Planning to Win in the Long Run: Best Practices in Multi-Year Financial Projections

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The Power of the Number

Chapter 2, page 29 – 31: “Without the Number, they could not even try to begin to move the City forward.”
Why do Multi-Year Projections?

A multi-year financial projection is a forecast of your government’s revenues and expenditures over a defined period of time (normally around 5 years) based on a specific set of assumptions.

The projections do not need to be done for each individual account or budget line, but should be at a sufficient level of detail to facilitate planning and decision making around the following questions:

- **Budget position:** Can we generate sufficient revenues annually to meet all expenditures and not incur deficits?
- **Structural position:** Are we structurally balanced such that recurring revenues meets recurring expenses, or is our balance predicated on actions that have a short-term benefit?
- **Community Goals:** Will we have the financial resources to deliver desired services over time and respond to changing needs and preferences (investments, reserve levels, tax rates)?

The multi-year projection (when combined with your cash flow report, your annual budget, and your annual audit) provides a good picture of your past, present and future financial position.
What is the Baseline Projection?

We recommend starting with a baseline projection showing what your revenues and expenditures will be absent significant changes. For revenues, this means you wouldn’t assume changes in tax rates, new taxing powers, new grants, large fee increases, or reassessment. For expenditures, you wouldn’t assume new hiring or layoffs or wage increases that are out-of-line with recent results. *Your baseline projection is like the diagnosis your doctor gives you after a physical. It reflects your current condition, given the major underlying factors. Then the treatment recommends corrective action in response to the diagnosis.*

Your baseline projection is usually driven by large revenues and expenditures, such as your major taxes and legacy costs (debt, pension, OPEB). Within the Whitebirch platform, you can show how changes in these lines drive your overall performance.
Why You Don't Want to Do Multi-Year Projections

- I'm one of only [X] people in my department and I've already got enough to do.
- You can't predict the future any way, so why worry about it?
- If I put something out there and it’s wrong, then the projections cause more trouble than they’re worth.
- We are focused on the next two years because that’s when we have another election.
- Multi-year projections are something that bigger (or wealthier or poorer) governments do.
What do I Need to Build the Projection?

Here are the basic building blocks you’ll need to develop your projections:

• **Historical revenues and expenditures**: We usually use 3-5 years to provide a starting point for calculating growth trends. It’s okay if you don’t have immaculate, detailed, consistently organized and formatted data. Start with what you have and what you know

• **Debt service schedule** for bonds, leases, etc.

• **Labor contracts**, which determine employee salaries and the cost of other forms of compensation (including health insurance). You should also note provisions that set minimum staffing requirements

• **Projected liabilities for pension and other post-employment benefit**: Ask your actuary or consult your OPEB valuation

• **Statutory provisions**: Do you have a policy that sets a minimum level of reserves you have to maintain? Do you have provisions that restrict the annual growth in tax revenue or tax rates or how the money can be used? Do you have revenues or expenditures that are automatically indexed to something else (CPI, COLA)?
What Drives my Projection?

For revenues and expenditures that don’t have a fixed future amount (e.g. debt schedule), you’ll calculate growth rates that project how those revenues and expenditures will change over time. You can start with the simple mathematical calculation (what was the average annual growth rate for X over the past 3-5 years?) and then apply management insight.

- **Factor out one-time spikes or plunges**: You may have non-recurring events that skew your averages (asset sale, debt refinancing, pay-as-you-go capital project)
- **Factor in programs that are limited in duration**: Do you have a grant that expires during your projection period? Will you have a temporary change in staffing levels?
- **Account for major changes in service delivery** that make the early years in a period less relevant

You’ll apply the growth rates to a fixed starting point (usually your adopted budget) and project them through whatever period is most helpful.
Growth Rate Resources

There are useful resources that can inform your growth rate calculations, though you’ll still need to weight them against historical trends and your insight into why the numbers have changed.

- **Tax assessments**: Is the total assessed value growing? Is the total taxable value growing (i.e. tax exempt properties)?
- **Sales tax**: additions and reductions in retail outlets, online sales growth, etc.
- Building permits, plan review activity, utility usage
- **Consumer price index** (US Bureau of Labor Statistics): How much will the cost of X increase?
- **Population and housing unit estimates** (US Census Bureau): Are we growing or shrinking?
- Annual survey on employer health benefit costs (http://ehbs.kff.org/)
- Your actuary, your health insurance plan administrator, your financial advisor, your neighboring municipality, etc.
Revenue Estimating Committee

One approach is to form a revenue estimating committee. This committee is usually led by someone in Finance and populated by relevant external actors who have a working knowledge of the City’s finances.

