Southern Huntingdon County School District Financial Analysis

PFM Group Consulting, LLC

January 15, 2020

Background

- PFM was founded in 1975 on the principle of providing sound, independent financial advice to state and local government agencies
  - **PFM Group Consulting LLC** is a team of 30+ full-time professionals whose passion and mission is to improve the performance of school districts, cities, and other public sector agencies
  - We have worked extensively with school districts around the country focusing on operational performance and financial improvement
- **Ian Tyson** is a Senior Managing Consultant at PFM. He supervises school financial modeling, and has played a key role in several school district organizational studies. Ian is the lead for development and support of the Erie School District financial improvement plan, and the implementation of the Scranton School District financial recovery plan.
- PFM has worked with Southern Huntingdon County School District to evaluate the assumptions used in the financial estimates for the elementary school building consolidation project
- In addition, we have provided a third-party analysis of the District's long-term financial position through a multi-year budget projection
- PFM reviewed the methodologies used in the District's financial proposals, but we did not evaluate the non-financial considerations such as the academic benefits of various options

Multi-Year Financial Projections

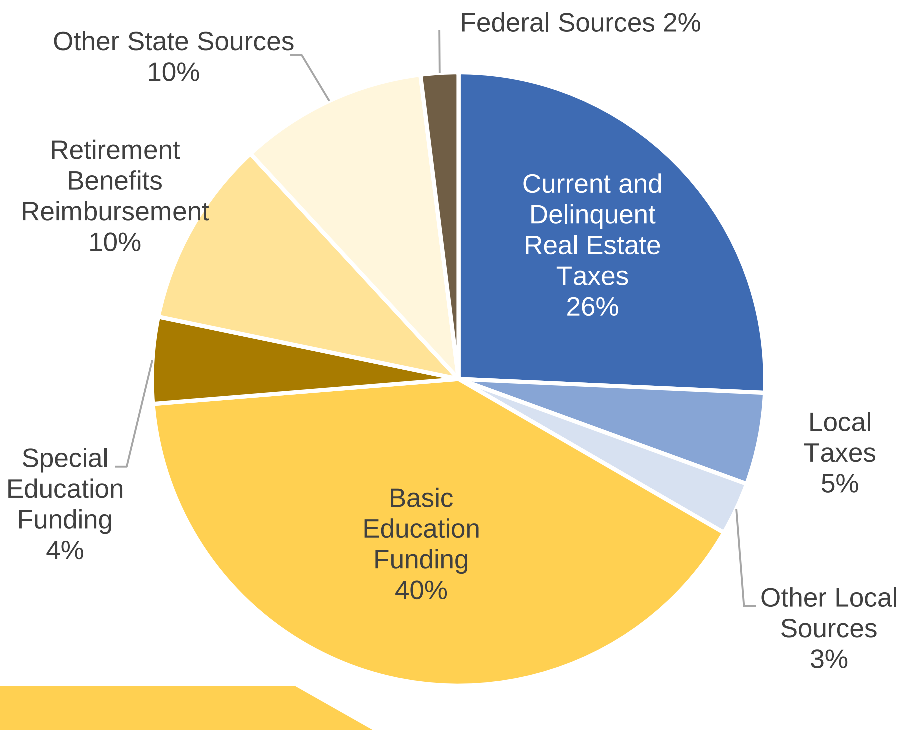
Multi-year projections

- PFM has prepared a multi-year financial projection for SHCSD beginning with this year's budget and continuing through 2025-26 in order to understand the District's current and future financial position
  - These projections are intended to assist the Superintendent and Board in financial decision-making
- Analysis of financial and operational information was supplemented by interviews with District staff to provide context for data trends and to understand issues unique to SHCSD
- This projection is made on a **status quo** basis, assuming no change in the District's current operations or initiatives to control costs and improve revenues
  - As a result, in most cases, this process identifies a gap between revenues and expenditures resulting in projected deficits in future years
  - Many school district cost categories grow more quickly than revenues if no action is taken
- The status quo projection is important to highlight the sources of financial stress in the District's operating budget and set a common baseline for planning and decision-making so that corrective action may be taken if needed, and provide additional information for the building consolidation process

