

## Major Assumptions Used in the Preparation of the Five-Year Forecast Prepared October 10, 2018

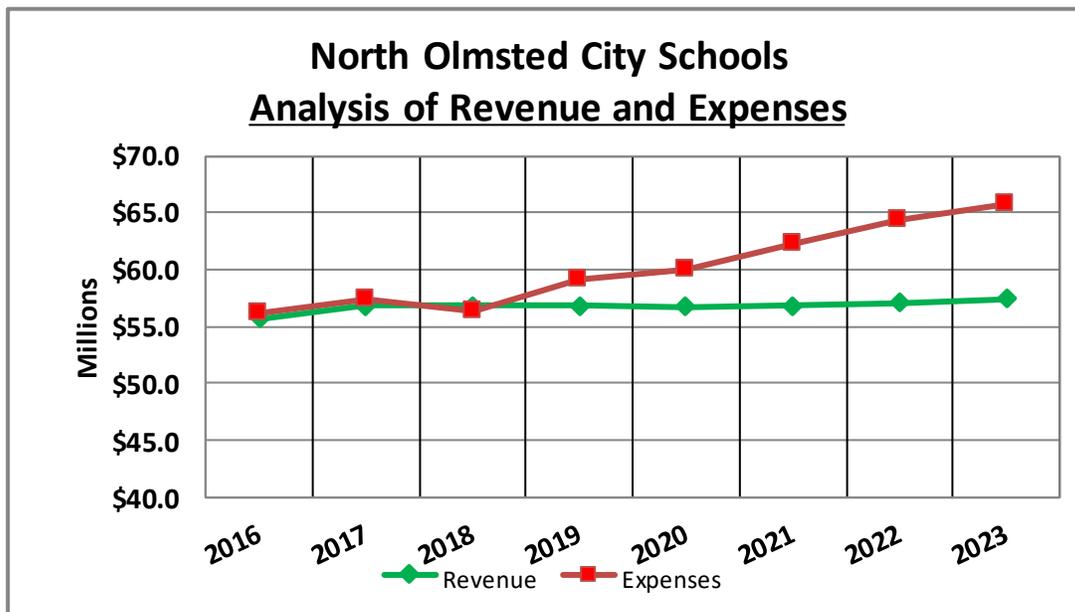
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### Financial Summary

Enclosed is a summary of major assumptions used in the preparation of the District's Five Year Financial Forecast. The forecast is based upon the District's knowledge of conditions at the time it is transmitted to the Ohio Department of Education. Factors contained in the forecast are subject to change and the forecast may vary significantly in the future based upon changing conditions. If you have any questions or comments concerning the District's financial position, you are encouraged to contact the District's Treasurer, Robert J. Matson CPA. He can be reached by email at [robert.matson@nocseagles.org](mailto:robert.matson@nocseagles.org) or by telephone at 440-588-5317.

During fiscal years 2008 and 2009, the North Olmsted Schools, like most school districts in Ohio, faced a serious decline in operating revenues due to the nationwide economic recession, the real estate foreclosure crisis, and cutbacks in state funding. The Board of Education was able to stabilize the District's finances through a combination of budgetary cuts, wage concessions for the Unions, and community support with the passage of 7.9 mill operating levy in November 2010.

The District is now on the downside of the November 2010 levy life cycle. As illustrated in the charts below, operating expenditures have started to exceed revenues.



The operating deficit will get progressively larger over the next five years because of stagnant growth in operating revenues while expenditures continue to increase due to inflation, the addition of new programs and unfunded state mandates. These future operating deficits can be temporarily funded with the District's cash reserves until the reserves are exhausted in fiscal year 2022. To avoid disruptions in the academic program, the Board of Education will have to consider placing a property tax levy before the voters in calendar year 2019.

Over the years, the Board of Education has examined the pros and cons of substituting a school income tax for the traditional property tax levy to fund the cost of educating children. Each time, the Board of Education has concluded a school income tax would be a greater financial burden on our residents than a traditional property tax levy.

