The Case for Long-Range Financial Forecasting

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20+ years
of service exclusively to local governments

Over 1,500 projects
successfully completed in 42 states

80+ associates
including generalists and subject-matter experts

3 national offices
in Costa Mesa and San Jose, CA and Cincinnati, OH

Served 80%
of California cities with more than 100,000 people

Services
- Operations Improvement
- Strategic Planning
- Service Sharing
- Financial Planning/Budgeting
- Organization Analysis
- Organization Development
- Performance Management
- Process Improvement
- Facilitation and Training
- Executive Recruitment
- Executive Coaching

Experienced helping many California cities facing fiscal challenges, including: Fremont, Hayward, Long Beach, Oxnard, Sacramento, San Jose, Stockton, San Bernardino, Santa Ana and Tracy

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Fiscal Challenges Ahead

- **Revenue gap persists**: Per capita revenues still well below pre-Great Recession trend
- **Wage gap**: Low/no COLAs post-recession, and lower pension benefits for new hires, create pressure to boost wages
- **Health costs**: Have grown at triple the core inflation rate, federal law uncertainties
- **Pension costs**: Funded status of most plans is too low, discount rates (expected investment returns) are too high; these pressures will boost employer rates in most states in coming years
- **OPEB/retiree medical benefits**: Many agencies contribute less than actuarially required amount, plans are not funded; day of reckoning ahead
- **Service solvency**: Cuts made post-recession aren't being restored; how to maintain adequate service levels for current residents, much less future growth/workload
- **Infrastructure failing**: Deferred maintenance of aging roads and facilities is a common problem, leading to higher costs in the long-run

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Financial Weaknesses Not Always Obvious

- **CAFR:** Looks backward and data late
  - CAFR not always clear on factors contributing to fiscal distress (e.g. labor impacts, contingent liabilities)
  - Shortfalls may not be evident due to aggregating funds, uncollectible receivables or loans
  - Cash may look adequate because of sweeping resources from other funds and past cuts that are unsustainable long-term
- **Budget:** Looks forward but short-term
  - Doesn't reflect long-term trends from growing obligations (labor, debt, retiree medical, pension)
  - Need longer-term perspective and ability to model alternate outcomes

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Other Diagnostic Tools

General

- **GFOA's Long-Term Financial Planning Recommendations**
  - Best Practices includes forecasting; "Fiscal First Aid"
- **ICMA's "Financial Trend Monitoring System"**
  - Measures indicators that ICMA, credit rating agencies and others cite as most relevant in determining the financial condition of local governments
- **League of California Cities' "Financial Diagnostic Tool"**
  - 14-point report card that grades the near-term financial health of a city's General Fund and other operations, including financial health indicators

Specific

- **Prepare long-range forecast model tailored to agency's specific needs**

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# Many Advantages of Long-Range Forecasting

- **Transparency:** Stating assumptions improves credibility, communicates true fiscal condition
- **Fiscal Discipline:** Realistic forecasting precludes wishful thinking about capacity for revenue growth
- **Early Warning:** Reveals adverse trends, gives staff and Council time to craft appropriate solutions, avoids crisis mode
- **Promotes Sustainability:** Identifies long-term impacts of policy decisions; encourages sustainable solutions rather than short-term fixes promoted by budgets of only one or two years
- **Living document:** Continuously updated with new information

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Some Reasons Agencies Don't Do Forecasting

- We're overworked as it is
- Forecasting sounds complicated
- You can't predict the future anyway
- If my projections are wrong, I'll be criticized
- We just have to get through this year's budget
- We just have to get through the upcoming election
- Forecasting is for those bigger/wealthier/poorer agencies

Not enough time

Could be criticized

Too many variables

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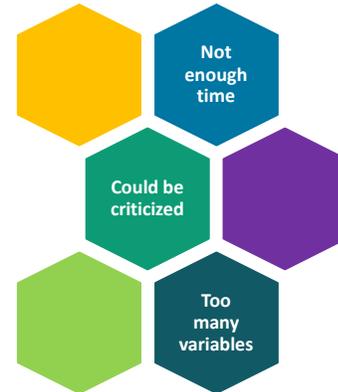
All Agencies Should Do Forecasting

Large or Small

Fast-Growing or Mature

Wealthy or Distressed

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Forecast Building Blocks

- **Identify Factors Driving Forecast**
  - Pressures on agency revenues and spending levels
- **Create Baseline Forecast**
  - Long-term projections under current service levels with reasonable growth assumptions and known increases, before corrective actions
- **Test Alternative Outcomes**
  - Optimistic and pessimistic revenue scenarios, including recession
  - Build in costs that should be in baseline budget but aren't (internal services, reserves, deferred maintenance) to make current level of service sustainable over time
  - Impact of potential service level increases (tied to agency priorities/goals)
- **Recommend Policies and Corrective Actions**
  - Impact of spending cut or revenue increase options needed to balance forecast

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Putting Budget Puzzle Together

- **Budget Document**
  - Identifies spending priorities in the near-term (1 to 2 years)
- **Long-Range Forecast**
  - Identifies demand on available resources over the long term (10-20 years), under a given set of assumptions
    - Different assumptions = different forecast
    - Facilitates development of budget parameters
- **Budget Model**
  - Tool for preparing a forecast – spreadsheet on steroids
    - Tests sensitivity of assumptions, what is sustainable over time
    - Can produce many alternate forecasts and "what-if" scenarios
    - Visual dashboard charts show results as variables are revised

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For More Information

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