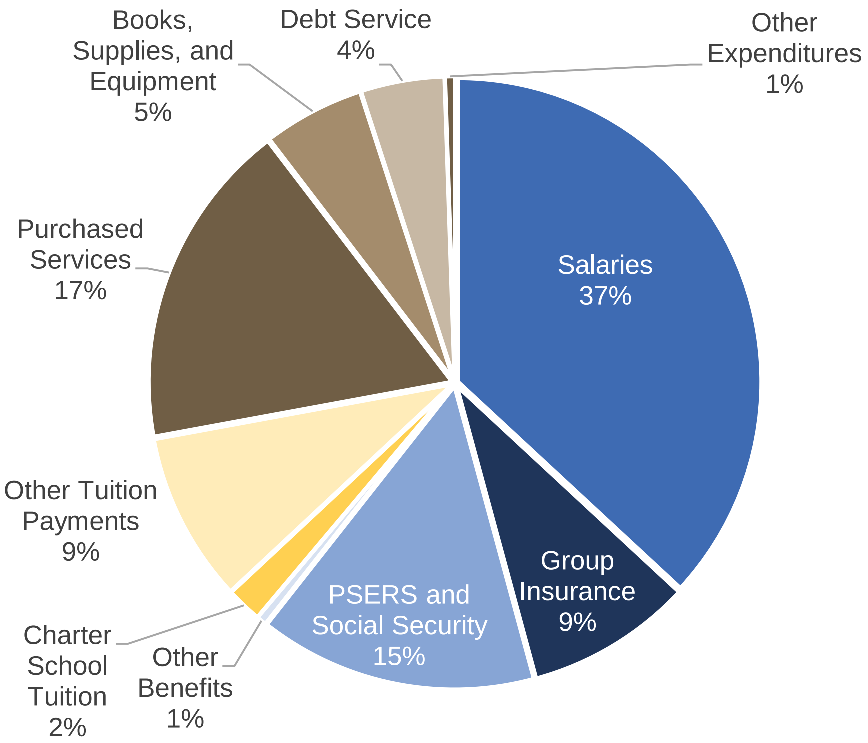
Starting year: 2019-20 adjusted budget (~ $18.4 million)

- The charts below show the major categories of District revenues and expenditures for the current year
  - Local sources account for 33 percent of revenue, while state sources provide almost 65 percent
  - Employee salaries and benefits make up nearly 61 percent of District spending

