Knowing What You Can Spend

The Importance of Multi-Year Financial Forecasting in Cities and Towns

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What I hope you learn...

• How to get help with forecasting through the Division of Local Services

• The need to manage expectations in an environment of “structural deficits”

• The implications of which approach you take toward budgeting
What is “structural balance/deficit”

Structural balance – program cost growth equals revenue growth

Structural deficit – Currently in balance but recurring revenues do not cover recurring expenses

Why is structural balance so elusive?

• Environment created by Prop 2 works against structural balance

• The Commonwealth has worked both toward and against structural balance

• Cities/towns have worked against structural balance (often without even knowing it)
How much is that dollar really worth?
CPI vs. Proposition 2 1/2 since 1980

State aid and structural balance

- Increases in State aid that outpace cost increases can help balance the budget
- Level funding/cuts can lead to deficits
Sometimes communities work against structural balance

• By not understanding financial impact of future events

• By not considering full future costs of expenses

• By spending one-time funds for on-going costs

Budgeting:

Traditional approach vs Forecasting approach
Traditional approach to budgeting

- Balanced only for one year
- Line items in budget are changed incrementally year-after-year
- Often results in level service, level funded, or funding cuts

The case against the traditional approach

- Income & Expenses: No consideration for on-going relationship
- This year’s surplus can very quickly spiral into next year’s deficit
Forecasting approach to budgeting

• Identifies future shortfalls (structural deficit)

• Focus on departments/programs

• Calculates approximate funding for planned service levels

Why forecast?

• To manage expectations

• To enhance fiscal stability/enable corrective action

• To quantify financial impact of policy decisions
What you need to understand first...

• In the beginning, projections almost always involve deficits

• Multi-year projections are the only way to identify trends

• Integrating timing of capital spending is crucial

Critical considerations in forecasting

• Consensus around assumptions

• Identifying trends vs spikes/depressions

• Creating realistic expectations
The revenue side

- Develop revenue inventory

- Analyze impact of rate changes or changes in economic conditions

- Craft reasonable assumptions for out-years

The expenditure side

- Quantify year-over-year salary obligations
  - Easy for contract employees (just read the contract)

  - Make assumptions on non-contract employees

  - Estimate ongoing program/staffing needs
The expenditure side (continued)

- Estimate non-salary departmental expenses
- Make reasonable assumptions on healthcare, other benefits and shared costs
- Insert costs of capital plan estimates

Our new Revenue and Expenditure Forecasting Tool is here to help:

http://www.dls.state.ma.us

click on “Financial Management Assistance”