INFORMATION ITEM

Date: **November 13, 2017**

To: **Board of Education**

From: **Dr. Raymond Lechner**

Subject: **Levy Update**

In December, the Board of Education will vote on District 39's tax levy request. Three reports this month address the issues involved. Each report is summarized here.

Report #1: The Levy Process: How it Works
This report explains many of the mechanics of the Tax Levy process. Key points are:

- The District's Levy Request is for a dollar amount, not a percent increase or specific tax rate.
- The change in funding that the District can receive is limited by a combination of the Consumer Price Index (CPI) and "new construction" growth. The dollar amount of the limit is calculated and enforced by Cook County.
- The change in property values in the District's area does not directly affect D39's revenue.
- The tax rate is an output of the process, determined by the dollar amount the District receives and the total value of properties, as determined by the County.
- Individual taxpayers' bills do not change by the percentage change of the District's levy; this is due to fluctuating property values and the impact of new construction.
- The most important factor in an individual taxpayers' change in tax bill, is the change in their individual property's value relative to the total property value in the district.

Report #2: District 39 Financial Philosophy Since 2011
This month's second report related to the Tax Levy outlines four principles that the Board has generally followed since the 2011 referendum. While these principles are not formalized, they have helped guide the Board's financial decisions over six years. The four principles are:

- Maintain or improve educational excellence while living within our financial means
- Target a minimum fund balance of 30%; approach that level with a "shallow" trajectory
- Budget conservatively to enable flexibility in reacting to state law changes and/or allocation and distribution of state funds.
- Create a relationship between expenses and revenues to enhance financial stability

Report #3: The Levy Decision and Its Impact

With process and past principles reviewed, the third Tax Levy report presents facts to help the Board determine the District's funding needs in support of the tax levy decision. The "baseline" scenario implies our current levy practice. Other levy scenarios are also presented. Some of the key factors are:

- The District expects that revenues will not be sufficient to cover expenses, in any of the next five years, under the "baseline" scenario. The "baseline" scenario includes the assumption that the Board raises the levy request each year with inflation (CPI) and new construction growth. The total deficit over five years would be $9 million.
- Under the baseline scenario, the District's fund balance will decline to 37.7% over five years, consistent with the Board's financial principles (presented in Report #2).
- Uncertainty in the baseline assumptions have significant impact on the forecast. CPI, new property growth, and the potential for a property tax freeze are some of the key assumptions that involve uncertainty.
- Several other sources of significant uncertainty are described with varying levels of quantification.

LEVY UPDATE

Report 1 - The Levy Process: How it Works

Introduction

The purpose of this report is to explain, in plain terms, the mechanics of how District 39 requests and receives money from its taxpayers through a formal process of a "levy," Each year only three things can result in an increase in the amount of money the District receives: the inflation rate (Consumer Price Index or CPI), the incremental value of significant new construction, or a voter approved referendum. Cook County sets (often raises) the assessed value of property. If an assessed value goes up, the amount that a property owner pays in property taxes will probably go up, but no additional incremental money is received by the District.

This report focuses on the significant points of the levy process. For more detail, please read the Addendum - Technical Points.

The Levy Process

The levy process can be thought of as having three parts: (1) the District's levy request; (2) the County's adjustments and apportionment; and (3) the taxpayers' payment or "tax bill." This report explains each of the three parts.

1) **The District's Levy Request**

   Every year, the District requests a specific dollar amount of funding from the County's property tax receipts. This request is known as a "levy request" and must be approved by the Board of Education, typically at its December meeting. For instance, in 2016, the District requested $51.3 million. Note that the District does not ask for a tax rate or percentage of property taxes, but rather a specific, total dollar amount. Cook County turns this dollar amount into a rate in the adjustment and apportionment phase of the levy process.

   The District's levy can be limited by only two things: the consumer price index (CPI) or referendum. The District requests a dollar amount, but by law, the County limits the amount it provides the District. A referendum is a direct vote open to all registered voters in the District. In practice, the District rarely places a referendum on the ballot, so the limit on the District's levy is nearly always the CPI. The law also states that the District can request an additional amount for new construction.

   Determining the levy request based on CPI:
   Generally, two components, added together, go into the levy request.

   The CPI limit is based on 1994 tax legislation and specifies that the increase over the previous year's levy can be no greater than the previous year's CPI or 5%, whichever is less. This is known as the "CPI increase." The District determines a dollar amount for the CPI increase that meets the legal limitation.

   The amount that can be added for "new construction," is based on new buildings or significant renovations in the community. There is not a limit on the amount that can be added for new construction, and the District uses an estimate for this portion of the levy request.

As a simple mathematical example, assume the District revenues are $100 in a given year, and CPI was 2% in that year. In determining the levy for the next year, the CPI increase component would allow the District to levy $102. If there was also some new construction in the District, which was estimated to add $1.50 to the levy, then the District could levy up to $103.50. In Report 3, "The Levy Decision and its Impact," actual data is presented for historical growth amounts, including the CPI increases and new construction portions.

The alternate limit: referendum
If the Board determines that it needs to increase the levy by more than the CPI increase, it must obtain voter approval through a referendum on the ballot. If the referendum passes, the Board can increase taxes by the amount approved in the referendum. In practice, the Board has seldom placed a referendum on the ballot. Historically, the last referendum in D39 was in 2011; the last referendum prior to that was in 1998. Even in the case of a referendum, the District may still be able to add an amount for new construction.

