

*GFOA Research Report 07-005*

# **Making the Grade**

## **Long-Term Financial Planning for Schools**

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# Making the Grade

## Long-Term Financial Planning for Schools

*By Shayne C. Kavanagh*

All local governments, including public schools, are facing a period of transition: new sources of fiscal distress are arising, demographic shifts such as the aging of the population and the increasing size of minority groups are occurring, and globalization is transforming the competitive landscape. Each of these transitions has important implications for the delivery of public education. To successfully navigate this new environment requires a long-term, comprehensive approach not available through the traditional locus of government planning, the annual budget.

This research report introduces long-term financial planning – an indispensable complement to annual budgeting. A long-term financial plan is most commonly associated with its most conspicuous technical element – long-range revenue and expenditure projections. However, true financial planning entails much more. Over a five- to ten-year horizon, a long-term plan articulates the present and future educational needs of community, the actions the school district must take to meet those needs, and how those activities will be funded.

With a long-term financial plan serving as an overarching framework, annual budgets can be linked together into an integrated program to address long-term issues like the need to adapt the curriculum to a changing student body and to the changing world for which public education must prepare its students. Further, long-term planning allows a consistent and stable provision of educational programs over time and prevents the initiation of projects or programs which would have to be abandoned later because of an inability of the school district to finance them.<sup>1</sup> It also promotes financial management rigor by helping the school board and management see the long-term impacts of decisions made today and is particularly effective for discouraging unsustainable practices, such as using debt or fund balances to finance operating expenditures. The combined effect of these virtues is to demonstrate to the community that the district is an effective steward of the public's resources, thereby ultimately increasing the level of trust citizens have in the district. As trust increases, citizens will be more likely to approve additional funding for schools as they are confident that their taxes will be used to create value for the community.

### **Growth and Planning**

Financial planning can help both districts that are growing and those that are not. Growing districts need to plan for investments such as facility construction and workforce expansion to accommodate an increasing population. Districts that are not growing need to make sure their current cost structure does not over-commit the district to an unsustainable level of expenditures that would later necessitate dramatic and painful cuts if not scaled back gradually.

### Sources of Financial Distress

There are many issues that could precipitate a financial crisis if not recognized and prepared for in advance. Some of the most prominent include:

**Flat state funding.** Despite recent surges in tax receipts, officials in many states “remain concerned that state spending growth will outpace ongoing revenue growth over the longer term, leading to structural deficits beginning as early as FY 2008.”<sup>2</sup> This does not bode well for revenues that have been traditionally directed to education.

**Stagnant or falling property taxes.** The slowdown in the housing market could have ramifications for property taxes and by default, school revenues. Across the country, a record number of appeals are being filed to counteract rising assessments that are, in many cases, pushing up annual tax payments significantly.<sup>3</sup> In fact, in Nassau County, New York, in one year more than 60,000 single-family homeowners challenged their annual assessments and half won tax refunds.<sup>4</sup> This impacts schools as lower assessments translate into lower future tax bills.

**Rising pension and healthcare costs.** Health care costs for current and former employees now add up to almost 10 percent of school district budgets.<sup>5</sup> With the impending retirement of large swaths of the workforce and the rising costs of pension and healthcare benefits generally, this could increase significantly, especially for districts where teachers’ benefit packages heavily feature forms of compensation that are deferred until after retirement (e.g., post-retirement benefits, etc.).<sup>6</sup>

**Escalating fuel costs.** A confluence of factors may conspire to increase fuel prices, including strong global demand, limitations in refinery capacity, and political instability in key oil producing regions. In 2007 alone, the United States experienced an 8 percent increase in gasoline prices from the previous year.<sup>7</sup> This could have a dramatic impact on fuel costs for school transportation. According to the International Energy Agency, oil prices are expected to experience a steady, long-term upward climb through 2030.<sup>8</sup>

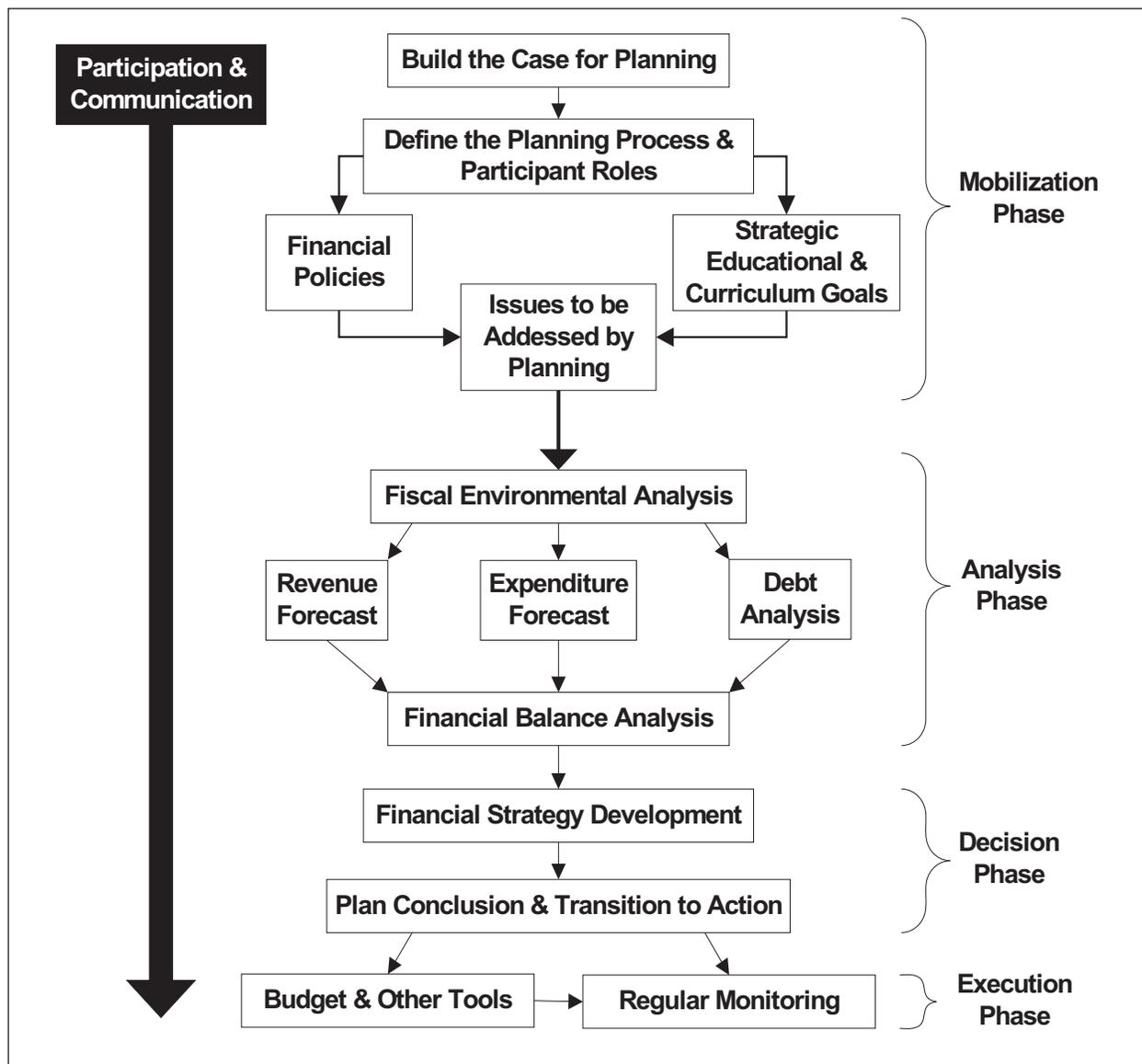
The Government Finance Officers Association (GFOA) has developed a four-phase approach to financial planning: the mobilization phase, the analysis phase, the decision phase, and the execution phase. Exhibit 1 presents a graphic summary of these phases, as well as their subcomponents. This report describes these four phases and subcomponents, using the experiences of school business officials who practice long-term planning from Geneva Community Unit School District 304, Illinois; Rockwood School District, Missouri; and Lynbrook Public Schools, New York (referred to in the text of this report as “Geneva,” “Rockwood,” and “Lynbrook,” respectively) as well as information from the author of *State and Local Government Performance Improvement and Cost Control in Schools*<sup>9</sup> to illustrate the process of planning.

