

North Olmsted City Schools
Major Assumptions Used in the Preparation of the Five-Year Forecast
Revised October 10, 2011

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. He can be reached by email at robert.matson@nocseagles.org or by telephone at 440-779-3551.

North Olmsted Schools, like most school districts in Ohio, is facing a serious decline in operating revenues due to the nationwide economic recession, the foreclosure crisis and a cutback in state funding. The anticipated loss in operating revenue threatened to financially destabilize the District. The problem was so enormous; the Board of Education recognized that the only way to fix the problem was through a combination of budget cuts, staff concessions, and community support of a new operating levy.

The Board of Education set a goal of reducing operating expenses by \$4.5 million annually. This goal was exceeded when \$2.9 million in budgetary cuts were realized and \$2.8 million in salary concessions were obtained from employees. The majority of the budgetary cuts were obtained with the elimination of 39 staff positions during the 2010-11 school and an additional 10 positions anticipated for the 2011-12 school year.

The labor unions contributed to the cost reduction plan by agreeing to accept \$2.8 million in salary and fringe benefit concessions. Both unions voluntarily reopened their contracts and did not accept a 2.55% base salary increase they were legally entitled to receive during the 2010-11 school year. The unions also agreed to a base salary freeze for the 2011-12 school year.

The School District's financial position has been further stabilized with the passage of 7.9 mill operating levy in November 2010. This levy will be phased in over a period of two years and will generate an additional \$6.5 million of real estate tax revenue annually. Approximately 33.0% of the taxes will be paid by commercial property owners.

Over the years, the Board of Education has examined the pros and cons of substituting a school income tax for a 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 in North Olmsted, the school income tax would be assessed only on residents. There are two types of school income taxes. The traditional school income taxes are 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 has created a school earned income tax which would be

levied only on W-2 wages. Senior citizens 65 years of age or older qualify for a tax credit of \$50.00 under both types of school income taxes.

Currently 178 school districts in Ohio have successfully passed a school income tax, of which only 25 are the earned income type. What is interesting, not one of these school districts is located in a large urban area. These school districts are primarily located in rural farmland areas without a significant amount of commercial or industrial tax base. School income taxes in these areas generally benefit farmers who bear a disproportionate share of the property tax burden. Farm income is subject to large fluctuations from year to year and a school income tax offers farmers some relief during periods of low profits, unlike a property tax levy.

The 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 the real estate taxes collected. Under a school district income taxing structure, residents' taxes would be 33.0% higher.

Major Financial Forecast Assumptions

Real Estate Property Tax Revenue:

The District's primary source of operating revenue (80 percent) comes from the collection of real estate taxes levied on residential, commercial and public utility properties located within the community. The District has experienced 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.

Each year, the District receives an estimate from the Cuyahoga County Budget Commission of the anticipated real estate taxes that will be collected. This estimate serves as the basis for determining future tax collections for financial forecast purposes. Last year's tax collections (2009 tax year collected in the fiscal 2010 and 2011 school years) fell short of the Cuyahoga County Budget Commission's estimates by \$1,237,000. This is the eighth straight year the District has experienced a shortfall in tax collections as illustrated in the following chart:

Trends in Real Estate Tax Collection

<u>Tax Year</u>	<u>Budget Commission</u>		<u>Short Fall</u>	<u>Percent Collected</u>
	<u>Estimate</u>	<u>Actual</u>		
2002	\$30,795,000	\$30,423,101	(\$371,899)	98.8%
2003	31,519,000	31,148,900	(370,100)	98.8%
2004	31,563,000	31,436,471	(126,529)	99.6%
2005	31,659,000	31,299,305	(359,695)	98.9%
2006	31,985,000	31,458,928	(526,072)	98.4%
2007	37,812,000	37,153,898	(658,102)	98.3%
2008	37,655,000	36,696,678	(958,322)	97.5%
2009	37,105,000	\$35,867,890	(1,237,110)	96.7%
Three Year Average.....				97.5%

The Cuyahoga County Budget Commission has established a \$2.2 million reserve for anticipated uncollectible taxes for the 2011-12 school year. However, it is assumed that as the economy improves, the tax delinquency rate will decline and prior year tax delinquent taxes will start to be collected. Therefore, for forecast purposes, the estimated dollar amount uncollected taxes have been decreased as follows:

<u>School Year</u>	<u>Uncollected Taxes</u>
2011-12	\$1,500,000
2012-13	1,000,000
2013-14	700,000
2014-15	500,000
2015-16	300,000

The District continues to receive bad news regarding future real estate tax collections. Over 100 commercial owners filed requests with the Cuyahoga County Board of Revision seeking to lower the taxable value of their properties. When combined with the outstanding complaints filed in the previous years, approximately \$3.0 million in tax revenue is in jeopardy. The Board of Education is unable at this time to assess the merits of these reduction requests. Therefore, no provision has been made in the Five Year Financial Forecast for the potential loss of future tax revenue from these filings.

