

North Olmsted City Schools
Major Assumptions Used in the Preparation of the Five-Year Forecast
Revised May 15, 2010

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 telephone at 440-779-3551, or by email at robert.matson@leeca.org.

Uncertainties in the economy, rising real estate tax delinquencies and possible cut backs in state funding makes this forecast vulnerable to potential large fluctuations in projecting future revenue and expenditures. However, the forecast clearly indicates the District's financial position is deteriorating rapidly. Of the eight years presented in this forecast, the District has operated in the black only once. To stabilize the District's financial position the Board of Education has placed a 7.9 mill operating levy on the August 3, 2010 ballot. It is anticipated that the passage of this levy during calendar year 2010 will provide the District with sufficient operating revenue for the next four years.

Over the years, the Board of Education has examined the pros and cons of substituting a school income tax for a traditional real estate tax operating 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 real estate tax operating 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 levied 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 are 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 city. 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 the property tax levy.

Under the proposed 7.9 mill operating levy on the August ballot, businesses will pay 33% or \$2.2 million of the total taxes that will be assessed. If this operating levy was replaced with a traditional school income tax, the business portion of the tax would be shifted to the individual resident and the overall tax burden substantially increased to the average taxpayer.

A 1.0% school district income tax would be required to raise a similar amount of money as the proposed 7.9 mill operating levy. Based upon information provided by the Cuyahoga County Auditor's Office and the Ohio Department of Taxation, the average market value of a home in North Olmsted is \$136,041 and the average Ohio Adjusted Gross Income per tax return is \$46,067. The taxes assessed on the proposed 7.9 mill operating levy would be \$329.13 while the taxes assessed from a school income tax would be \$460.67 or 40.0% higher than the proposed 7.9 mill operating levy. A school district income tax just does not make economic senses in North Olmsted.

Real Estate Property Tax Revenue

The District's primary source of operating revenue 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. 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 (2008 tax year collected in 2009) fell short of the Cuyahoga County Budget Commission's estimates by \$958,000. This is the seventh 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%
Seven Year Average.....				98.6%

Because of rising delinquencies, the foreclosure crisis, and unfavorable rulings from the Board of Revision and Board of Tax Appeals, the Budget Commission has established a \$1.6 million reserve for uncollectible taxes during the 2010-11 school year. This represents a collection rate of only 95.5% of the taxes assessed. The collection rate is assumed to increase at an annual rate of approximately 1.0% during each of remaining years of the forecast.

The District continues to receive bad news regarding future real estate tax collections. Over 100 commercial and residential property owners are seeking a \$1.3 million reduction in real estate taxes. When combined with the outstanding complaints filed in the previous years, approximately \$3.6 million in tax revenue is in jeopardy. The Board of Education is unable at this time to assess the merits of the claims filed. Therefore, no provision has been made in the Five Year Financial Forecast for the potential loss of future tax revenue from these filings.

The District has experienced a decline in the taxable value of public utility property in 9 of the past 10 years due to of the deregulation of the electric utility industry. In June 1999, the Ohio General Assembly passed Senate Bill 3, which dramatically reduced the assessment rate on electric utility property. The legislation contained a hold harmless provision to prevent the loss of revenues for a five-year period funded by levying a new kilowatt-hour tax on electric users. The District receives \$357,000 annually from the kilowatt tax and the revenue is reported under the heading "Other Unrestricted Grants-in-Aid" for financial forecast purposes.

The five-year hold harmless period ended December 31, 2006. The Ohio Department of Education determines whether a school district is eligibility to continue receiving these funds on a year-to-year basis. It is assumed for financial forecast purposes, the District will continue receiving the kilowatt-hour tax reimbursement.

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.

The District is being partially reimbursed by the State of Ohio for the loss of this revenue over a period of 12 years. In June 2009, the Ohio General Assembly changed the reimbursement rate and will reimburse school districts at 100% of the 2004 tangible personal property valuation for the next two biennia. The amount of the reimbursement will be reported under the heading "Unrestricted Grants-in-Aid" in the financial forecast. The long-term financial impact of House Bill 66 will be the shifting of approximately \$3.9 million, or 4 mills of taxation, from the business community to residential homeowners.

Unrestricted Grants-in-Aid

The primary source of revenue under this heading comes from financial aid from the State of Ohio through the Foundation Program. The Foundation Program has been declining as a major source of operating revenue for the District. During fiscal year 1991, the Foundation Program provided over 26% of the General Fund's operating revenue. Today, operating revenue from the Foundation Program accounts for only 13.9%.

The formula used to distribute 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 state aid. Increasing property values and declining enrollments have reduced North Olmsted's basic state aid to state minimum funding levels.

An analysis of the Governor's proposed biennial budget prepared by the Ohio Office of Budget and Management has indicated the District will receive a 2.0% reduction in basic state financial aid for the 2010-11 school year. The District is facing further cuts in state aid because of the continuing economic recession. The State of Ohio is facing an \$8.0 billion operating deficit for its next biennial budget. Based upon a study performed by State Representatives Nan Baker and Randy Gardner, the District is facing a \$1.4 million to \$1.9 million reduction in state funding during the next biennium budget. For forecast purposes, it is assumed state funding will be cut \$1.0 million during fiscal 2011-12 and 2012-13; and \$500,000 in fiscal 2013-14.