## The Mobilization Phase

Long-term financial planning is a comprehensive and considerable undertaking. The mobilization phase, therefore, serves to prepare the school district to plan. It is essential to first build a compelling case for why planning is needed. The introduction to this report provided a general rationale for planning, but the reasons for planning must be the district’s own if it is to sustain the endeavor through the hard work and tough decisions that planning entails.

Crisis often provides a powerful catalyst for planning. In 2002, Geneva had a deficit of \$2.7 million in the operating fund and \$8.8 million in the educational fund, out of approximately \$41 million and \$32 million budgets, respectively. A clear depiction of the problem by the school’s business officials helped the board realize the need for change. Hence,

Exhibit 1 – The Four Phases of Long-Term Financial Planning



the board and staff jointly developed two goals: first was to erase the operating fund deficit and create a positive balance by 2006, and, second, to stabilize the educational fund by 2008. The fact that these goals were collaboratively set was crucial to the district's success in meeting them – the operating fund balance goal was achieved in 2004, while the district's projections show it to be on track to achieve its objectives for the educational fund. The board and staff were able to refer back to the shared goals throughout the process in order to renew their positive momentum and overcome the angst inherent in making difficult financial choices.

Crisis need not be the reason to undertake planning, as Lynbrook's experience demonstrates. Lynbrook's board was determined to see the school run in a manner more consistent with the for-profit businesses the board members were involved with in their private lives. Lynbrook's school business officials embraced this vision by initiating a long-term financial plan in 2006. The school district has already realized more disciplined

budgeting as a result of the rigor in financial decision making engendered by long-term planning and looks forward to using its new plan to better communicate to citizens its long-term vision for educational attainment coupled with financial stewardship. In this case, Lynbrook's business official took what could be viewed by some administrators as a negative development (a demand by the board for more accountability) and turned it into a force for positive change through financial planning.

After a shared set of objectives for the plan has been agreed upon, the next step is to define a clear process and the roles stakeholders will play in it. A clearly defined process gives participants confidence that their time will be well spent and increases the undertaking's credibility. A process can be given definition through graphical depictions of the steps involved, schedules for critical events, and forms used to facilitate key decisions and analyses. Clear roles for stakeholders allow for an effectively managed, broad base of participation. Broad participation leads to recognition of stakeholders' central issues so that they can be accounted for in the planning process. It also generates buy-in to the plan and its strategies for financial sustainability, thereby improving the chances for successful implementation of those strategies. Here are some of the roles typical of key stakeholder groups in a school environment:

**School Board.** The board has ultimate fiduciary responsibility for the district, so it must be an integral part of the planning process. The board leads in making policy-level decisions, such as articulating a broad, strategic vision; setting program goals; and sponsoring strategies for financial balance.

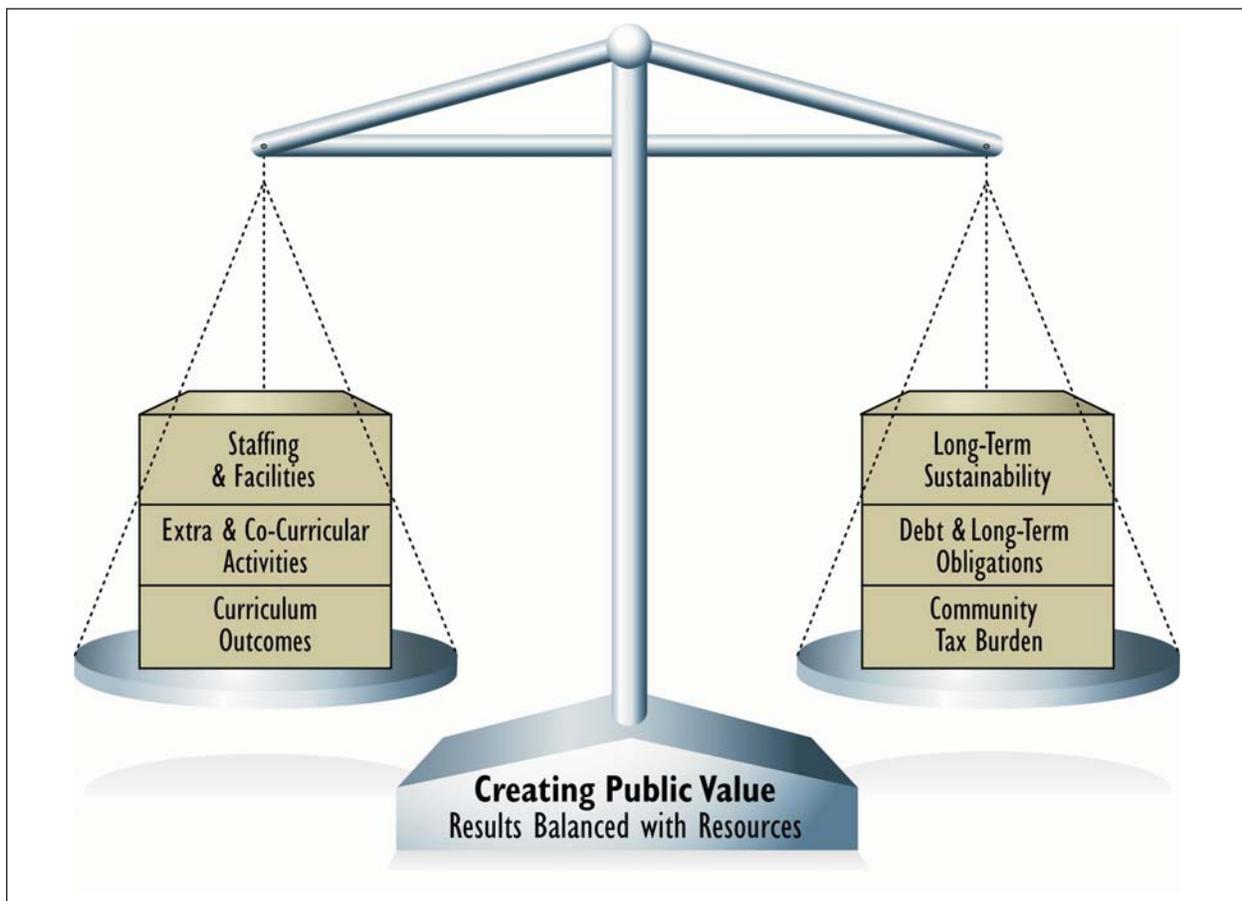
**Superintendent.** The superintendent implements the board's vision and serves as the leader of the planning process. The superintendent also networks with organizations outside of the district in order to extend planning capabilities. For example, he or she fosters good relationships with local cities and counties to learn of future land use trends. Communicating with other schools in the region can provide insight into how they perceive the financial environment and how they plan to tackle long-term challenges.