Personal Property Tax Revenue:

Personal property taxes were originally assessed on the value of inventory and equipment owned by businesses located within the community. In June 2005, the Ohio General Assembly passed House Bill 66, which eliminated the assessment and collection of this tax over a period of 4 years. Prior to the phase-out period, the District received approximately \$3.9 million or 8.7% of its operating revenue annually from this tax.

Unrestricted State Grants-in-Aid:

The primary source of revenue under this heading comes from the State of Ohio's basic financial aid and reimbursement payments for the loss of tax revenues due to the phase-out of tangible personal property (TPPT) and public utility taxes (PUT).

Basic state aid 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 11.9% 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, receives a relatively small allocation of basic state aid.

The Ohio Department of Education is in the process of developing a new funding formula to distribute basic state aid. However, it is anticipated that there will be no significant change the amount of state aid North Olmsted will be receiving in the foreseeable future.

Over the last 7 years, the Ohio General Assembly has overhauled the State's taxing structure and has eliminated the assessment of tangible personal property taxes and has deregulated the public utility companies. The General Assembly agreed to partially reimburse school districts for the loss of these local taxes. The Governor's biennium budget, Amended House Bill 153, will begin phasing-out these reimbursement payments during the 2011-12 school year. The District is scheduled to lose over \$10.2 million in operating revenue during the next five years.

The annual loss of Unrestricted State Grant-in-Aid reporting in the Five Year Financial Forecast is summarized in the following chart:

Reduction in State Funding as Proposed by the Governor

State						
Reimbursement	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	Total
PUT	\$340,918	\$347,918	\$347,918	\$347,918	\$347,918	\$1,732,590
TPPT	946,150	1,899,150	1,899,150	1,899,150	1,899,150	8,542,750
Total	<u>\$1,287,068</u>	<u>\$2,247,068</u>	<u>\$2,247,068</u>	<u>\$2,247,068</u>	<u>\$2,247,068</u>	<u>\$10,275,340</u>

Restricted Federal Grants:

Operating revenue in this category represents Federal Stimulus and Education Jobs Program funds received by the District. These funds are available for only two years and were deposited into a separate non-General Fund operating account. The State requires school districts to include these funds and corresponding expenditures in the Five Year Financial Forecast. It is assumed that at the end of the two year period, these funds will not be available to the school districts in Ohio.

Property Tax Allocation:

The property tax allocation represents reimbursement from the State of Ohio for real estate tax credits granted to residential commercial property tax owners under the State's rollback and homestead exemption programs. Historically, revenue from this source has been approximately 12.9 percent of total property tax receipts. 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.

All Other Revenue:

The primary source of revenue under this heading comes from investment earnings, tuition reimbursements for nonresident students, student fees, and tax abatement revenue sharing agreements. The decline in reported revenue during the past three years is due primarily to the historically low interest rates. Investment earnings have fallen from a high of \$990,000 during

the 2007 school year to only \$23,000 for the 2011 school year. It is assumed investment earnings will remain at their present historic low levels for the next 18 to 24 months.

Personnel Services:

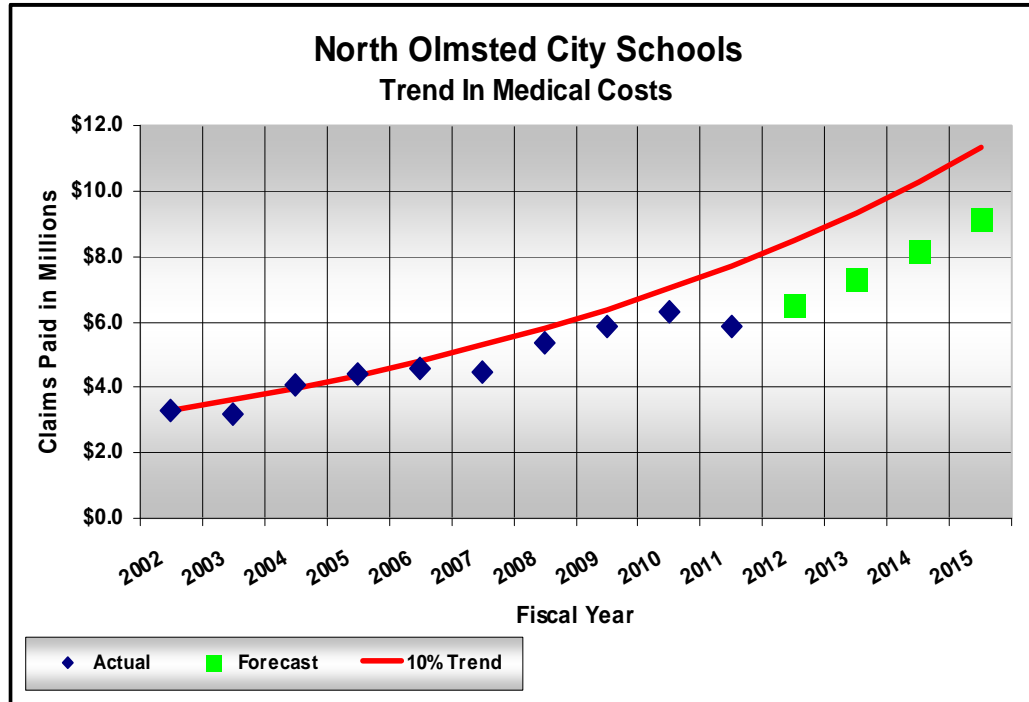
In an effort to help the District during this economic recession, the teachers, non-professional and administrative staffs agreed to salary concessions by giving back a 2.55% base salary increase scheduled for the 2010-11 school year and a base salary freeze for the 2012-13 school year. These salary concessions will reduce the District's personnel expenses approximately \$10.2 million during the five year period of this forecast. The remaining years of the financial forecast assumes annual base salary increases of 2.55% based upon the last salary increase negotiated by the Unions. All longevity and education credit increases in salaries as required by contract have been factored into the financial forecast.

The Administration has performed a comprehensive review of its staffing needs and has eliminated 39 positions (2 administrative, 12 teaching and 25 non-professional) for the 2010-11 school year and 10 teaching positions for the 2011-12 school year. The elimination of these positions will save the District approximately \$14.2 million during the five year period of this forecast. The financial forecast assumes no other significant changes in the size of the staff or change in the number of academic programs provided or the implementation of all day kindergarten.

Employee's Retirement/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 \$125,000. 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 26.1% 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 to pay any unanticipated increase in medical claims.

Over the past few years, the unions have agreed to make significant changes to the District's medical plan to control costs. All employees are required to pay 7.5% of monthly insurance premium, enroll their spouses into a mandatory coordinated benefit program, require the use of generic drugs, and double prescription drug co-pays. These changes are projected to reduce District's medical expenditures approximately \$7.1 million during the period of the financial forecast and are clearly illustrated in the enclosed graph of "Trend in Medical Costs." Future medical costs are assumed to increase at an annual rate of 10.0% based upon the recommendations from 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 8% for financial forecast purposes. The District could experience significant fluctuations in future energy costs due to market instability.

The District is in compliance with the budgetary, textbook and capital maintenance set-a-side requirements of House Bill 412, and these reserve requirements have been integrated into the forecast.

Capital Outlay:

Capital expenditures by the General Fund are minimal. The majority of these expenditures are paid from a separate 1.5 mill permanent improvement levy, which is deposited into a capital improvement fund and is not reflected in this forecast. Capital expenditures from the General Fund are primarily for unanticipated emergency purchases.

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 budgetary reserve for the next 27th pay period, scheduled to occur in fiscal year 2016. Annual

contributions of \$216,000 will be made to the reserve fund. As of June 30, 2011, \$864,000 has been deposited into this budgetary reserve fund.

As required by law, the District is making annual contributions of \$100,000 to a Medical Claims Stabilization Fund to pay outstanding incurred medical claims and protect the District from unanticipated adverse medical expenditures. As of June 30, 2011, the District has accumulated \$1.7 million in this fund. An actuarial evaluation of the outstanding medical claims and adequacy of the reserve fund balance is made annually.

The District transfers approximately \$100,000 annually to subsidize the Food Service Lunch Program. The Administration is performing a comprehensive review of the food service operations to reduce the program's operating deficits.