General Fund Revenues

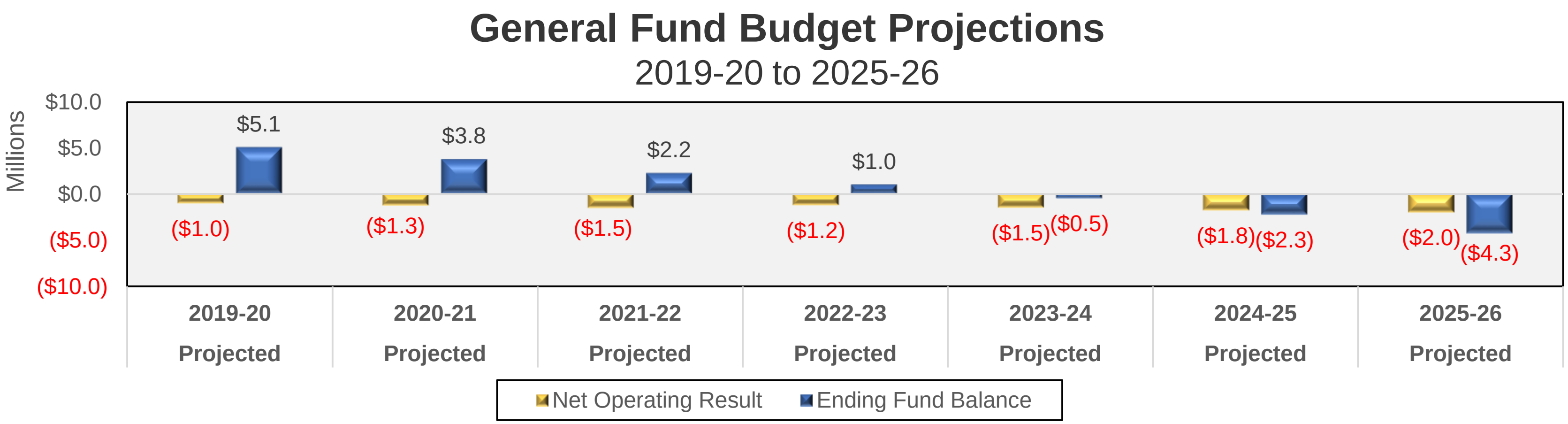


General Fund Expenditures



Baseline multi-year projection

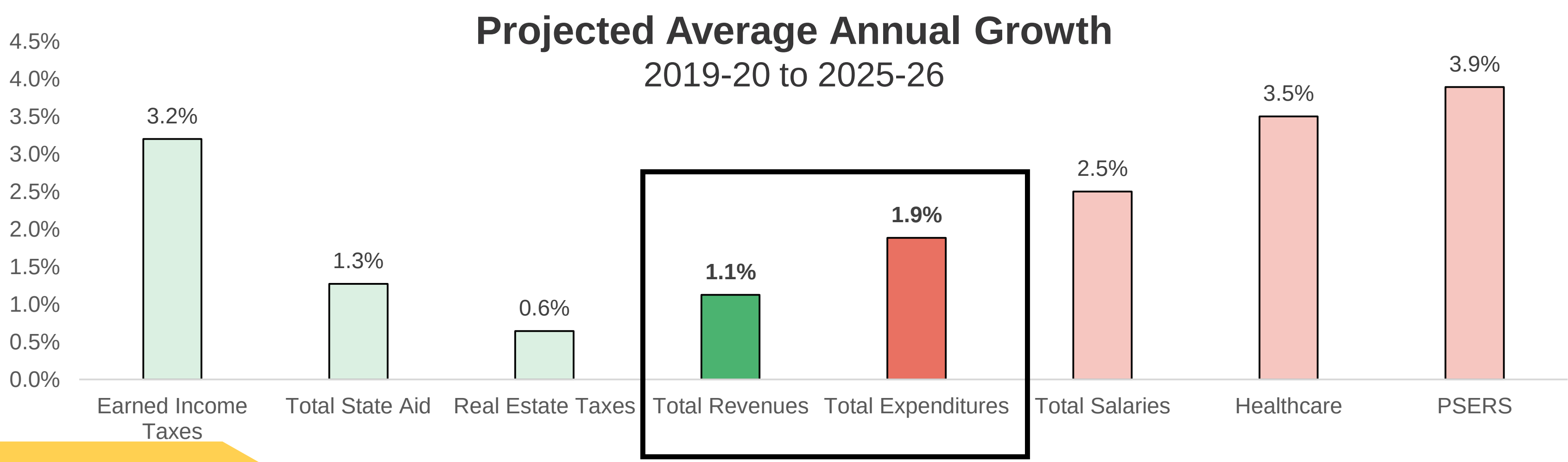
- The chart and table below show the District's baseline budget projection using the assumptions described on the previous slides
- These projections incorporate the 2018-19 audited results, and adjustments to the 2019-20 budget
- This is a **status quo** projection, assuming no corrective action is taken
- This does not include additional debt service or capital spending after the final bond payment in 2021-22



	2019-20 Projected	2020-21 Projected	2021-22 Projected	2022-23 Projected	2023-24 Projected	2024-25 Projected	2025-26 Projected
Total Revenues	$17,404,686	$17,606,556	$17,832,094	$17,814,619	$18,051,896	$18,293,061	$18,614,665
Total Expenditures	$18,435,206	$18,881,936	$19,358,715	$19,041,736	$19,550,099	$20,070,577	$20,616,444
Net Operating Result	**($1,030,520)**	**($1,275,380)**	**($1,526,621)**	**($1,227,116)**	**($1,498,202)**	**($1,777,516)**	**($2,001,779)**
Ending Fund Balance	**$5,050,824**	**$3,775,444**	**$2,248,823**	**$1,021,706**	**($476,496)**	**($2,254,012)**	**($4,255,791)**

Major budget drivers

- The chart below shows the projected growth of the District's major categories of revenues and expenditures
- In the current 2019-20 school year, the District is expected to use nearly $1 million in fund balance to cover the projected deficit
  - This structural imbalance grows over time as expenditures grow faster than revenues
- The District will make its final debt service payment for its current bonds in 2021-22, which will slow the growth in total expenditures if no new bonds are issued (consistent with the baseline scenario assumption)
  - However, it is possible that at that time the District would need to replace some of the lapsing current spending on the net local share of the bonds (approximately $570,000) with a new source of capital spending (new debt service or pay-as-you go capital spending)