**Chief Financial Officer (CFO).** The CFO drives the planning process on a day-to-day basis. Given that the focus in schools is naturally on children, the CFO's role in evangelizing for financial sustainability as it impacts the children cannot be underestimated. The CFO should spread the message that creating value for the community demands balancing educational services and programs with the tax burden placed on the community, long-term obligations like debt, pension costs, and facility maintenance, and considerations for how a consistent level of curriculum quality will be maintained over the long term. When the school district's programs provide educational outcomes of value to the public at a level of resource usage that is within the community's willingness to pay, public value creation is optimized. Exhibit 2 depicts this philosophy.

**Principals.** Principals and other administrators below the districtwide-level support the process by communicating financial planning issues downward to school staff and communicating their vision for their particular school upwards to the administration. As principals often have much closer contact with parents than district-level officials, they are vital to effective communication with the public. At the end of the planning process, principals and other local officials will be lead players in implementing the strategies needed to achieve and maintain financial sustainability.

### What Might a Planning Process Look Like?

Visit [www.gfoa.org/itfp](http://www.gfoa.org/itfp) for examples of process maps used by local governments.

**Exhibit 2 – Creating Public Value Requires Financial Balance**

**Teachers.** Teachers can be involved in committees to: 1) evaluate programs and anticipate future curriculum changes; and 2) create strategies to reach fiscal balance. During initial revenue and expenditure forecasting, such committees can make use of teachers' intimate knowledge of student needs to reveal possible required curriculum changes, which would then suggest prospective future costs. Teacher committees also can be helpful in identifying strategies for financial balance. Classroom instruction is the most important cost area, so teachers can provide insight into efficiencies that can generate important savings while minimizing the impact on the quality of instruction.

**Support Staff.** Similar to teachers, support staff can be engaged through committees to provide consultation on cost reduction strategies. Committees can be successful when they are focused on a single issue that is of direct interest to the membership of the committee. For example, a committee composed of maintenance personnel could focus on safety issues in order to reduce workers' compensation costs. One of the interviewees for this article was able to achieve an 85 percent reduction in grievances and a 50 percent reduction in workers' compensation insurance costs in this way.<sup>10</sup>

**Parents.** Parents should provide feedback on issues central to the future of the district through surveys, specialized focus groups, pre-existing groups (like parent-teacher associations), and similar mechanisms. This is necessary for realizing the potential of financial planning to build public trust and confidence in the school. In fact, at its best,

this type of involvement can actually transform parents into community-level advocates for the district – crucial for building support for funding initiatives among citizens without children in the school system, who may otherwise be difficult to reach with the district’s message.

## Educational Goals as the Basis for Planning

After setting the foundation by building the case for planning and defining a clear process and roles for stakeholders, the actual planning can begin. First and foremost, the district’s strategic educational and curriculum goals must be defined. Only if there is a shared understanding of how the district plans to create value for the community and children can there be a meaningful discussion of the resources needed to produce that value over the long term. The goals pursued will vary for each jurisdiction. For instance, some districts may find it useful to build their goals around meeting standards promulgated by No Child Left Behind or by the state, while others may have goals beyond these external benchmarks. Geneva developed long-term mission and goal statements that help the district keep its focus during financial planning on maintaining and expanding the “tradition of excellence” that the district has identified as its guiding vision. Some examples of its goals include:

- *Maintain focus on academic program renewal.* The district must constantly seek to get the best results from its programs and students, changing its program structure as necessary.
- *Anticipate and respond to growth.* Geneva is in a high-growth area, so it must be mindful of future facility and staffing impacts.
- *Maintain high-quality staff.* Quality staff provides a superior educational experience for students. Establishing the requisite personnel recruitment, development, and evaluation systems is a long-term commitment.

Beyond strategic goals, districts should consider establishing performance scorecards with goals and measures that keep educators, administrators, and operations staff focused on district strategic goals. Scorecards and measures translate strategic and long-range goals into meaningful division, department, and even individual objectives, thereby engaging the entire district in the pursuit of strategic objectives.

In a school environment, it can be difficult to cut programs, even under-performing ones, because of the emotional appeal of any program’s potential to help at least some children on some level. For example, one of the interviewees for this article was confronted with a teacher who stated that they would “support any program that helped even just one child.” While perhaps a nice sentiment, it is incompatible with the realities of limited funding and the imperative to make the most out of scarce educational resources. Establishing formal metrics of performance can make program evaluation more objective, allowing more frankness in resource allocation discussions. Performance measures can also help change

### Benchmarking Performance

Performance measures can be coupled with “benchmarks” – external standards that provide a yardstick against which to judge a district’s own performance. Benchmarks provide a context for evaluating measurement results and can help create a sense of urgency by highlighting under-performing areas. Benchmarks are often constructed using the performance of comparable school districts as the basis for the standard. The district should then apply its own expertise to develop a set of benchmarks that are most useful for its own environment.

the nature of discussion of school finances more fundamentally – moving away from narrowly defined *data* on costs, towards *information* on the value being created (or lost) for children.

The Center on Educational Governance at the University of Southern California has created a scorecard of “charter school indicators”<sup>11</sup> to assess the performance of charter schools in the state. This project provides a good example of how measures can be combined to gain multiple perspectives on school performance. The center’s scorecard uses commonly available school data, such as expenditures-by-classification, teacher/pupil ratios, and standardized test scores, to calculate twelve indices of school performance. These indices are placed into one of four categories: 1) financial resources and investment; 2) school quality; 3) school performance; and 4) academic productivity. Together, these indicators provide a well-rounded view of performance. The center’s report, available on its Web site ([www.usc.edu/dept/education/cegov/](http://www.usc.edu/dept/education/cegov/)), describes in detail the twelve indices and the data and methods used to construct them.

## Establish Standards for Financial Stewardship

The final piece of the mobilization phase is to identify financial policies. Financial policies describe the standards for financial stewardship to which the district will hold itself. To illustrate, Rockwood’s board adopted the following policy on financial planning, which helps to keep the district committed to planning from year to year:

*[The board seeks to] engage in thorough and advanced planning, with broad-based board, staff, and community involvement, in order to develop financial plans which will achieve the greatest educational returns in relation to dollars expended.*

Polices concerning the fund balance level to be maintained, the permissible levels and uses of debt, cost-recovery goals for fee-based programs, and the proper role of grants in funding school activities can provide invaluable guidance when creating long-term financial plans and strategies. Additionally, such policies clearly inform other stakeholders of what the district’s goals and rules of operation are in such a way that greater transparency, and ultimately, trust are direct outcomes of the plan. To illustrate, consider the following from Geneva’s financial policies:

*Unrestricted reserves in the operating funds shall be maintained at a level equal to 35 percent of the operating budget. (The operating budget is composed of the education, operations & maintenance, transportation, retirement, tort immunity and the working cash fund.)*

This policy sets forth a clear standard (i.e., 35 percent) against which the district’s financial performance can be judged and therefore provides a clear guideline for the development of the district’s financial plan.

## Concluding the Mobilization Phase

At the end of the mobilization phase, the planning participants should have a clear vision of what the rest of the planning process will look like, their roles in it, and the issues that the plan will address. The case on which financial planning was made, the identification of strategic educational and curriculum goals, as well as the examination of financial policies will all suggest the issues that planning should address. For example, Geneva’s deficit

prompted financial planning and provided a very immediate and clear goal. However, in a case like Lynwood's, where the initial motivation for planning was not so specific, strategic goal setting and financial policies might reveal the particular issues financial planning must resolve. Strategic goal setting might articulate the need for a new facility or program, which the financial plan then must find a way to fund, or a multi-year strategy might be required to comply with the board's policy goals for the level of fund balance to be held in reserve. The issues to be solved by planning must be clearly and unambiguously stated in the mobilization phase so that planners are able to focus their efforts in the right direction during the analysis phase and so that the participants can effectively evaluate the planning endeavor's success at the conclusion of the entire financial planning process.