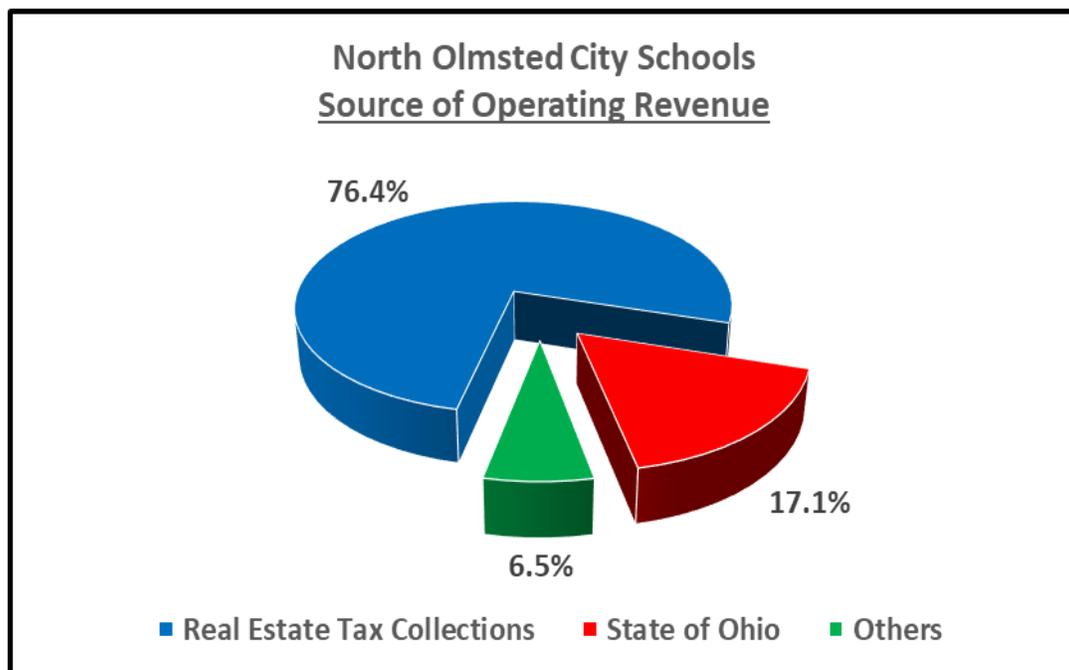
A school income tax should not be confused with a municipal income tax. Whereas a municipal income tax is assessed on residents, workers and businesses located within the City of North Olmsted, a school income tax would be assessed only on residents. There are two types of school income taxes. The traditional school income tax levy is assessed on Ohio Adjusted Gross Income. Therefore, wages, salaries, interest, dividends, unemployment compensation, pensions, annuities, IRA distributions, capital gains, and alimony would be subject to the tax. In recent years, the Ohio General Assembly created a school earned income tax which would be levied only on W-2 wages. Senior citizens 65 years of age or older can qualify for a tax credit of \$50.00 under both types of school income taxes.

The tax burden of a property tax levy, unlike a school income tax, is shared by the residents and the businesses located within the school district. In North Olmsted, commercial property owners pay 33.0% of real estate taxes collected. Under a school district income taxing structure, commercial property owners would pay nothing and, therefore, residents' taxes would have to make up the loss tax revenue.

Below is a summary of major assumptions used in the preparation of the current Five Year Financial Forecast.

### **Revenue Assumptions Used in the Preparation of the Financial Forecast**

There are three major sources of operating revenues for the District: the assessment of real estate taxes, funding from the State of Ohio, and other local sources which are illustrated in the following chart:



**Real Estate Property Tax Revenue**

The District’s primary source of operating revenue (76.4%) comes from the collection of real estate taxes levied on residential, commercial and public utility properties located within the community. The District has experience limited growth in this source of operating revenue during the past 10 years because the City of North Olmsted is a mature community with very little undeveloped land. It is anticipated that there will be no significant increases in future tax collections.

During the nationwide economic recession and the real estate foreclosure crisis in 2010, the District experienced a 12.3% decline in the market values of properties within the City which resulted in an annual loss in tax collections of \$1.0 million. Property values are starting to return to pre-recession levels. The Cuyahoga County Auditor is predicting properties for taxing purposes will increase 13.2% when the County completes its reappraisal for 2018. Unfortunately, House Bill 920 will limit the additional taxes the School District will received to only \$300,000.

For financial forecast purposes real estate tax revenue for the fiscal year 2018-19 and 2019-20 are based upon estimates provided by the Cuyahoga County Budget Commission. Tax revenues for the remaining three years are assumed to increase approximately \$100,000 or 0.25% annually because of new construction and remodeling.

The financial forecast also includes a \$300,000 annual reserve for the potential shortfall in tax collections due to delinquent tax payments and the refund of taxes from reductions in property values granted by the Board of Revision and Board of Tax Appeal.

**Unrestricted State Grants-in-Aid**

The primary source of revenue under this heading comes from the State of Ohio’s basic financial aid and taxes levied on casino gambling.

