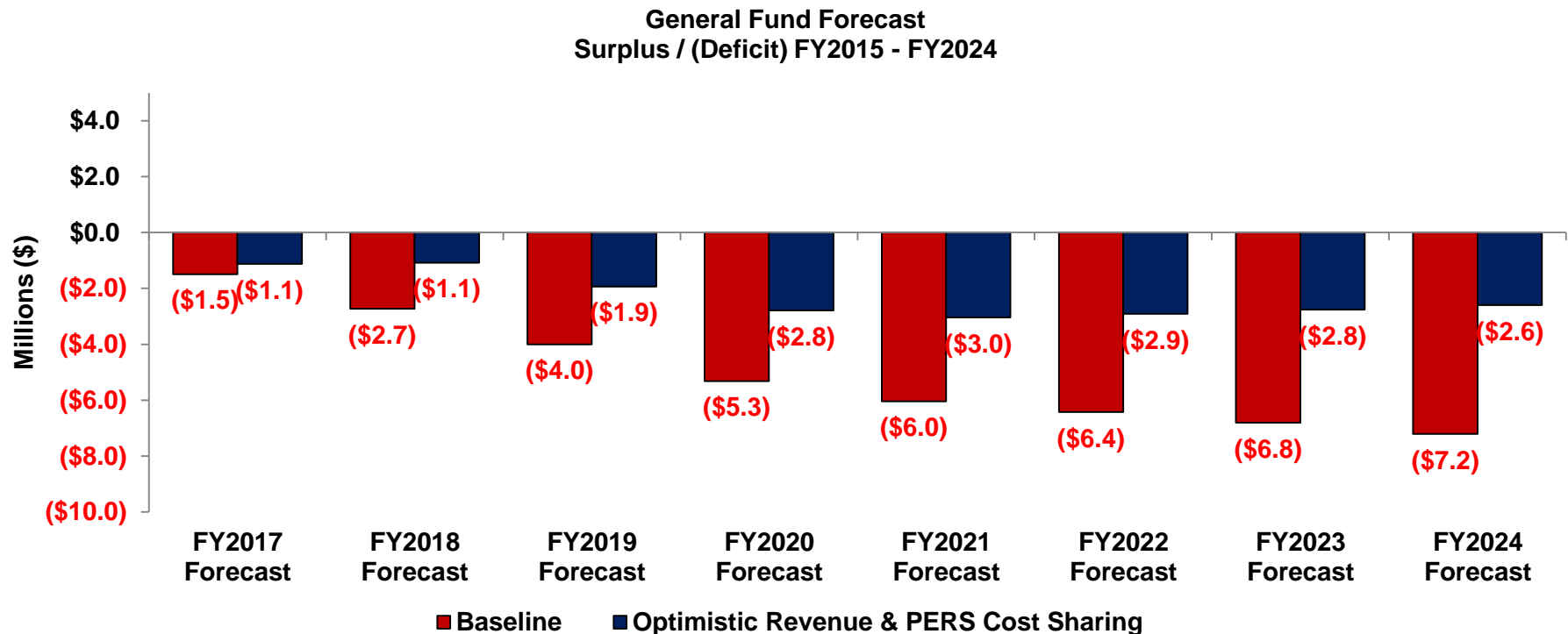
- Even if property and sales taxes grow by an additional 1% above the rates used in the baseline forecast beginning in FY17, the City will still face a structural deficit
 - Under “optimistic” revenue growth assumptions, the City’s cumulative 10-year budget gap declines from a deficit of **\$39.9 million** to a deficit of **\$24.7 million**, an improvement of **\$15.2 million**, but still a significantly deteriorated long-term financial position



Policy Option – City “A”