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## Analysis Phase

Based on the work done in the mobilization phase, staff can proceed to generate the information needed to identify potential future financial imbalances and, then, to support development of strategies for financial sustainability. There are five main activities that occur in the analysis phase: fiscal environmental analysis, revenue forecasts, expenditure forecasts, debt analysis, and financial balance analysis.

### Fiscal Environmental Analysis

Fiscal environmental analysis underpins the analysis phase. It builds planners' expert knowledge and awareness of the district's financial environment in general, as well as of special issues confronting the district. This leads to improved forecasting because the forecasters are more knowledgeable about major revenue and expenditure drivers. Fiscal environmental analysis also will increase the quality of financial strategy development because of the improved understanding the planners will develop of related issues.

There are certain issues that any local government should examine as part of the fiscal environmental analysis. One example involves the national and regional economic trends that are germane to revenue receipts, such as the performance of the housing market as it impacts property tax revenues. Other examples of issues that are of near universal concern to local governments include the state's fiscal condition as it might impact shared revenues; likely future behavior of the top tax-generating properties in the community and the top employers; and political developments at the national, state, or local level that could impact either the services local government is required to provide or the revenues it receives. On top of these general concerns, the analysis must also cover several issues that are particularly crucial for school districts, including: future enrollment trends, staffing considerations, curriculum developments, land use trends, fund balances, and school competition. Each of these areas is discussed below.

**Future Enrollment Trends.** Future enrollment trends are the most important environmental concern for districts because of their far-reaching impacts. Enrollment

#### A Complete Analysis Framework

The GFOA's *Financing the Future* is a full-length publication on financial planning that describes a complete framework for conducting a fiscal environmental analysis in local government. It includes concepts and practices that enable planners to develop their own customized analysis framework that is best suited to local conditions. Visit [www.gfoa.org/lftp](http://www.gfoa.org/lftp) for more information.

affects facility needs, staffing needs, both for instructors and support staff, and revenues that are distributed to the district on a per-student basis. A study of future enrollment trends may suggest program or curriculum changes if certain characteristics of future students differ from the past and current students. For instance, a rising immigrant population may require bolstering multi-lingual instructional capabilities. To cite another example, the future may hold a significant increase in special education – an expensive program to provide. So important is the analysis of future enrollment that Lynbrook engages a specialized outside firm to conduct it.

### **The Importance of Policy to Planning**

A policy on desired instructor-to-student ratio is elemental to projecting future staffing costs in light of projected enrollment trends.

**Staffing Considerations.** Salaries and benefits comprise 81 percent of total current education expenditures in the United States,<sup>12</sup> so an environmental analysis would be incomplete without a treatment of staffing issues. Schools should investigate impending potential retirements, which would drive post-retirement benefit costs – an especially important consideration if the school has not pre-funded these obligations. Retirements also could result in a temporary reduction in salary costs as new teachers are hired at entry-level salaries. Of course, one of the great benefits of long-term planning is to recognize this reduction as temporary – as the new teachers gain seniority, these savings will evaporate. Depending on the extent of the potential retirements and conditions of the local labor market, recruitment costs for new teachers also may be a significant factor to consider in the district's planning. The analysis should consider the potential long-term behavior of non-salary benefits, such as pension and health care costs. These areas have experienced explosive cost growth in the past, so planners should analyze current plans for vulnerabilities to changing market conditions. For example, pension plans in several states are experiencing serious under-funding. In New Jersey, for instance, the state shortfall for teachers' pensions has grown to \$10 billion in 2007, which represents a 22 percent increase in the gap over the previous year.<sup>13</sup>

Severe pension funding problems could tempt fund managers to adopt riskier investment strategies in pursuit of higher yields. In Alaska, which faces pension funding difficulties of its own, a proposal is being debated to sell \$2 billion in bonds and to invest the proceeds in higher-yielding instruments.<sup>14</sup> If the investment market were to take an unexpected downward turn, strategies like this could further harm the position of teachers' pension funds and require an unexpected spike in district contributions to the plan.

**Curriculum Developments.** The curriculum must regularly be adapted to the community's changing requirements. The strategic educational and programmatic goals articulated by the board are the main source of information on future curriculum changes. However, planners also should study the environment for cues. As discussed earlier, enrollment trends are one source of information. Trends in job markets, advances in educational theory and orthodoxy, as well as program innovations at other school districts also can suggest future curriculum changes. To take one example, the decline of manufacturing and heavy industry requires high schools to re-orient their vocational training programs toward the types of employment found in an information and service economy. State and federal standards also can require significant changes in the curriculum. For better or worse, No Child Left Behind has transformed the way many districts approach education. Forming relations with professional associations, peers in other

school districts, and state officials helps give planners insight into many sources of curriculum change.

**Land Use Trends.** The land use trends within and around the spatial boundaries that define a school district impact future enrollment trends as well as tax revenues. School districts should work closely with overlapping municipal and county governments to understand expected development projects and should examine the comprehensive land use planning documents of these same jurisdictions in order to better appreciate their long-term development vision for the community. When conducting this analysis, districts should be particularly aware of the potential use of tax increment financing or other development incentive instruments that divert school revenues to development purposes. Fostering a good relationship with municipal and county development officials can not only provide more advance warning of the potential use of such instruments, but can also help make local development officials more mindful of their impact on school districts, prompting them to look for mitigating strategies.

**Fund Balances.** Fund balances, also sometimes known as reserves, are a primary determinant of the district's financial flexibility. They allow the district more options for responding to unexpected economic downturns, to make "soft landings" in a spending cut-back environment, and to maintain program stability during revenue fluctuations. In addition to reserves for operating and educational funds, reserves to support pay-as-you-go capital spending, employee benefit obligations, and equipment/technology replacement should all be analyzed. Finally, fund balance analysis must also take into consideration the district's revenue stream (i.e., cash flow). This allows the district to assess the ability of its reserves to stabilize normal expenditures during the course of the year.

Reserve analysis should be supported by a financial policy that articulates the desired level of reserves so that actual reserves can be compared against the policy goals. Reserves for capital spending and equipment/technology replacement also should be supported by comprehensive plans and schedules that describe how much will need to be spent and when it will be need to be spent over a long-term time horizon.

**School Competition.** School competition is becoming an increasingly relevant concern for school districts. The number of students in a district drives revenues, so if students are going to alternative providers, districts will lose revenues. What makes this even more critical is that a very high proportion of a district's costs are fixed – it cannot easily reduce expenses in

### Who Performs the Analysis?

Analyzing these issues will require a significant effort by the district, but who will perform the work? In GFOA's research, "issue groups" were used to distribute the work, while also producing a quality analysis. Under this approach, the district identifies a limited number of the most important issues. Small teams are then assigned to investigate an issue and provide a report to the leader of the planning process (e.g., the CFO). The teams should include not just administrative or finance staff, but also staff from other areas of school operation. For example, if facility construction and maintenance is an important problem, then that issue group should be composed of members of the district's facility and maintenance organizations. Finance staff can support the group by helping to run numbers or process quantitative information, but the lead role would be taken by operational staff. In addition to distributing the work of analysis, it promotes buy-in to the plan as operational staff will have had a direct hand in creating it.

In addition to issue groups, external resources like consultants, bond rating agencies, state agencies, and other school districts can be used to supplement the district's own resources.

response to a decline in enrollment. Large capital assets must be maintained and the size of the labor force, especially in unionized environments, cannot easily be reduced. School competition is coming from a number of quarters. Besides traditional alternatives like religiously based private schools, for-profit private educational institutions and home schooling are gaining traction. In fact, home schooling could have an even more significant impact on traditional school organizations as legislative changes make home schooling easier and technology makes educational content more accessible to home schoolers.