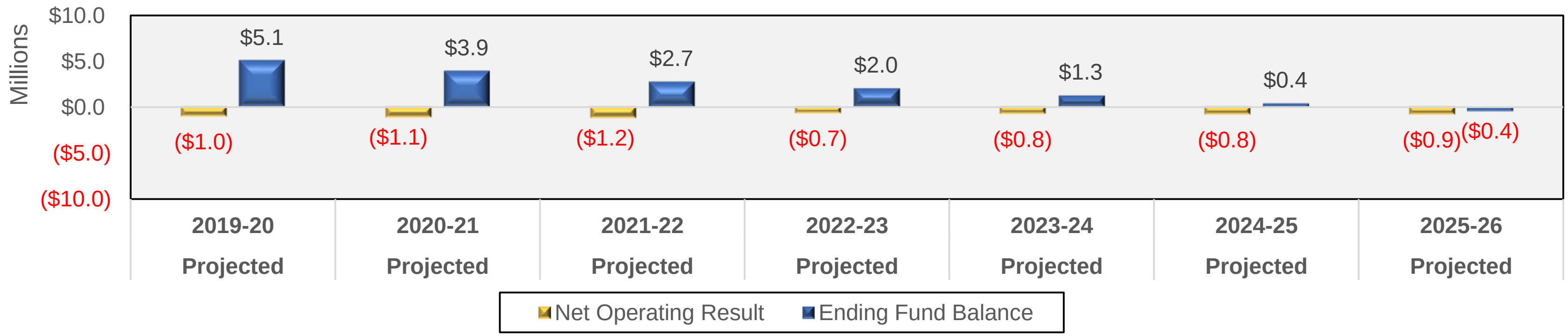


Tax scenario

- The chart and table below show the District's budget projection with property tax increases to the Act 1 Index in each year beginning with the 2020-21 school year
- These projections assume that the District raises property taxes by 3.6 percent each year, which is the District's 2020-21 Adjusted Index
- This does not assume additional debt service or capital spending after the final bond payment in 2021-22

General Fund Budget Projections with Act 1 Index Increases

2019-20 to 2025-26



	2019-20 Projected	2020-21 Projected	2021-22 Projected	2022-23 Projected	2023-24 Projected	2024-25 Projected	2025-26 Projected
Total Revenues	$17,404,686	$17,761,300	$18,167,593	$18,339,550	$18,775,306	$19,224,388	$19,763,750
Total Expenditures	$18,435,206	$18,881,936	$19,358,715	$19,041,736	$19,550,099	$20,070,577	$20,616,444
Net Operating Result	**($1,030,520)**	**($1,120,636)**	**($1,191,122)**	**($702,186)**	**($774,792)**	**($846,190)**	**($852,694)**
Ending Fund Balance	**$5,050,824**	**$3,930,188**	**$2,739,066**	**$2,036,880**	**$1,262,088**	**$415,898**	**($436,796)**

Maintaining long-term balance

- Similar to other Pennsylvania school districts, Southern Huntingdon County faces cost pressures that are difficult to manage without tax increases or savings initiatives
  - Funding raises in the current teachers contract, and continuing to provide competitive salaries
  - Covering the costs of increased benefits such as healthcare and PSERS
- However, the District faces expected annual shortfalls in the current year budget that will eventually consume the remaining fund balance as the costs of labor and goods grow faster than the local tax base and state aid
  - The District has multiple opportunities to adjust its spending and revenues to eliminate the annual shortfalls before they consume its fund balance
  - With careful planning and ongoing monitoring, timely execution of budget adjustments, and prompt response to changes in condition, the District should continue to be financially stable
- As noted in the District’s feasibility study, there are many capital needs that must be addressed in the District’s school buildings
  - Even if the District decides not to complete the elementary school consolidation, the District would still need to identify funds to maintain its current elementary schools

Consolidation Scenario

Consolidation scenario

- PFM worked with the District to review the savings assumptions in the elementary school consolidation estimates
- Cost estimates were compared to PFM's methodologies and experience working with other Pennsylvania school districts
- In the table to the right, the operational savings are shown for each of the major categories
- These savings are based on current year estimates, and they are grown to account for future cost increases used in the projections