**Basic State Aid** – This source of revenue has been declining as a major source of operating revenue for the District for many years. During fiscal year 1991, basic state aid provided 26.1% of the District’s operating revenue. Today, the State of Ohio provides only 16.0% of the District’s operating revenue. The formula used to distribute basic state aid among school districts in Ohio is heavily dependent upon student enrollment and property values. North Olmsted City Schools is considered a wealthy school district in terms of property values and therefore, received a relatively small allocation of basic state aid. Beginning in fiscal year 2015, a new funding formula to distribute basic state aid was created which factors family income. Based upon the new formula North Olmsted City Schools received the following increases during the past 5 years:

<u>Fiscal Year</u>	<u>Increase</u>
2015	10.1%
2016	7.4%
2017	7.0%
2018	3.8%
2019	3.4%

The direction of future funding is difficult to determine until after the election of a new Governor in November 2018. Therefore, it is assumed basic state aid will increase only 2.5% in each of the remaining years of the financial forecast.

**Casino Revenue** – In 2009, a constitutional amendment was passed by the voters in Ohio that allowed for the construction of four casinos in the state. The Governor then authorized, through the Ohio Lottery Commission, the installation of seven video lottery facilities (slot machines) at the existing seven horse racing tracks. The school district was initially projected to receive approximately \$320,000 annually in taxes assessed. During the past 5 years, the District received the following amounts:

<u>Fiscal Year</u>	<u>Increase</u>
2015	\$196,118
2016	193,944
2017	187,750
2018	193,203
2019	200,000

Because tax collections have been significantly less than initial projections from the Ohio Department of Taxation, no growth in this source of revenue has been included in the financial forecast.

### **All Other Revenue**

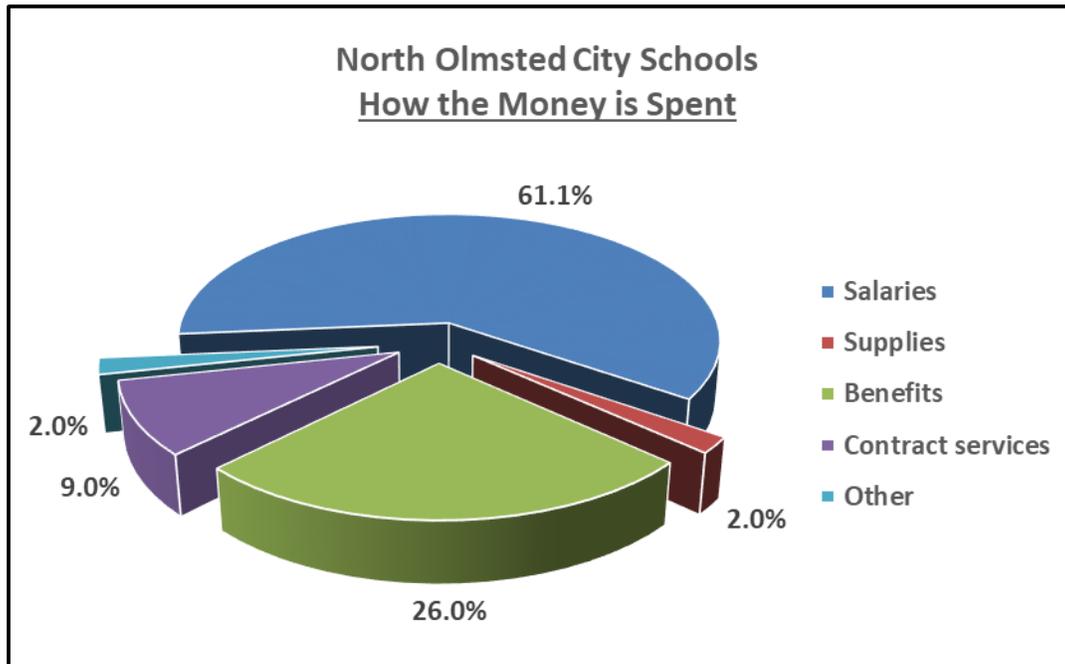
The primary source of revenue under this heading comes from investment earnings, tuition reimbursements for nonresident students, student fees, and negotiated settlement of tax complaints filed with the Board of Revision and Board of Tax Appeals, payments received from the City of North Olmsted's Tax Increment Financing (TIF) program and reimbursements received for services provided to Medicaid eligible students. For forecast purposes, it is assumed there will be no significant change in the amount of funds received from these sources.

### **Property Tax Allocation**

The property tax allocation represents reimbursement from the State of Ohio for real estate tax credits granted to residential and commercial property tax owners under the State's rollback and homestead exemption programs. In June 2005, the Ohio General Assembly eliminated the 10% rollback credit on commercial real estate. The loss of this revenue was offset by a corresponding increase of additional real estate taxes paid by commercial property owners.

## Expenditure Assumptions Used in the Preparation of the Financial Forecast

As illustrated in the charts below, 86.9% of the District's operating expenditures are spent on salaries and benefits. Of the money spent on salaries and fringe benefits, 74.1% is paid for teachers and direct instructional support for student. Only 9.3% of salaries and fringe benefits are paid to administrators.