## Revenue Forecasts

Revenue forecasts describe the amount of resources that will be available to fund programs in pursuit of the community's desired level of educational service. Accurate projections allow better long-term spending plans and improve the credibility of the long-term plan, thereby increasing the chance of it being institutionalized.

Research has shown that the most accurate forecasting does not depend on using the most sophisticated forecasting technique.<sup>15</sup> Rather, it depends on the expertise of the forecaster and his or her knowledge of the factor being forecasted – in this case, school district revenues. Armed with expert knowledge of the district's financial environment and the factors underpinning a revenue's yield, a forecaster can create accurate projections using relatively simple quantitative techniques (such as historical trend analysis) paired with qualitative-based expert judgment. Hence, the first step in long-range revenue forecasting is to understand the drivers of revenue yield.

Common drivers include land uses, population, and state politics. These drivers can be fashioned into a "mental model." A mental model is a graphical depiction of how the forecaster thinks about the influencing factors and how those factors interact. In addition to forcing the forecaster to think critically about how he or she conceives of these relationships, a mental model provides an explicit basis for discussion with others about revenue forecasting. Discussion with other knowledgeable parties about how the revenue is expected to behave introduces additional perspectives into the forecast, thereby improving quality.

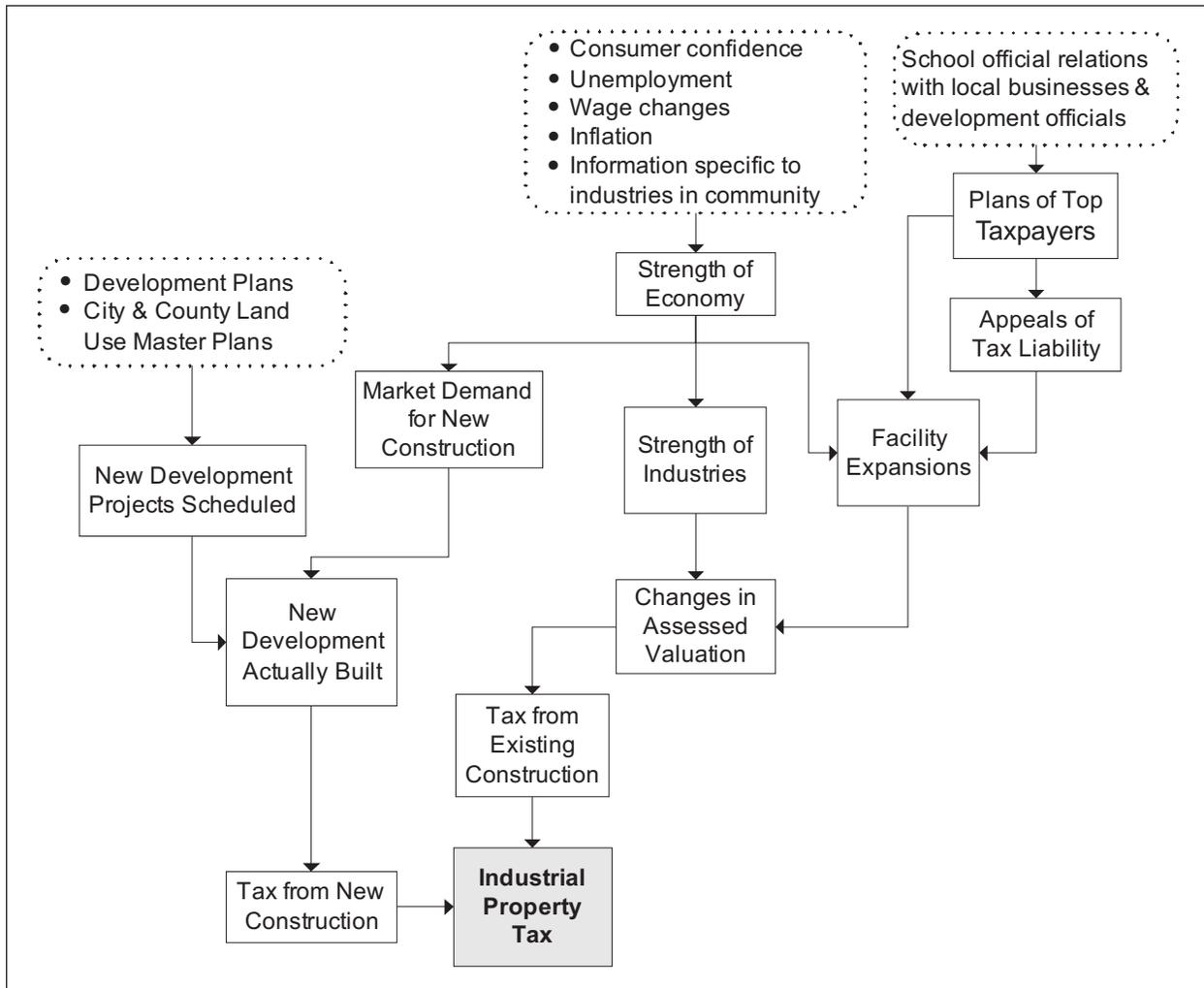
Exhibit 3 shows an example of a mental model for industrial property tax. The boxes represent causal factors and the items encircled with a dotted line are sources of information that could be used to inform the districts understanding of the causal factors.

Expert knowledge also is dependent on knowing the history of revenues. Past behavior can foreshadow future behavior and studying revenue history can reveal longer-term trends that are not apparent from an examination of only the most recent data. Property tax trends, for example, develop more slowly because of the time required to complete development projects and for the impact of development to show up in tax revenues. In addition to studying the growth history of tax revenues, forecasters should scrutinize the history of the most important causal factors. For example, historical trends in assessed value can help the forecaster better understand property tax revenues.

Maximizing the expert knowledge available for forecasting involves not only honing the forecasters' own knowledge, but also leveraging the expertise of others. Therefore, an important part of effective forecasting is nurturing relations with others who can help improve forecast accuracy. Here are some of the most essential relationships of this kind:

- *Local tax assessors.* Assessors can help forecasters better understand property tax behavior.
- *Overlapping cities and counties.* These jurisdictions approve development plans and know the projected build-out rate of planned development. They also may project out reve-

Exhibit 3 – Mental Model of Industrial Property Tax Causal Factors



nue sources that behave similarly or identically to the district's revenues (e.g., property taxes).

- *Local Association of School Business Officers (ASBO) Chapter.* Local ASBO chapters provide a ready-made network of other school officials who will want to know much of the same information as the district's own forecasters. There should be great potential to share information and pool capabilities.
- *State education officials and legislators.* These officials can provide insight into policies or trends that may impact school district revenues.
- *State revenue officials.* State revenue officials often produce long-term forecasts of state revenue sources that are shared with school districts. These forecasts can be used by the district with minor modification.

Forecasts should be routinely validated. Validation points out areas where the forecaster may need to revise the mental model, engage in further study, or where new forecasting techniques may need to be applied. First is to establish a target for forecast accuracy. For instance, 2 percent accuracy is a commonly used threshold for short-term forecasting. If short-term forecasts are not meeting this threshold, it suggests that

long-term forecasts will not be any more accurate. Forecasting is a skill developed over time, so those just beginning long-term planning should not expect to immediately achieve maximum precision. By regularly validating forecasting methods and striving to develop greater accuracy over time, however, forecasters improve the credibility of their projections and, with it, the credibility of long-term planning.