Category	Current Year Savings	Notes
Staff & Travel (General Fund)	$655,622	Savings are contingent upon the staffing plans presented by the District for the new school building.
Capital and Maintenance	$134,100	Savings are based on a joint review by the District and PFM of current costs and likely changes in new school building. Costs of preventive maintenance for new equipment are likely to be lower than spending for the District's current three elementary schools. Over the long-term, these costs will rise as equipment ages on the new building.
Staff & Services (Food Service Fund)	$96,001	Savings will reduce the subsidy from the General Fund.
Education and Services	$30,800	Savings from classroom materials, copiers, and internet service.
Energy	$6,100	Savings from more efficient equipment are likely to be partially offset by increased electricity usage from air conditioning.
Total Expenditures	**$922,624**	

Debt service for new elementary school (30 year scenario)

	1	2	3	4
	Step 1	*Step 2*	*Step 3*	Total
Principal	$9,995,000	$9,995,000	$8,080,000	$28,070,000
Capitalized Interest	$643,874	$365,507	$0	$1,009,380
Net Cash for Project	$9,351,126	$9,629,493	$8,080,000	$27,060,620
Term	30 years	29 years	28 years	NA
Settlement	6/1/2020	4/1/2021	4/1/2022	NA

5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
Fiscal Year Ending	Existing Local Effort	Proposed Local Effort	Total Local Effort	Proposed Local Effort	Total Local Effort	Proposed Local Effort	Total Local Effort	Gross Millage Equivalent	Estimated Capitalized Interest	Net Local Effort	Millage Equivalent Net of Capl [1]	Estimated Operational Savings [1]	Net Local Effort	Net Millage Equivalent [1]
6/30/2020	562,593		562,593		562,593		562,593			562,593			562,593	
6/30/2021	565,993	314,796	880,789		880,789		880,789	2.91	(314,796)	565,993	0.00		565,993	0.00
6/30/2022	565,749	329,078	894,827	365,507	1,260,334		1,260,334	3.51	(694,585)	565,749	(0.00)		565,749	(0.00)
6/30/2023		558,951	558,951	556,117	1,115,067	448,524	1,563,591	2.81		1,563,591	9.24	(922,624)	640,967	0.70
6/30/2024		562,958	562,958	550,124	1,113,082	448,037	1,561,119	(0.02)		1,561,119	(0.02)	(922,624)	638,495	
6/30/2025		556,686	556,686	559,132	1,115,818	443,064	1,558,882			1,558,882		(922,624)	636,258	
6/30/2026		560,316	560,316	547,732	1,108,048	448,092	1,556,139			1,556,139		(922,624)	633,515	
6/30/2027		558,559	558,559	556,362	1,114,920	442,844	1,557,764			1,557,764		(922,624)	635,140	
6/30/2028		561,487	561,487	554,472	1,115,958	442,514	1,558,472			1,558,472		(922,624)	635,848	
6/30/2029		558,954	558,954	547,264	1,106,217	451,949	1,558,166			1,558,166		(922,624)	635,542	
6/30/2030		561,089	561,089	554,870	1,115,959	450,829	1,566,787			1,566,787		(922,624)	644,163	
6/30/2031		557,738	557,738	556,862	1,114,600	449,412	1,564,012			1,564,012		(922,624)	641,388	
6/30/2032		559,038	559,038	553,365	1,112,403	447,691	1,560,094			1,560,094		(922,624)	637,470	
6/30/2033		559,858	559,858	554,515	1,114,373	450,659	1,565,032			1,565,032		(922,624)	642,408	
6/30/2034		555,248	555,248	555,182	1,110,430	453,159	1,563,589			1,563,589		(922,624)	640,965	
6/30/2035		555,357	555,357	555,417	1,110,774	450,203	1,560,977			1,560,977		(922,624)	638,353	
6/30/2036		555,022	555,022	555,212	1,110,234	451,988	1,562,222			1,562,222		(922,624)	639,598	
6/30/2037		554,235	554,235	554,559	1,108,794	453,353	1,562,147			1,562,147		(922,624)	639,523	
6/30/2038		552,988	552,988	558,450	1,111,438	449,290	1,560,728			1,560,728		(922,624)	638,104	
6/30/2039		556,273	556,273	556,714	1,112,987	449,952	1,562,939			1,562,939		(922,624)	640,315	
6/30/2040		553,915	553,915	554,504	1,108,419	450,172	1,558,591			1,558,591		(922,624)	635,967	
6/30/2041		556,109	556,109	556,812	1,112,921	449,942	1,562,863			1,562,863		(922,624)	640,239	
6/30/2042		552,679	552,679	558,501	1,111,180	454,254	1,565,433			1,565,433		(922,624)	642,809	
6/30/2043		553,788	553,788	559,561	1,113,348	447,964	1,561,312			1,561,312		(922,624)	638,688	
6/30/2044		554,256	554,256	549,983	1,104,239	451,404	1,555,643			1,555,643		(922,624)	633,019	
6/30/2045		554,074	554,074	560,105	1,114,179	449,228	1,563,407			1,563,407		(922,624)	640,783	
6/30/2046		553,234	553,234	559,226	1,112,460	446,599	1,559,058			1,559,058		(922,624)	636,434	
6/30/2047		551,820	551,820	557,682	1,109,501	453,511	1,563,012			1,563,012		(922,624)	640,388	
6/30/2048		549,828	549,828	560,561	1,110,389	449,607	1,559,996			1,559,996		(922,624)	637,372	
6/30/2049		552,255	552,255	557,684	1,109,939	450,311	1,560,250			1,560,250		(922,624)	637,626	
6/30/2050		548,921	548,921	559,224	1,108,145	450,443	1,558,588			1,558,588		(922,624)	635,964	
TOTAL	1,694,335	16,209,505	17,903,840	15,925,694	33,829,534	12,584,984	46,414,518	9.21	(1,009,380)	45,405,137	9.21	(25,833,472)	19,571,665	0.69