The Committee should meet early in the budget/projection process, before the expenditure budget/projections are released. The goal is to adopt a consensus estimate of the major revenues for the next year (budget) or more (projection).

The Committee leader provides an initial projection for the major revenues, along with a couple years of historical results and the mid-year results for the current year. The Committee then discusses the projections with the goal of coming up with a consensus on the amount of money that will be available to spend absent any tax or fee increases. This can help improve communication, build trust and frame future expenditure discussions.
Presentation Tip: The Number

Projecting revenues and expenditures will give you a baseline result that will help you frame the conversation going forward - “the number.”
Presentation Tip: Focus on Major Drivers

In addition to the simple graphical presentation of your baseline situation, you can show how changes in certain lines drive your overall performance. In the example below, the government should discuss the property tax history because it’s large, high profile and growing in an unusual way.

Other examples: Graphs that show how certain expenses are growing relative to each other or total revenues; graphs that show if legacy costs (debt, pension, OPEB) are consuming a growing or shrinking portion of total expenses.
### Labor Costing

In depth planning on personnel costs puts a focus on both near term salary/benefits and long-term retirement liabilities.
Example: Debt Service From a Different View

This chart shows debt service from a multi-year perspective to guide a decision on whether to debt finance or cash fund capital. The projection period is much longer because the relevant financial and operational activity has a similar time frame.
Capital Planning

This planning often includes an evaluation of what financing method is most suitable - in the process balancing debt vs. cash levels.
Reviewing Your Baseline Projection

The baseline projections will help you discuss your organization’s goals within the context of its financial resources.

- Is there a deficit? Is it a one-time problem or something structural?
- How are the drivers of our financial performance changing? Are they in balance? Is our operating margin growing or shrinking?
- Do we want to change where we’re spending our limited resources?
- Do we want to focus on keeping our charges/rates where they are or lowering them?

The baseline projections also should help you identify specific areas for corrective action. Now you can go beyond anecdotal evidence and invest your time and energy where it will make the biggest difference.
Planning for the Unknown

Contemplating what-ifs, such as the recession Scenario 1 shown below, allow you to be proactive and have contingency plans in place.
From Diagnosis to Treatment

Once you have a baseline projection and discuss the related challenges and opportunities, you can move to the next step – developing initiatives to change the projection.

Guiding questions: Given this baseline assessment and our goals, what kinds of initiatives (on both the expenditure and revenue side) should we pursue, and what is the likely financial impact of those initiatives?

Many governments struggle to keep their expenses in line with their revenues without raising taxes or cutting services. Your goal is to develop a menu of options, with as many quantified as possible, that represent a well-rounded approach to achieving and maintaining balance. Approaches would typically involve some (or all) of the following:

- Management and productivity initiatives
- Debt restructuring
- Cost recovery (fees and service charges)
- Workforce strategy
- Program prioritization
- Tax rate or base changes
Planning for the Known

Below, the results are shown for a Scenario with a combined set of strategic initiatives to improve long-term financial performance.
Why You Do Want to Do Multi-Year Projections

Reason No. 1: It’s a better way to bridge the gap

Many local governments face structural challenges. Property tax revenues are flat or grow by small amounts, tax rates other than the property tax are capped and there may be limited opportunity for economic development. Meanwhile expenses rise because of pension issues, health insurance costs, energy costs, etc.

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

• Short-term strategies often yield short-term benefits that expire or may even increase your deficit in out years
• Looking exclusively at the short term limits public/elected official appreciation and understanding of long term challenges (e.g. pension, OPEB, debt service)
• The options for addressing structural imbalance are much better before cash and current-year budgetary shortfalls arrive. Multi-year planning allows you to move away from “putting out the next fire”
Why You Do Want to Do Multi-Year Projections

Reason No. 2: It changes the budget conversation

Budget processes are often stressful and tense because scarce resources lead to an “us versus them” dynamic between elected officials, department heads, unions and management, 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 set 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 in addition to what reductions you need now
Why You Do Want to Do Multi-Year Projections

Reason No. 3: It’s considered a best practice by GFOA and other entities

“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
Thank You & Questions