## Expenditure Forecasts

Expenditure forecasts describe the amount of resources school districts can expect to spend in pursuit of the community's desired level of educational service. The fiscal environmental analysis supports expenditure forecasting. It provides information on enrollment trends, such as birth rates and in-migration to the district, and staffing issues, such as changes to pension and benefit structures.

Like with revenue projections, though, forecasters will have to delve deeper into the factors that have the greatest impact on costs. Staffing is the most important cost area. Ideally, a district should develop a staffing master plan that accounts for enrollment trends, class-size standards, and curriculum goals and that describes the number and type of staff required given these factors. In the absence of an official plan, forecasters can examine these same factors in order to get a better feel for long-term cost potential. As a more immediate predictor of costs, forecasters should look at collective bargaining agreements, which often describe salary and benefit structures over a multi-year period. Forecasters also should consider the prospects for upcoming negotiations and how they might change compensation packages. An examination of staff costs would be incomplete without considering pension and benefit costs, so if not already addressed in the environmental analysis, they should be addressed at this point.

Facility cost estimates should be guided by a long-term facility plan. A facility plan should describe anticipated facility planning and construction costs over a five- to ten-year period. The plan should account for upkeep and maintenance costs for facilities after they are built, including standard maintenance, utilities, and staffing. One tool that could be used is found at the Building Owners and Management Association (BOMA), which provides data on

### Making the Forecast

The GFOA's research has found that the most common and effective forecasting technique is hybrid forecasting - the combination of quantitative and qualitative techniques. For example, a baseline forecast may be built using simple historical trending techniques and this baseline would be adjusted upward or downward by the forecaster based on his or her understanding and feel for the revenue and financial environment. The City of Palo Alto, California, has long practiced financial planning and uses such a hybrid forecasting technique. Palo Alto engaged an economist to validate its methods against more quantitatively rigorous techniques and found that no appreciable improvement in accuracy was available. This demonstrates the value of the city forecasters' expert knowledge for forecasting and that good forecasting does not depend on sophisticated statistical methods. The GFOA's book *Financing the Future: Long-Term Financial Planning for Local Government*<sup>16</sup> describes how to perform revenue forecasting in more detail, including practices for using qualitative and quantitative forecasting most effectively.

### Limiting Exposure to Utility Cost Risk

Given the scale on which many school districts operate facilities, fluctuations in utility prices can be a challenge to fiscal stability. To minimize exposure to fluctuating prices and to provide greater long-term predictability of facility maintenance costs, Rockwood is considering utility futures contracts for its facilities in order to lock-in prices for a multi-year period.

over 5,000 buildings and over 1 million square feet of office space in the United States and Canada. This data provides benchmarking information on costs of operation (maintenance, utilities, etc.) by facility type (public vs. commercial) and by square footage. The facility plan should be linked to classroom utilization monitoring. This avoids over-building by ensuring that the best use is being made of available space. Finally, the plan should account for associated equipment costs to furnish new facilities, with technology being a contemporary and increasingly vital example, as it must regularly be refreshed to keep up with evolving standards and capabilities.

In addition to aiding expenditure forecasting, a long-term facilities plan can be very effective for demonstrating to the community that the district has a responsible vision for facility expansion. Geneva, for instance, developed a long-term master facility planning plan, which received a favorable reaction from the community. This helped the district pass a referendum for an approximately \$80 million bond issue for school facilities.

Pension costs are notorious for creating a liability that that does not impact the current period, but that has important long-term ramifications. However, pensions are not the only “non-current” liability that a school district should be concerned with. Equipment maintenance and replacement requirements also create a future claim on school resources. While these obligations can theoretically be deferred, responsible financial planning will consider how to fully fund them. Deferring maintenance/replacement can increase operational costs, reduce service effectiveness, accelerate depreciation, and, at worst, compromise the safety of students and employees. Districts should identify long-term replacement and maintenance schedules for important asset classes, including the bus fleet, computers, recreational equipment, and building and grounds and include the associated costs into their expenditure projections.

#### **Forecasting the Future, Not the Status Quo**

When considering the cost factors described in this report, an expenditure forecast should account for the costs necessary to realize the board’s strategic goals over a multi-year time period. In other words, the forecast should not just project forward the status quo but should account for the actions necessary to realize the better future envisioned by the board and the community. This will provide a better sense of the revenue required to realize the vision, and can provide valuable feedback on the scope of the vision, the timeframe for its realization, and prioritization of its elements, especially if long-term forecasts show the preferred vision to be financially infeasible.

## **Debt Analysis**

Due to facility construction responsibilities, debt is a prominent part of the long-term financing strategy of many school districts. A long-term financial plan should analyze both the current debt obligations of the district and the district’s capacity to issue new debt vis-à-vis future facility needs as well as state statutes that establish ceilings for debt issuance.

When analyzing current obligations, planners should start by considering two essential perspectives: budgetary impact and community ability to pay. The budgetary-impact perspective considers the impact that debt has on the district’s operating budgeting and is most germane to non—self-supporting debt (i.e., debt issued without a self-supporting tax levy on the community). The community-ability-to-pay perspective considers the overall tax burden on the community and is most relevant to self-supporting debt, like general obligation bonds, that places an additional tax on citizens. This latter perspective also should consider the total overall tax burden placed on the community from overlapping jurisdictions.

Debt performance measures or ratios can be used with each perspective. Exhibit 4 contains some common measures for each perspective (please note that the table does not address measures commonly associated with revenue debt since that is typically a less common concern in school districts).

#### Exhibit 4 – Common Debt Measurements

##### Community Ability to Pay

- *Net direct debt per capita*—Describes the per capita distribution of net direct debt.<sup>17</sup> For communities where population is not the most meaningful measure of economic capacity (e.g., a heavily industrialized community), population may be replaced with another denominator like assessed value or personal income.
- *Debt service per capita*—Substitutes annual debt service requirements for net direct debt in the above measure. This analyzes the distribution of payment for debt. For example, if net direct debt indicators are high, but debt service indicators are low, it might indicate that debt issues have a repayment schedule that shifts the burden for repayment in later years.
- *Net overall debt per capita (overlapping debt)*—Takes into account the debt of other, overlapping jurisdictions for which constituents bear the repayment burden. Even if the district does not impose a high debt burden on the community, a high debt burden from other jurisdictions might make issuance of additional debt less feasible.

##### Budgetary Impact

- *Debt service as a percentage of non-capital expenditures*—This measure, made possible with the advent of the GASB 34 reporting model, describes how operating expenditures compare to debt service.<sup>18</sup>
- *Debt service divided by general fund revenue*—This measure reveals the proportion of general fund revenues that are consumed by debt service expenditures. This has been a widely used measure in the past, but has been supplanted, to some extent, by debt service as a percentage of non-capital expenditures.