1 mill= 108,000 (estimated)

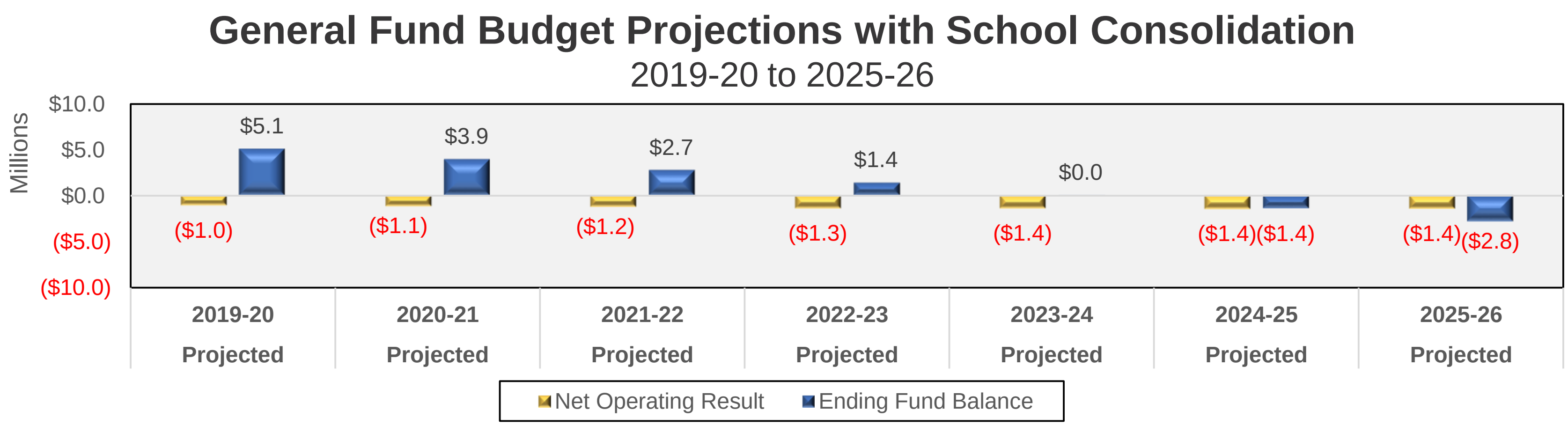
Estimated rates. Actual rates to be determined at the time of pricing. Assumes no state reimbursement on new issuance.

[1] Estimated operational savings developed by District Administration in conjunction with PFM Group Consulting LLC.

Actual savings to be determined based on Board Action at the time of each budget and actual revenues/expenditures of the District.

