

BOARD OF EDUCATION
The School District of South Orange and Maplewood
525 Academy Street
Maplewood, NJ 07040

November 15, 2004

MEMORANDUM

TO: Members, Board of Education
Peter P. Horoschak, Superintendent

FROM: Karla Milanette, Business Administrator

SUBJECT: BUDGET PROJECTIONS: 2005-06, 2006-07, 2007-08

School budgeting is very complex. The number and complexity of variables makes it very difficult to forecast with any degree of reliability into future school years. Each year's assumptions regarding CAP calculations, state aid formula, anticipated revenue, enrollment changes, expenditure rates, facility needs, etc. all impact subsequent years. Minor changes in any one variable can greatly alter future projections.

The purpose of creating three-year budget projections is to plan for long-term changes and to forecast possible tax increases. More importantly, they are intended to give the board and the community the ability to gauge the magnitude of resource cuts that might be necessary in the face of external constraints, such as the more stringent budget CAPs imposed by the recently-adopted S1701 legislation. As a planning tool, the following projections are intended to answer two key questions:

- What expenditure increases would be necessary to maintain the current level of programs and services and what would be the tax impact of doing so, given a range of three resource pricing scenarios?
- What level of dollar cuts will likely be necessary from this "maintenance" level, to conform to the new spending restrictions of S1701, again viewed across a range of three resource pricing scenarios?

The projections detailed in this report hold most assumptions constant across all three scenarios in order to gauge the impact of different rates of increase in salaries and benefits. Expenditures for salaries and benefits were selected as the key variable because they comprise the bulk (80%) of the expenditures in the school budget. For all other expenditures, a realistic rates of increase have been assumed across all three years of the projections.

Revenue to support the school budget comes from two sources: local taxpayers and formula-driven state aid. A small amount is earned from interest on investments and facilities rental but it is an insignificant amount for purposes of this discussion. Therefore, as the cost of delivering

a quality education continues to increase, and the amount of state aid provided remains constant, the local tax proportion of budget revenue also increases.

ASSUMPTIONS

The three-year budget impact is presented for three scenarios, “A”, “B”, and “C”. In each scenario, an amount needed for the General Fund is determined. All three scenarios are based on the following assumptions:

Revenues

The sources of revenue for the school budget are limited. The school budget is funded primarily from formula-based state aid and local taxes.

- The amount of state aid has remained relatively constant for the past several years. Therefore, it is assumed that it will continue to be approximately \$5,523,353 as provided in the 2004-05 budget. Of this amount, \$5,003,424 is available to support the General Fund and \$519,929 is restricted in use.
- Recent legislation requires that unreserved fund balance in excess of 3% of the actual 2003-04 expenditures be appropriated toward reducing taxes in the 2005-06 school budget. A total of \$226,522 has been reserved for this purpose.
- In addition, an estimate of available fund balance will be made at the time the budget is submitted and unreserved fund balance in excess of 2% of the planned 2005-06 expenditures will also be appropriated toward reducing taxes for the 2005-06 budget. It is estimated that an amount equal to approximately \$325,000 will be appropriated.
- Appropriation of fund balance only reduces taxes. It is not available to increase spending.
- It is not anticipated that unreserved fund balance will be available for reducing taxes in the 2006-07 and 2007-08 school budgets.
- Miscellaneous revenue received from interest earned on investments, facilities rentals, etc., is also assumed to remain constant at \$100,000, a minimal portion of revenue.
- Local taxes are assumed to comprise the balance of the district’s revenue.
- Restricted federal funding and state entitlements are not included in the discussion.
- Additional local taxes, needed for debt service, are also not considered for this discussion. Since all currently authorized debt has been issued, debt service is expected to remain constant at approximately \$3,000,000 annually. A request for bond authorization of about \$10,000,000 for capital projects is anticipated in the near future that would add approximately \$500,000 to annual debt service.

Expenditures

Determining expenditures for the school budget is not done by simply inflating prior year spending. The planning and analysis that goes into building the budget has been taking place over the past several months and will continue until the Superintendent presents his budget recommendation to the Board of Education on January 24, 2005. It requires thoughtful review of all education programs, compilation and analysis of a variety of data, and the involvement of a multitude of stakeholders. Community participation through the strategic planning process will play a large role in the development of the 2005-06 school budget.