After constructing debt measures (which can usually be done using data commonly available in a comprehensive annual financial report), the results must be compared against a meaningful standard in order to put them in context. Comparison with past history is one available reference point. Historical comparisons can show meaningful trends, but there is not always an unambiguous indication of whether these trends are favorable or unfavorable. Benchmarking against other school districts can help make a value judgment on measurement results. Comparing with other schools is often intuitively attractive to decision makers and will help engage them in the discussion. However, care must be taken when selecting the districts to benchmark against in order to ensure they are truly comparable. As an alternative to benchmarking against specific districts, bond rating agencies like Moody's Investors Service, Fitch Ratings, and Standard & Poor's publish more generic standards against which a district can compare itself. While historical comparisons and benchmarking are useful, the optimal standard is one set through board policy in advance of the analysis. Under this approach, board and staff work together to identify ideal values for the debt performance measures and then compare actual performance

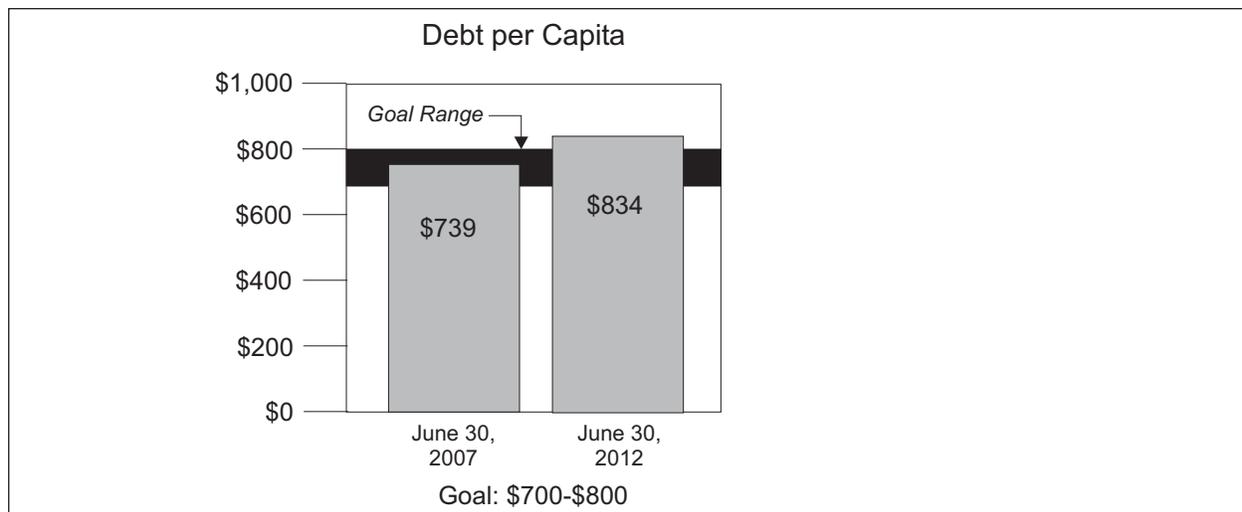
against those values. Historical experience and consultation with bond rating agencies can be used to inform the development of the policy.

Analyzing future potential indebtedness requires an understanding of future capital requirements, as would ideally be articulated through a facilities plan. The GFOA's research indicates that governments have found it useful to construct debt issuance "scenarios" that explore different possible future levels of issuance by modulating key variables that impact the amount and cost of debt. Some of the most important variables to consider are:

- *Number and scale of projects undertaken.* If the capital improvement/facility plan attaches a priority to capital needs, scenarios can be developed to show issuances for a scenario where only the highest priority projects are constructed versus some mixture of the highest priority projects and other projects.
- *Interest rates.* Interest is vital to determining the total cost of a debt issue. As a baseline, the analyst can specify an assumed bond rating and then use historical interest rates for that rating, modified for expectations of the future interest rate environment in order to arrive at an assumed rate. Given that future interest rates are virtually impossible to precisely predict, using scenario analysis to explore multiple possible futures is particularly appropriate.
- *Level of issue self-support.* The extent to which debt is self-supporting (i.e., comes with its own revenue stream) is critical to both the budgetary-impact and community-ability-to-pay perspectives of analysis. Self-supporting debt minimizes the impact on the district's budget, as existing revenue sources are not further drawn upon. However, self-supporting debt does put strain on the community's ability to pay, as the community must devote a greater amount of its resources to government activity than in the absence of the debt.

After defining scenarios, planners can project future levels of debt issuance and then compare those to some of the same standards what were used to analyze the current level of indebtedness. Exhibit 5 provides an example of a presentation that compares present and projected levels of debt to a standard for debt per capita that is defined through a financial policy. There are other more sophisticated analysis techniques available. Readers

**Exhibit 5 – Comparing Debt Present and Future Debt to a Policy-Based Standard**



wishing to learn more are encouraged to consult *Financing the Future* and/or the GFOA's *Benchmarking and Measuring Debt Capacity*.<sup>19</sup>

### Financial Balance Analysis

At this point, the analysts bring together the results of the environmental analysis, revenue and expenditure projections, and debt analysis in order to identify potential imbalances in future financial position. The most obvious type of imbalance is where expenditures are projected to exceed revenues. However, the financial balance analysis should consider other types of threats to financial stability as well. For example, the environmental analysis might reveal certain trends that, while not having an immediate impact on long-term revenue or expenditure projections, have serious implications for future financial stability. For example, a significant drop in birth rates would not have an immediate impact on revenue or expenditures and might not have much impact at all on five-year projections, but is certainly a phenomenon with serious longer-term implications with which the district should be prepared to contend. In another example, the analysis might uncover a weakness in the district's financial policy portfolio. For instance, perhaps the debt analysis highlights the need for policy guidance on appropriate target values for debt

### Exhibit 6 – Rockwood's Fund Balance Presentation

	<b>Amount</b>	<b>% of the Next Year's Operating Expenses</b>
Beginning Balance 6/30/00	37,404,082	28.1%
FY01 Operating Fund Surplus	1,225,666	
Ending Balance 6/30/01	38,629,747	26.7%
FY02 Operating Fund Deficit	(1,467,677)	
Ending Balance 6/30/02	37,162,070	24.6%
FY03 Operating Fund Deficit	(1,042,102)	
Ending Balance 6/30/03	36,119,969	23.2%
FY04 Operating Fund Deficit	(4,155,092)	
Ending Balance 6/30/04	31,964,877	20.5%
FY05 Operating Fund Deficit	4,662,494	
Ending Balance 6/30/05	36,627,371	22.4%
FY06 Operating Fund Deficit	5,567,566	
Ending Balance 6/30/06	42,194,936	23.6%
FY07 Operating Fund Deficit	(307,137)	
Ending Balance 6/30/07	41,887,799	22.5%
FY08 Operating Fund Deficit	(1,499,542)	
Ending Balance 6/30/08	40,388,287	

performance measures so that full issuance strategies can be constructed consistently with the policies.

Once imbalances are identified they must be presented to decision makers. A potent presentation is the catalyst for remedial action. Data visualization techniques like charts and graphs are time-honored and effective means for communicating quantitative information. A simple, but effective presentation is to plot projected revenues on the same graph as projected expenditures and to highlight the point where expenditures begin to exceed revenues. Another powerful technique is to plot expected financial performance against financial management standards established through board policy. Exhibit 5 provided an example of how this could be accomplished for debt and a similar concept could be extended to other areas of financial management. For example, Exhibit 5 could be adjusted to compare current and projected fund balances (perhaps as a percent of annual revenue) to the district's policy goal.

Tables are also useful. Exhibit 6 shows a table used by Rockwood.<sup>20</sup> The power of this table is that it puts a focus squarely on fund balances, which are the ultimate product of successive surpluses and deficits and which are a key determinant of the district's flexibility to respond to unanticipated situations. The table also highlights how fund balance compares to the next year's operating expenses, in terms of a percentage. Rockwood's management and board of education regards this statistic as a key measure of the district's financial health, so emphasizing in the table makes for a more powerful presentation. The presence of a financial policy that identifies a desired level of fund balance (like the Geneva example shown earlier) makes such a presentation even more compelling.

## Concluding the Analysis Phase

At the end of the analysis phase, the planning participants should have reached agreement on the nature of the fiscal imbalances they need to resolve. This leads directly into the decision phase.

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## Decision Phase

Strategies will need to be developed to achieve and maintain fiscal balance in light of any potential future imbalances uncovered in the analysis phase. Districts could adopt many possible strategies to achieve fiscal balance. It is *how* the strategy is developed that matters, though. It must be developed in a way that builds a strong consensus in order to generate the sustained commitment to implement it in the long term.