Budget projections with school consolidation

- The chart and table below show the District's budget projection **with tax increases to the Act 1 Index and the financial impact of the elementary school consolidation** (operational savings and debt service)
- It includes the 30-year debt service alternative and the impact of the savings from consolidation
- In this scenario, the District's long-term annual shortfall ranges between $1.2 and $1.4 million



	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	Projected	**Projected**	**Projected**	**Projected**	**Projected**	**Projected**	**Projected**
Total Revenues	$17,404,686	$17,761,300	$18,167,593	$18,222,342	$18,651,731	$19,096,828	$19,627,897
Total Expenditures	$18,435,206	$18,881,936	$19,358,715	$19,570,840	$20,018,188	$20,508,719	$21,023,807
Net Operating Result	**($1,030,520)**	**($1,120,636)**	**($1,191,122)**	**($1,348,499)**	**($1,366,457)**	**($1,411,890)**	**($1,395,910)**
Ending Fund Balance	**$5,050,824**	**$3,930,188**	**$2,739,066**	**$1,390,567**	**$24,111**	**($1,387,779)**	**($2,783,689)**

Conclusions

- Under all of the budget scenarios presented, the District is expected to have a budget shortfall in all of the projected school years

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	Projected	**Projected**	**Projected**	**Projected**	**Projected**	**Projected**	**Projected**
Baseline	($1,030,520)	($1,275,380)	($1,526,621)	($1,227,116)	($1,498,202)	($1,777,516)	($2,001,779)
Baseline with Tax Increases	($1,030,520)	($1,120,636)	($1,191,122)	($702,186)	($774,792)	($846,190)	($852,694)
Tax Increases and Elementary School Consolidation	($1,030,520)	($1,120,636)	($1,191,122)	($1,348,499)	($1,366,457)	($1,411,890)	($1,395,910)

- As the District enters the planning process for next year’s budget, the District should evaluate all major revenue and expenditure categories to refine the estimated shortfall for the current year
  - The increase in net local share of debt service (debt service minus operational savings) is the equivalent of nearly 42 percent of a property tax increase to the Act 1 Index
- During the evaluation of the consolidation proposal, several other potential cost savings were identified by the District, such as evaluating the possibility of reducing costs of out-of-district placements by providing the services with District personnel
  - Some savings options such as this one may only be available in the consolidation scenario
- It is recommended that the District implement changes as soon as consensus is achieved so that the budget adjustments this year and in the future can be gradual rather than radical

Thank you

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Appendix

Why should we take the long view?

- A **multi-year financial projection** is a forecast of your District's revenues and expenditures over a defined period of time (normally 3-5 years) based on a specific set of assumptions
- The projections should be at a sufficient level of detail to facilitate planning and decision making around the following questions:
  - **Structural position:** Are we structurally balanced such that recurring revenues meet recurring expenses throughout the projection period? Are we relying on short-term measures to cover long-term obligations?
    - Note both the annual results (one-year positive or negative results) and the fund balance (cumulative trend)
    - What is the reason for any one-time variations?
  - **Sensitivity (or scenario) analysis:** How would changes in key variables (e.g. enrollment, staffing levels) impact our projected financial performance? "How will we handle situation X if Y happens…"
  - **Community Goals:** Will we have the financial resources to deliver the educational services that our residents value at a price they are willing to pay?

Reason #1: It's a better way to bridge the budget gap

Many Pennsylvania school districts face structural challenges. Real estate tax revenues are flat or grow by small amounts and tax rates are often capped (earned income) or can only grow by a certain amount (real estate). Meanwhile expenses rise because of the need to pay competitive salaries, pension funding demands, health insurance costs, energy costs, new mandates, etc.

One-year budget cycles are not an ideal way to address systemic, long-term challenges:

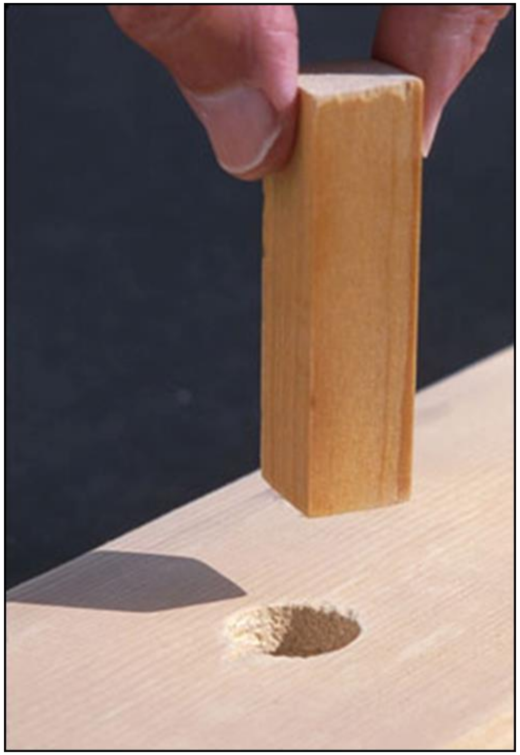
- Short-term strategies often yield short-term benefits that expire or may even increase your deficit in out years
- Looking exclusively at the short term limits elected officials' understanding of long term challenges (e.g. enrollment, pension, OPEB, capital needs) and ability to focus on solutions to those challenges
- The options for addressing structural imbalance are typically more effective and less painful to implement before cash and current-year budgetary shortfalls arrive