- For the purpose of this discussion, however, realistic rates of increase were assumed as follows. These numbers may change substantially as the final budget is built and presented.
 - An inflation factor of 3.01% was applied to most categories for supplies and materials.
 - Textbooks and equipment are replaced on a staggered, multi-year schedule in order to keep spending in these categories level at an annual rate of increase of approximately 3.01%.
 - Health benefits and out-of-district tuition are key cost drivers and have been inflating at a much more rapid rate in previous years. Rates imposed on the district for these items are projected to increase 15% each year. Recent management efforts may result in a reduced annual increase projected in the final budget recommendation.
 - Similarly, legal costs and judgments against the district are expected to decline sharply with the hiring of in-house counsel but still are expected to increase at a rate greater than 3%. Costs for these items are projected to increase at a rate of 10% in each year of the projections. The results of further analysis may result in changing this projected rate of increase.
 - General insurance and utilities costs are other key cost drivers that have been inflating at a rapid rate in recent years. These areas are projected to rise at a rate of 20% each year. Insurance premiums are increasing due to natural disasters and terrorism riders. Energy costs continue to climb because of increased fuel costs and the inefficiency of aged HVAC systems throughout the district's facilities. Further analysis will be done to reflect some of the measures that have been and are being instituted to try to curtail these costs in the future.
 - Salaries and benefits comprise nearly 80% of the school budget. This category is the key variable in the projections. The SOMEA contract expires June 30, 2005. The cost of movement up the guide in the current contract (referred to as the "cost of increment") for current SOMEA members projected across the next three years would be 2.86% for 2005-06, 2.6% for 2006-07 and 2.75% for 2007-08. This is the minimum amount that would be required for SOMEA member salaries if current staffing levels and salary guide structures are maintained. The three scenarios

examine the impact of SOMEA settlements, inclusive of increment at 2.5%, (Scenario A), 3.01% (Scenario B), and 4.67% (Scenario C). The increase of 4.67% was used because it represents the current statewide average salary increase. Actual salaries are of course subject to negotiation.

- The ASCA contract was recently settled and does not expire until June 30, 2007. Based on the negotiated rate of increase of 2.5% in each of 2005-06 and 2006-07, the cost of ASCA salaries can be projected fairly well. The negotiated ASCA salary guides were used to project actual costs in those two years, assuming that the current staff remains and moves up the salary guide in accordance with the terms of the contract. Costs for ASCA salaries in the 2007-08 year are unknown and subject to future negotiations, but are assumed for purposes of this projection to be 2.5%.
- Central office salaries are negotiated each year. For purposes of this discussion, they follow the ASCA increases of 2.5% in all three years of the projection.
- The total benefit package includes group insurance, social security contributions, retirement contributions, unemployment compensation, worker's compensation, dental and medical benefits, tuition reimbursement, and banked sick leave reimbursement. The total cost of benefits averages 20% of salaries.
- Expenditure rates of increase, other than salaries, remain relatively constant across all three years of the analysis for the purpose of this illustration. The actual recommended budget will reflect more realistic cost estimates in these areas as a result of further analysis performed as the budget is built. Other typical key cost drivers such as out-of-district tuition, related services and building repair may be understated at this time pending a full analysis.
- The expenditures considered are to support the General Fund only. Local taxes also are raised for debt service. At this time, the debt service needs are \$3,102,600 in 2005-06, \$3,019,650 in 2006-07, and \$2,519,120 in 2007-08. A plan is in place to issue new debt for capital projects as existing debt retires in order to maintain a level debt service and minimize the impact on local taxes to the extent possible. A request for bond authorization of about \$10,000,000 for the next round of capital projects is anticipated in the near future that would add approximately \$500,000 to annual debt service.

THREE-YEAR PROJECTIONS:

Three scenarios, A, B, & C, are provided each of which presents: (1) an estimated minimum amount needed to maintain current programs and services at the pricing level assumed by that scenario, and, alternatively, (2) the dollar value of resource cuts necessary to conform to the stringent expenditure limitations of \$1701. Since salaries are the largest expense of the district, changes to salaries has the greatest impact on future spending and thus salaries were selected as the key variable illustration purposes.