Optimistic Revenue & PERS Cost Sharing

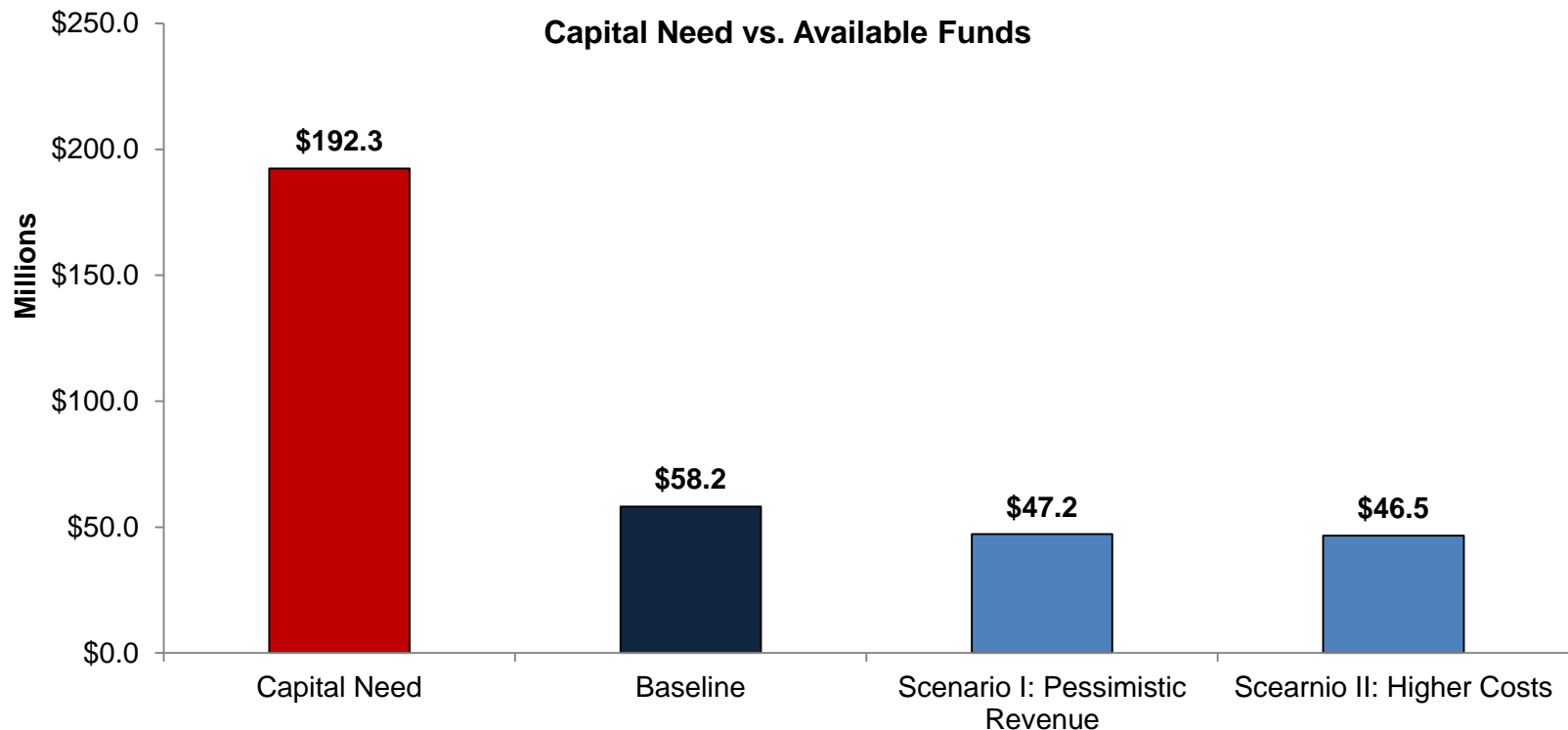
- Assuming “optimistic” revenue projections, and instituting that employees pay half of the normal PERS would save the City up to **\$4.6 million** annually by FY2024, for a cumulative savings of **\$21.8 million**
- Instituting a PERS normal cost sharing approach alone will generate estimated savings between **\$880,000 and \$996,000 annually**



Policy Option – City “B”

Excess GF Revenue to Unfunded Capital Needs

- The City’s ability to fund capital projects on a Pay-Go basis is directly related to the health and performance of the General Fund
- If the City transfers all operating surpluses to capital throughout the duration of the forecast, only **30.2%** of actual need would be met
 - This is reduced as more pessimistic alternatives are tested



Debt Funding Options - City “B” follow-up

- In order to fund community-wide projects, the City will need to consider debt financing
- Proposition 13 and 218 impose significant restrictions on the ability to issue debt without the vote of registered voters or property owners

Description	Vote Required	Potential Revenue/Notes
GO Bonds	2/3 rd approval of voters	Requires strong community support
Certificates of Participation	Lease Agreements Approved by Council	Lease payments of approximately \$1.8 million per year to fund \$25 million in communitywide improvements. Will impact General Fund
Mello-Roos Community Facility Districts (CFDs)	2/3 rd approval of voters	Varies depending on special tax amount. Could be included in new development projects.
Assessment District	Majority approval through protest proceeding vote	Based on improvements. Needs to have special benefit to properties
New: Enhanced Infrastructure Finance District	No requirement to form, but 55% vote to issue bonds	Allows tax increment financing

Conclusion

Lessons Learned the Hard Way

- Being comprehensive will help sell the more painful options.
- Start acting now to avoid a crisis 3 to 5 years from now
- Focusing on reducing expenses first will help you to make the case to increase revenue later



Resist having sacred cows!



Why Should You Do Multi-Year Projections?

It's a better way to bridge the gap

- One-year budget cycles are not an ideal way to address systemic challenges:
 - **Short-term strategies often yield short-term benefits** that expire or may even increase your deficit in out years
 - **Limit public/elected official/labor union appreciation and understanding of long term challenges** (e.g. pension, OPEB, debt service)
 - **Multi-year planning allows you to move away from “putting out the next fire”**
 - As revenues rise in good economic climates, **understanding long-term issues will help direct where revenue should go** (e.g., increased wages vs. deferred building/park maintenance)
- **Helps you determine what you can afford** before you begin processes that will set your expenses for several years (e.g. issuing debt, collective bargaining agreements)

Why Use Financial Policies to Implement Projections?

It changes the budget conversation

- Financial policies can help reduce the “us” vs “them” attitudes of department heads and labor unions
 - **Offers a broader perspective** and challenges people to think beyond their departmental boundaries
- Budget solutions can take years to implement!
 - **Get buy-in to addressing future problems** before they become problems
- Implementing financial policies as part of a multi-year perspective changes the conversation
 - Talk about **what investments are worth making** down the road and how you afford them



Thank You!

Questions? Comments?

For more information, please contact:

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