Multi-year planning allows you to move away from "putting out the next fire."

Reason #2: It changes critical conversations

Budget processes are often stressful and tense because scarce resources lead to an "us versus them" dynamic between school board members, district administration, unions, etc. Using a multi-year perspective changes the conversation:

- You can present the challenges to interested parties from a broader perspective and challenge people to think beyond their departmental boundaries
- Revenue projections help you determine what you can afford before you begin processes that will determine your expenses for several years (e.g. issuing debt, collective bargaining)
- Multi-year planning allows you to talk about what investments are worth making down the road, even if you have to make reductions now



Reason #3: Scenario analysis can help build consensus

Budget processes are often stressful and tense because scarce resources lead to an “us versus them” dynamic between school board members, district administration, unions, etc. Using a multi-year perspective changes the conversation:

Example: Two board members argue how the District should close its deficit – cost cutting or attracting students back from the charter schools.

- Scenario analysis shows that the District would have to attract a very large number of students back from charter schools to close the deficit if that’s the only strategy. That would require higher staffing levels, which increases spending, which results in higher charter tuition payments, even if there are fewer charter students.
- Scenario analysis also shows that cost cutting may make the district schools less attractive to parents which could lead to higher charter enrollment, which leads to higher charter tuition payments, which negates some of the cost cutting benefits.

Instead of an “either/or” approach, maybe a blend of the two would work. Let’s talk about which combinations get us to our goal…

Reason #4: It can help lower borrowing costs

"Multi-year planning is a critical exercise. These plans will often have out-year gaps projected which allow governments to work out, in advance, the optimal way to restore fiscal balance."

– Standard & Poor's

"The multiyear plan's value is to anticipate future challenges that may be encountered due to projected revenue and expenditure imbalances. This allows executives and legislators to 'get in front of' potential budget stress, and take corrective action long before budgetary gaps develop into crises.

– Fitch Ratings

Financial forecasts are at the crux of foresight.

[Use] forecasts to identify the parameters within which to develop and execute strategies, rather than to try to "predict" the future.

- GFOA, Building a Financially Resilient Government through Long-term Financial Planning

Major Baseline Revenue Assumptions

- **Local Sources:**
  - Assessed value grows at 0.6 percent based on historical trends, and no increases in tax rates
  - Growth for earned income taxes at 3.2 percent based on historical trends in the District's personal income from 2011 to 2017
  - All other local sources held flat
- **State Sources:**
  - Basic Education Funding and Special Education Funding are adjusted based on the Commonwealth's 2019-20 budget, and are grown using the District's share of formula-based funding
  - Transportation subsidy grown at an inflationary rate with increases in costs
  - Reimbursement for Social Security and PSERS based on changes in salaries and projected PSERS rates published by the Commonwealth
  - PlanCon (debt service reimbursement) based on figures provided by Piper Jaffray & Company
- **Federal Sources:** Held flat

Major Baseline Expenditure Assumptions

- **Salaries:** 2.5 percent annual salary increases for all bargaining units based on PFM's review of the District's teacher contract; growth continues after contract expiration, and no changes in headcount
- **Employee Benefits:** Healthcare growth rate of 3.5 percent per year based on trend provide by SHCSD; Social Security and unemployment expenditures grow with salaries; PSERS contributions change with salaries and projected PSERS rates
- **Charter School Tuition:** Assumes enrollment is held flat at amounts in the 2019-20 budget; future tuition costs are based on growth in the District's budget
- **Debt Service:** Debt service payments based on the District's debt schedule provided by Piper Jaffray & Company
- **Other Non-Personnel Expenditures:** Inflationary rate for all non-personnel related expenditures (except for Other Objects and Other Use of Funds) based on CPI