### Salaries

In an effort to help the District during the economic recession in 2010, the teachers, non-professional and administrative staffs agreed to salary concessions by reducing base salaries 2.25% during the 2010-11 school year and a base salary freeze for the 2011-12 school year. The District continues to realizing savings of \$1.7 million annually from these wage concessions.

Labor Contracts with Teachers and Non-Certified Unions will expire on July 31, 2019. Future salary increases are assumed to be limited to 1.75% in each of the years reported in the financial forecast. Salary increases for longevity and educational credits provided under the current union agreements have been included in the financial forecast.

Potential savings from the future retirement of personnel has not been factored into the financial forecast because of the difficulty and unreliability of estimating future savings.

### Medical Insurance Benefits

The District provides employee medical, prescription drug and dental benefits through a self-insured program administered by Medical Mutual of Ohio. The District limits its liability for medical and surgical claims by maintaining a specific stop-loss insurance deductible of \$150,000. As required by law, the District has accumulated \$1,700,000 in a medical claim stabilization fund to pay outstanding incurred medical claims and protect the District from unanticipated adverse claims experience. This reserve represents approximately 17.0% of the total annual projected health care costs. Based upon an annual actuarial evaluation of

outstanding medical claims prepared by Medical Mutual of Ohio, the medical claims stabilization fund should be adequate during the duration of the financial forecast.

Over the years, the Unions have worked with the Administration and have made significant changes to the District's medical plan to control costs. During 2012, employees started paying a portion of the cost for medical coverage. Employees are current paying \$1.5 million or 16.0% of the monthly insurance premiums. Payments from employee for the past five years totaled \$6.1 million.

Other changes agreed to include enrolling spouses into a mandatory coordinated benefit program, require the use of generic drugs, and the doubling of prescription drug co-pays. These changes have saved the District over \$6.3 million in medical expenditures during the past five years. Future medical costs are assumed to increase at an annual rate of 8.0% based upon the recommendations of Medical Mutual of Ohio.

### **Purchase Services, Supplies and Other Expenditures:**

Based on historical patterns, these expenditures are generally assumed to increase 3.0% annually except for energy related costs. Expenditures for utilities and transportation fuels are anticipated to increase approximately 4% for financial forecast purposes. The District could experience significant fluctuations in future energy costs due to market instability and changes in winter weather conditions and the configuration of the school buildings.

### **Capital Outlay**

Capital expenditures by the General Fund are minimal. The majority of these expenditures are paid from a separate 1.9 mills Permanent Improvement Levy, which is deposited into a capital improvement fund and is not reflected in this forecast. Starting in January 2015, approximately \$390,000 or 0.5 mill has been set aside in a separate maintenance fund to be used only for repairs of the newly constructed Middle/High School Campus.

Capital expenditures from the General Fund are primarily for unanticipated emergency purchases. However, it is anticipated the General Fund will have to subsidize the Permanent Improvement Fund approximately \$150,000 to \$200,000 annually for the purchase of computers and network system upgrades that will be used for educational instruction.

During fiscal year 2013, the District developed a comprehensive energy savings program that will reduce the District's utility costs \$284,000 or 31.0% annually. The energy savings will be guaranteed by the contractor with an insurance performance bond for a period of 11 years. In addition to the above annual energy savings, the District received \$90,000 in utility company rebates, and will realize \$70,000 annually in reduced maintenance and operating expenses. The \$3.2 million cost of the program was funded with the sale of general obligation notes. Energy savings realized from the program will be used to retire these notes.

### **Other, Advances and Transfers**

Anticipated expenditures in these areas are based on historical patterns.

During fiscal year 2008, the Board of Education authorized the Treasurer to establish a separate budgetary reserve to fund the 27<sup>th</sup> pay of June 30, 2017. On June 27, 2017, \$1,464,000 was transferred to the General Fund leaving an unencumbered balance of \$264,000 in the budgetary reserve. The District will be making annually deposit of \$125,000 into this fund in anticipation of the next 27<sup>th</sup> pay period.

As required by law, the District is making periodic contributions to a separate Medical Claims Stabilization Fund to pay outstanding incurred medical claims and protect the District from unanticipated adverse medical

expenditures. As of June 30, 2016, the District has accumulated \$1.7 million in this fund. An actuarial evaluation of the adequacy of the Medical Claims Stabilization Fund balance is made annually. It is assumed the Medical Claims Stabilization Fund is adequately funded and no transfers of money into the fund are anticipated during the duration of the forecast.

The District transfers approximately \$150,000 annually to subsidize the Food Service Lunch Program. The Administration is performing a comprehensive review of the food service operations to reduce future operating deficits.