The first step to building a strong consensus is to use a participative process for developing strategies. For instance, the school board and executive staff can work together in joint workshops to develop strategies. Participation should extend deeper into the organization than the board and executive staff, however, and should also extend out into the community. Many of those financial strategies that have the greatest potential for far-reaching positive impacts will require a concerted effort from staff throughout the district, thus requiring that these staff actively support the strategy.

Geneva, for example, used staff focus groups to consult on cost-reduction strategies. These groups' membership came from across the district: teachers from different grades, special services staff such as social workers, special education instructors, and psychologists, as well as operational and maintenance staff were all represented. The work of Geneva's focus groups took place over several meetings. The first few meetings were used to simply explain the problem the district was facing – a massive deficit in its educational

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and operations and maintenance funds. This created awareness among staff of the problem and helped them understand why the district could not continue on its current course. These initial meetings also were used to show how the district's financial challenges could directly impact staff, such as through program or compensation reductions, and that corrective action was needed. The message was that teachers and staff could either be a part of the solution and work with the district's administration to realize a better future, or the district could develop its own solutions that teachers and staff might not like. The effect was to create a strong desire on the part of staff to participate in the process. The district then provided a framework for helping the focus groups to identify and prioritize programs and services, with the intent of cutting those of lower priority. The guiding framework pointed the groups in the right direction and gave them a sense of empowerment that they could tackle the problem.

A broad base of participation complicates gaining consensus due to the size of the group across which consensus must be built. Therefore, the leader of the planning process must frame the entire discussion around what is best for the district's children. This moves the group one giant step closer to consensus at the start because there is broad agreement on the purpose of their deliberations. Focusing on what is best for children means that if a program is not generating results it should be cut, regardless of whose entrenched interests may be affected. This is where performance measurement and benchmarking can be helpful for depoliticizing the discussion about which programs are achieving results. Even in the absence of performance measures, just the political will and long-term focus that a broad base of participation and joint vision can generate is able to provide the momentum to cut programs that have outlived their usefulness. This phenomenon enabled Geneva to cut a number of unneeded programs that were in the district's budget due to simple inertia. For example, the 5th grade play consumed a considerable amount of resources while providing comparatively little educational value and high school teachers were receiving stipends for extracurricular clubs that had no or minimal activity.

Consensus building also necessitates overcoming the natural tendency toward risk aversion in schools so that participants will be comfortable moving forward with strategies for change. This requires creating a positive vision with financial planning – one that is about how the schools can provide more educational value for the tax dollar and sustain the value over the long term. It also requires communication and collaboration with stakeholders so that all feel that they are in the process together and that any risks are shared. Joint goal setting in the mobilization phase is a good start because it establishes a positive shared vision and provides the basis for communications throughout the planning process. These goals can be enhanced with verifiable and measurable metrics of performance. This brings an additional level of clarity to the objectives.

### **Unions and Committees**

Unions are a prominent feature of many school environments. School business officers must be mindful of how unions may react to the employee focus groups and committees. Union leaders should be engaged up front to explain the committees' purpose and to emphasize the intention to find financial strategies that work for both the district and employees. Unions may even become valuable supporters if their leaders actively participate in developing the financial strategies.

## **Concluding the Decision Phase**

When financial strategies are developed along the lines described in this section they will enjoy a high degree of commitment from across the district. The leader can then place a

capstone on planning by adding a culminating event to the process. A board meeting where the plan document approved is a typical venue for such an event. The culminating event provides the opportunity to recognize the successes of the process and for the board to officially adopt the plan as its guiding vision.

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## **Execution Phase**

The work does not end with the culminating event. The strategies called for by the plan must be carried forward and the ethos of planning institutionalized in the school district.

The budget document is the main vehicle for implementing financial strategies. The connection between the budget process and long-term planning must be deliberately designed and the CFO and superintendent should consider how this connection will be made when they are designing the long-term planning process in the mobilization phase. This connection can take a number of forms. Below are four such methods:

- The budget can be used to implement specific financial strategies by identifying an allocation of resources in the budget and describing achievement of the strategy as an explicit goal for the upcoming budget cycle. For example, if the district wishes to raise a reserve to a certain level, the set-aside of funds needed to reach that level would be shown in the budget.
- The long-term financial planning process will identify a multi-year strategy for implementing the district's broader goals for providing the best education value it can. The budget will be used to allocate resources to the appropriate annual activities to achieve that strategy.
- The long-term financial plan may identify a set of assumed limitations on expenditure growth that are consistent with the organization's projected resource availability over the long term. The budget must then be developed and managed within the parameters established by these assumptions. For example, perhaps the financial plan states that personnel costs cannot increase by more than 3 percent per year to maintain financial balance. Budgets would then be developed and controlled within that guideline.
- Long-term planning can be used to better identify the resources that will be available for capital expenditures, such as through its debt analysis. The results of these deliberations should be reflected in the organization's capital improvement plan and budget.

A scorecard of key indicators can be used to help execute the plan. Key indicators provide at-a-glance information on performance and should be focused on measuring progress toward the district's broader educational goals as articulated in the mobilization phase and the financial strategies developed in the decision phase. They also provide a convenient basis for ongoing monitoring of plan implementation. Examples of useful indicators are:

- The bond rating conferred by rating agencies like Moody's Investors Service, Fitch Ratings, and Standard & Poor's.
  - The percent of citizens describing the district as a responsible steward of their tax dollars, as might be ascertained through a community survey.
  - Indices like those developed by the Center on Educational Governance for its "charter school indicators," as described earlier in this report.
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A successful implementation will lead stakeholders to view planning as a positive experience and, therefore, as one they will want to repeat. The leader of the planning process can encourage institutionalization of financial planning by regularly reinforcing the imperative to identify and fund programs that create the most value for children, while cutting resource uses that destroy value. In addition to this inward perspective on institutionalization, an outward perspective toward the public should be employed. Demonstrating good stewardship of the public resources and then receiving positive feedback through public surveys and approved bond referendums can create a cycle where the public's approbation of the district's efforts encourages more of the same.

Besides instilling these general beliefs and attitudes into the school district's culture, the leader of the planning process can create organizational devices that encourage planning. For example, Rockwood School District has a finance committee made up of financially savvy citizens that reports to the board of education. One of the finance committee's central roles is to guide financial planning and help make decisions on key financial issues facing the district. This committee's focus on financial planning provides valuable support to the board, whose attention is often diverted away from financial matters. It also helps institutionalize planning at the district because the finance committee, as a matter of course, keeps financial planning at the forefront of its activities, despite any changes in the composition of the school board or administration.

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## Conclusion

Long-term financial planning is emerging as a discipline of greater importance as all local governments, including school districts, face new and complex challenges of a long-term nature. In addition to helping school districts confront these challenges, financial planning provides more immediate benefits. It makes for a more streamlined and productive budget process because it establishes common assumptions among participants in the process and identifies the goals that the budget will be built around. It helps stabilize operations by creating solid reserves that contribute to the ability of the district to commit to a sustained and consistent educational strategy for the community. Finally, the plan is a vehicle for communicating to the public – citizens can better know the educational value the district provides and how it intends to use their tax dollars.

School business officials are responsible for institutionalizing financial planning in their districts. They must make the case for planning, secure the involvement of critical stakeholder groups to develop the plan, and then lead the team to a successful implementation. This report has endeavored to provide assistance in fulfilling this responsibility. The GFOA and ASBO sincerely hope you have found it useful and encourage you to visit [www.gfoa.org/lftp](http://www.gfoa.org/lftp) if you would like further information on financial planning.

## Endnotes

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