The three attached Scenario Summaries thus present for years 2005-06, 2006-07 and 2007-08:

(1) the level of spending for current level of staffing (a “maintenance” budget that preserves most programs and services), including illustration of

- Resulting estimated annual rate of expenditure increase
- Resulting estimated General Fund tax burden in dollars
- Resulting estimated annual rate of tax increase

(2) the projected maximum level of spending permitted under S1701, with total General Fund expenditure increases limited to 3%, including illustration of

- Resulting necessary estimated cumulative dollar reduction in programs and services from the maintenance level
- Resulting estimated annual rate of expenditure increase
- Resulting estimated annual rate of tax increase

NEXT STEPS

These projections are provided to assist decision-makers in understanding the impact on local taxes of various budget decisions. The actual budget expenditures will be further developed as the 2005-06 budget is built considering demographer’s enrollment projections, historic costs from the audit, continued cost analysis, input from stakeholders on actual needs of the district. The Preliminary Budget will be presented to the Board of Education on January 24.

The input and guidance from the Board of Education’s Finance and Facilities Committee, Steve Latz, (chair), David Frazer, Lynne Crawford and Robert Little in developing a method of presenting three-year projections within the complexities of the school budgeting system is greatly appreciated.

Budget Projections: 2005-06, 2006-07, 2007-08

Table of Projected Revenue

(from sources other than local property tax)

	2005-06	2006-07	2007-08
State Aid			
General Fund	5,003,424	5,003,424	5,003,424
Restricted	519,929	519,929	519,929
Total State Aid	5,523,353	5,523,353	5,523,353
Miscellaneous	100,000	100,000	100,000
Budgeted Fund Balance	551,522	0	0

SCENARIO A - Maintenance Budget, salaries increased by 2.5% (less than increment)

(see Table of Projected Revenue for assumptions on revenue from sources other than local property tax)

Projected General Fund Expenditures at various levels of staffing	2005-06	2006-07	2007-08
Level of spending for current level of staffing (maintenance budget)	83,487,375	87,907,125	93,034,624
Resulting estimated annual rate of expenditure increase	5.44%	5.29%	5.83%
Resulting estimated General Fund tax burden in dollars	80,489,607	85,483,064	90,616,562
Resulting estimated annual rate of tax increase	6.08%	6.20%	6.01%
Level of spending if expenditures were held to 3% CAP	81,563,398	84,018,457	86,547,412
Resulting est. cumulative dollar reduction from maintenance level	(1,923,977)	(3,888,668)	(6,487,212)
Resulting estimated annual rate of expenditure increase	3.01%	3.01%	3.01%
Resulting estimated annual rate of tax increase	3.54%	3.83%	3.11%

SCENARIO B - Maintenance Budget, salaries increased by 3% (inclusive of increment)

(see Table of Projected Revenue for assumptions on revenue from sources other than local property tax)

Projected General Fund Expenditures at various levels of staffing	2005-06	2006-07	2007-08
Level of spending for current level of staffing (maintenance budget)	83,716,970	88,386,516	93,783,072
Resulting estimated annual rate of expenditure increase	5.73%	5.58%	6.11%
Resulting estimated General Fund tax burden in dollars	80,719,202	85,962,455	91,365,010
Resulting estimated annual rate of tax increase	6.38%	6.50%	6.28%
Level of spending if expenditures were held to 3% CAP	81,563,398	84,018,457	86,547,412
Resulting est. cumulative dollar reduction from maintenance level	(2,153,572)	(4,368,059)	(7,235,660)
Resulting estimated annual rate of expenditure increase	3.01%	3.01%	3.01%
Resulting estimated annual rate of tax increase	3.54%	3.83%	3.11%

SCENARIO C - Maintenance Budget, salaries increased by 4.67% (inclusive of increment)

(see Table of Projected Revenue for assumptions on revenue from sources other than local property tax)

Projected General Fund Expenditures at various levels of staffing	2005-06	2006-07	2007-08
Level of spending for current level of staffing (maintenance budget)	84,464,279	90,122,310	96,607,247
Resulting estimated annual rate of expenditure increase	6.67%	6.70%	7.20%
Resulting estimated General Fund tax burden in dollars	81,466,511	87,698,249	94,189,185
Resulting estimated annual rate of tax increase	7.37%	7.65%	7.40%
Level of spending if expenditures were held to 3% CAP	81,563,398	84,018,457	86,547,412
Resulting est. cumulative dollar reduction from maintenance level	(2,900,881)	(6,103,853)	(10,059,835)
Resulting estimated annual rate of expenditure increase	3.01%	3.01%	3.01%