Federal Stabilization Supplement

This revenue category represents federal stimulus funds the state used to subsidize the funding of primary education. These funds are available for only two years and were deposited into a separate non-General Fund 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 District.

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 is offset by the 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 nonresidential special education students, collection of 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 and delays in the collections of tuition and tax abatement revenue sharing from year to year.

For financial forecast purposes, it is assumed investment earnings will remain at their present levels during the next 12 to 18 months and there will be no major delay in the collection of tuition, student fees and tax abatement revenue sharing. Investment earnings will begin to decline in fiscal year 2011 as the District's cash reserves are depleted by the anticipated operating deficits.

Personnel Services

During fiscal year 2009, the Teacher and Classified Unions negotiated a new three year labor agreement. Based upon this agreement, base salaries were scheduled to increase 2.55% in fiscal year 2011. In an effort to help the District during this economic recession, both Unions agreed to salary concessions and will not accept this 2.55% salary increase. The Unions also agreed that if the 7.9 mill operating levy is passed by the community during calendar year 2010, they

would accept a base salary freeze for the 2011-12 school year. The remaining years of the financial forecast assumes salary increases of 2.85% based upon average increases negotiated during the previous 10 years. All longevity and education credit increases in salaries as required by contract have been factored into the financial forecast.

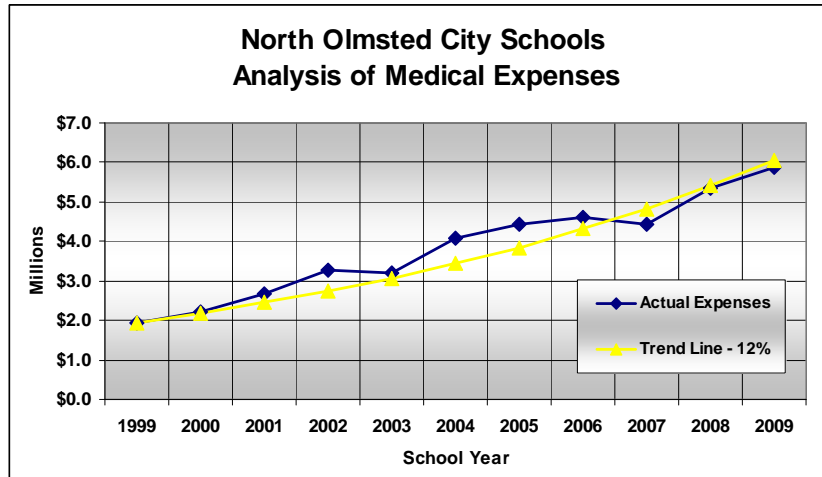
The Administration has performed a comprehensive review of its staff needs and will eliminate 2 administrative, 12 teaching and 25 classified positions for fiscal year 2010-11. The elimination of these 39 positions will save the District approximately \$2.1 million annually and have been factored into the financial forecast. The forecast assumes no other significant changes in the size of the teaching, non-professional and administrative staffs.

In July 2009, the Ohio General Assembly passed House Bill 1 which mandates school districts to implement all day kindergarten effective for the fiscal 2011-12 year. All day kindergarten would require the hiring of at least 6 additional teachers at an annual cost of \$260,000 to \$300,000. The Superintendent has requested a wavier of this mandate and the economic impact of all day kindergarten has not been factored into the forecast.

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 \$100,000. As required by law, the District has accumulated \$1,600,000 in a rate stabilization fund to pay outstanding incurred medical claims and protect the District from unanticipated adverse claims experience. This reserve represents approximately 24.5% of the total annual projected health care costs and based upon an annual actuarial evaluation of outstanding medical claims, appears to be adequate to fund any unanticipated increases in medical claims.

The Unions have agreed to make significant changes in the District's medical plan. Employees are required to pay 7.5% of monthly premium costs, enroll their spouses into a coordinated benefit program and double the amount of prescription drug co-pays. These savings have been factored into the financial forecast. Health care costs are assumed to increase at an annual rate of 12.0% based upon the recommendations from Medical Mutual of Ohio. Below is a chart analyzing the historic trend in health care costs for the past 10 years:



Purchase Services, Supplies and Other Expenditures

Anticipated increases in these expenditures are based on historical patterns and no major fluctuation is anticipated. Annual increases of 8% to 10% for utilities and transportation fuels have been integrated into the financial forecast. 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. During fiscal years 2006 and 2007, the General Fund paid \$1.6 million for renovation of the Middle School HVAC system.

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 incur in

fiscal year 2016. Annual contributions of \$216,000 will be made to the reserve fund. As of May 15, 2010, \$648,000 has been deposited into this reserve fund.

As required by law, the District is making annual contributions of \$100,000 to a Rate Stabilization Fund to pay outstanding incurred medical claims and protect the District from unanticipated adverse medical claims. As of May 15, 2010, the District has accumulated \$1.6 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 \$130,000 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.