Overview of PFM
Founded in 1975 to provide independent financial advisory services to the public sector

Independent registered financial and investment advisor

With senior professionals specializing in various municipal disciplines, PFM’s in-house talent includes experts in virtually every aspect of municipal finance

Nation’s leading financial advisory firm on overall municipal financings (see adjacent rankings chart)

Headquartered in Philadelphia
### The PFM Group’s Scope of Services

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The PFM Group of companies includes Public Financial Management, Inc. (PFM), a registered municipal advisor with the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB) under the Dodd-Frank Act of 2010. PFM Asset Management LLC (PFMAM), part of the PFM Group of companies, is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. PFM Swap Advisors LLC (PFMSA) is registered with the SEC and MSRB as a municipal advisor and is registered as a Commodity Trading Advisor with the Commodity Futures Trading Commission.
Factors Behind Establishing Multi-Year Planning and Budgeting
Multi-year financial projections

A multi-year financial projection is a forecast of your government’s revenues and expenditures over a defined period of time 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 meet recurring expenses over the next couple years? Is that balance predicated on actions that have a short-term benefit and when do those benefits expire? Is it predicated on revenue or expenditure growth assumptions that are at risk to change?

- **Community Goals:** Will we have the financial resources to deliver the services our residents want at a price they are willing to pay? How do we balance the need to invest in our infrastructure with the need to fund day-to-day services? What level of reserves should we maintain?

If you develop a multi-year Capital Improvement Plan, you’re already doing something similar to a multi-year financial projection.
“Best practice” argument for multi-year projections

GFOA’s National Advisory Council on State and Local Budgeting (NACSLB) has the following recommended practice.

9.2 Practice:

A government should prepare multi-year projections of revenues and other resources.

Rationale:

Projection of revenues and other resources is critical in order to understand the level of funding available for services and capital acquisition. Projections for future budget periods help determine the likelihood that services can be sustained and highlight future financial issues to be addressed. Preparing revenue projections also enhances a government's understanding of revenue sensitivity to changes in assumptions and to controllable factors such as changes to tax rates or fees.
Scrubinty and expectations are increasing

- GASB 67 and 68 put pensions on the balance sheet
  - OPEB is next (exposure drafts released earlier this year)

- The rating agencies are all increasing focus on retiree benefits, with the new Moody’s analytic methodology for assessing pension liabilities and a **doubling** of the weight their analysis assigns to debt and pensions (from 10% to 20%)

- Meanwhile, taxpayers remain constrained by tepid economic and wage growth, and the disconnect between public and private sector compensation approaches adds to the pressures around governmental retiree benefits:
  - Among U.S. private industry workers participating in employer-sponsored plans as of 2011:
    - Only 7% had a traditional DB pension only
    - Down from 62% in 1979

Source: Moody’s Investors Service. (2013, April 17). Adjustments to U.S. State and Local Government Reported Pension Data; EBRI
Pent-up demands have surfaced

- **From the workforce**, to reinstate concessions made during the downturn and increase wages
- **From the public, operating departments, and elected officials** to restore and enhance services
- **To address deferred and growing infrastructure needs**
- **To meet changing IT demands** (mobility, access) and opportunities

Managing competing expectations and goals from operating departments, labor, Councils/Boards, and the public – while positioning for long-term fiscal stability – is a major challenge and concern for public sector finance officers in this period of recovery.
Five key areas to address to position for enhanced sustainability

1. Establish a multi-year financial planning framework
2. Strengthen reserves and overall financial policies/practices
3. Rebalance the total compensation portfolio
4. Strengthen pension/OPEB and other liability funding (and liability management)
5. Invest in infrastructure renewal and replacement
Long-range financial plan

Defining the Challenges

- Develop a 5-10 year financial plan to create a framework for forward-looking policies
- Evaluate key budget drivers and policy parameters
- Identify the “as is” gaps (*clarity*)
- Address liabilities and long-term needs (e.g. infrastructure, tax policy)
- Determine the costs of key priorities and incorporate them into a financial planning model
- Develop strategies to bend the curves, close the gaps, and carve out new resources
- Establish parameters for addressing pent up demands
- Communicate the plan and gain buy-in from all levels of the organization (*accountability*)
- **Stress test** the plan under alternative economic scenarios, and to provide “pre-mortems”
Creating overall financial policies

Other Key Policies/Practices

1. Use of non-recurring revenues
2. Use of volatile revenues
3. Contingency budgeting
4. Revenue estimation
5. Fees and charges
6. Reserve policy
7. Debt policy
8. Outcome budgeting
9. Liability funding
10. Capital vs. Operating
1. **Facilities/Infrastructure Renewal and Replacement**
   - Condition assessment
   - Maintenance standards
   - Cost estimates
   - Financing plans
     - Pay-go? Dedicated funds

2. **Capital v. Operating Budget**
   - Time for a clean-up?

3. **Technology/Productivity Investment**
   - Not just IT, also energy efficiency, improved fleet/equipment, etc.
   - ROI and benefits realization
   - Capitalizing a Productivity (Revolving) Fund
Stakeholder buy-in

- **Consider a pre-mortem**
  - What bad things will happen if you are not successful in implementing a financial plan and policies? Again, stress test
  - Be able to tie the success of your plan to the success of the various stakeholders

- **Communicate, communicate, communicate**
  - Work to gain buy-in before you settle on a final set of initiatives to push
  - Include a variety of stakeholders in the discussion (Council/Board, chief executive, department heads, labor groups)
  - Be flexible and open to all options

- **Be transparent, accurate, and open to feedback**
Building A Multi-Year Financial Plan
Basic building blocks

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 electronically 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 revenues or expenditures that are automatically indexed to something else (CPI, COLA)? What are the terms and conditions for your major sources of intergovernmental revenue?
Home-grown growth rates

For revenues and expenditures that don’t have a fixed future amount, 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?), layer in guidance from external sources like economic and demographic trends 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 projects)

- **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 driven by external events?

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

**How long should my projection go?**

Three to five is a good starting point, but you may need longer projections with lesser levels of detail to address issues like capital investments, pensions/OPEB, etc.
Revenue forecasts drive the financial plan

Not all revenues are created equally. Some are more important to your financial picture than others. Consider…

- Forecast the major revenue sources separately, paying most attention to those that represent the greatest share of the revenue budget

Here’s a short checklist to work through as you project major revenues:

- What is the base and what drives changes in that base?
- Has the rate changed recently? Do we control the rates?
- Are there major exemptions, abatements, etc?
- Are there collection problems that impact yield?

For some revenues, particularly those that are tied to specific programs, you should consult your program managers, even if they don’t have a financial background. They can help you understand the variables that shape your projections.
Growth rate resources

There are useful resources that can inform your growth rate calculations, though they are not determinative. You’ll still need to weigh them against historical trends and your insight into how the numbers change.

- Tax assessments: Is the total assessed value of property growing? Is the total taxable value growing (i.e. factoring out tax exempt properties)?
- Building permits, plan review activity, utility usage
- Hotel room nights, attendance at major events
- Consumer price index: The US Bureau of Labor Statistics provides detailed historical data and the Federal Reserve Bank provides high level projections
- Population and housing unit estimates (US Census Bureau): Are we growing or shrinking?
- Your actuary, your health insurance plan administrator, your financial advisor, etc.
The current expansion phase of the business cycle began five years ago, after the recession bottomed out in June 2009.

- **70 months and counting** as of April 2015

Last five expansion phases (trough to peak):

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<th>Start/End</th>
<th>Duration</th>
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<td>November 2001 – December 2007</td>
<td>73 months</td>
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<tr>
<td>March 1991 – March 2001</td>
<td>120 months</td>
</tr>
<tr>
<td>November 1982 – July 1990</td>
<td>92 months</td>
</tr>
<tr>
<td>July 1980 – July 1981</td>
<td>12 months</td>
</tr>
<tr>
<td>March 1975 – January 1980</td>
<td>58 months</td>
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</table>

Average 1945-2009 (11 cycles): **58.4 months**

Range: 12 to 120 months

*Source: National Bureau of Economic Research*
Expenditures: Capital expenditures generally are a portion of the budget

The other side of your government’s fiscal condition is the expenditures, a large portion of which are related to your employees. Here is one government’s breakdown of total expenditures for FY2015. Salaries and premium pay (overtime) make up 33 percent and other personnel (benefits) make up another 16 percent. In other counties some “transfers” may also be related to personnel if the General Fund is subsidizing other operations (Human Services, E911, Nursing Home).
Boom, bust or base?

Consider starting with a **baseline projection** that shows 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, this means 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.*
Presentation tip: More than accounting

The baseline projection 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 major drivers of our financial performance changing? Are they in balance so that we have a stable level of resources? 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 a difference.
Projections, not predictions

To get ongoing value out of a multi-year projection, you should continually monitor your forecasts and make adjustments as annual processes allow:

- Monthly / quarterly actual results vs. projections
- Identify problems early and take corrective action
- Learn from variances to improve future forecasting or start/improve contingency planning

The world changes quickly, and forecasts will be wrong, requiring:

- Documentation of assumptions
- Contingencies and reserves
- Diversification where attainable
- Monitoring and mid-course corrections

An economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today.

Laurence J. Peter
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. Approaches 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 changes
From treatment to check ups

Guiding questions: How will we measure progress? How will we communicate that progress to others? How will we revisit our plan to incorporate what we learn?

Once a plan has been adopted and you begin implementing initiatives, it is important to find practical ways to do the following:

- **Measure:** “That which gets measured gets done.” What performance measures will help you track the progress made toward implementing an initiative? How do you measure whether the initiative had the impact(s) you wanted?

- **Monitor:** How will you communicate with staff in charge of implementing changes to discuss challenges, successes and failures? How will you communicate the lessons learned and progress achieved?

- **Manage:** It is okay to change strategies midcourse as the nature of the problem changes, new resources become available, etc. Measurement and monitoring will help you know when those changes are appropriate and how to communicate the rationale.
Why you *do* want to do multi-year projections

**Reason No. 1: It’s a better way to address any deficit**

Many governments face structural challenges and one-year budget cycles are not an ideal way to address them:

- 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”

Because governments are very limited in their revenue options, the default options to fill an impending deficit are often unpleasant – real estate tax increases, layoffs/wage freezes or depleting fund balance. Multi-year planning gives you more options.
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 them to think beyond their department 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 impacts your credit rating and borrowing costs

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<th><strong>“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.”</strong></th>
<th><strong>“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.”</strong></th>
<th><strong>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.</strong></th>
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Thank you!

Questions? Comments?

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