Levy request practicalities: it's an estimate
The timing of the levy request process creates an extra complication. Although the District must give its levy request to Cook County by the last Tuesday in December each year, the County does not determine the value of "new construction" or updated property values until later. As a result, at the time the District makes its levy request, it does not know the maximum amount the levy can grow. The District must estimate property values and the value of new construction in order to make a fair and reasonable levy request.

2) **The County's Adjustment and Apportionment**
The County has three significant roles in this part of the process: (1) it adjusts the District's levy request, if needed, based on the District's actual new construction amount and the legal CPI limit, (2) it determines the value of each property in the District, and (3) it calculates a tax rate in order to divide up the total levy request among the individual taxpayers.

Adjusting the District's levy request
As described above, a law passed in 1994 limits the annual increase in the District's levy (assuming there's been no referendum). The County takes the District's levy request, subtracts out the actual dollar amount for new construction, and determines if the remaining amount is within the limits of the CPI increase. If necessary, the County will reduce the District's levy request so that the amount that is not new construction falls within the legal limit for CPI increase. The County will never increase the levy request, which is why the District's estimates for new construction are important.

As a simple mathematical example based on the one above, assume the District underestimated when it added $1.50 to the levy request for new construction. Assume the actual new construction amount turned out to be $2.00. The District levy request was submitted for $103.50 amount $2.00 for CPI increase and $1.50 for new construction. The County would combine CPI and actual new property growth, which would be $104.00 in this case. However, since the request was only for $103.50, that is

what the County would allocate. The District would be getting $.50 less than was legally available, because the estimate for new construction was too low.

Determining the value of each property
Details are in the Addendum - Technical Points, but it's important to know that the County is responsible for assigning a value to each property. The County is also responsible for property tax appeals and exemptions, both of which can change the property values from year to year. An increase in property value does not lead to an increase in revenue for the District.

Apportioning the levy among taxpayers
Based on the levy request and the overall value of all properties, the County determines the tax rate and uses it to divide the total dollar amount of the District's levy among individual taxpayers, according to the value of each taxpayer's real estate. An increase in property value does not mean the District gets more money from that property. The value of each property only determines the portion of the total dollar amount of the levy that an individual taxpayer pays.

There are two common misconceptions related to this process.

Misconception #1: The percentage increase in the levy increase is the same percentage increase in tax bills for each homeowner:
The concept that each tax bill will increase by the same amount as the District's levy increase is not true for two major reasons:

1) The levy request includes new construction, but the additional property taxes for new construction are paid by the property owners who have the new construction. When owners significantly change their property - the recent opening of a Residence Inn in Wilmette is a good example - the County considers those changes to be new construction. The taxes that these "new" properties pay increase the dollars the District receives without increasing the other taxpayers' payments. When this happens, the average existing taxpayer's bill increases less than the overall District levy because the typical taxpayer's increase does not include the new construction amount. The historical data given in a companion report "The Levy Decision and its Impact," demonstrates that the new growth often makes up one quarter to one half of the total levy increase in years when CPI is low.

2) Property values fluctuate regularly. Cook County's Triennial Reassessment causes the most significant changes. As the Assessor changes an individual's property value assessments, the share of the total levy paid by that owner changes. If the value of an owner's property increases more than the average value, that owner's tax bill will rise faster than the average tax bill. Owners can also appeal their assessment and/or obtain exemptions. If a property owner receives a reduction, that owner's future tax bills will go down and other taxpayers' bills will go up to compensate. Frequently, the effect of changes in assessment outweighs the change in the average tax bill that occurs due to levy increases. As a concrete example, even though the average bill increased significantly after the 2011 referendum, some taxpayer's bills actually declined due to a decrease in property value from 2010.

Misconception #2: District 39 determines its tax rate
The tax rate is calculated by the County and is the result of the total dollar amount of the District's levy divided by the total value of all the property in the District. (the Addendum - Technical Points provides additional detail.) Historically, the tax rate has fluctuated depending on the relative growth of CPI compared to growth of property values.

3) The Taxpayer's Payment, or Tax Bill

After the District makes a levy request and Cook County has appropriately limited the request and proportioned the dollar amount among individual property owners, the County sends the bills to the taxpayers.

Individual taxpayers receive a single bill (albeit in two installments) from the County for all of the taxing bodies that apply to their property. District 39 taxpayers also reside in taxing bodies related to a village, a park district, a township, a high school district, a community college district, and so on. The tax bill shows the tax rate for each taxing body, which is determined as noted above. For each of the taxing bodies, the County goes through the same process: dividing the total amount requested by the taxing body among all of the taxpayers in that district, according to the relative value of their property. The taxpayer's total bill represents the sum of the bills from all of the applicable taxing bodies.

District 39 accounts for approximately one-third of each tax bill. This means that the District's levy decisions only impact one-third of each taxpayer's bill.

It is important to note that the relative value of property - relative to other properties in the district - affects the size of the tax bill. Even if no taxing body changed the size of its levy in a given year, some individual taxpayers would likely see noticeable increases in their bills, while others would see reductions related to the changes in individual property values (due to reassessment, successful protests, or changes in exemptions).

As with nearly any billing process, not all of those bills are paid. The number of unpaid bills varies from year to year, but has typically been less than 1% in District 39. Nonetheless, the non-payment can add tens of thousands of dollars of uncertainty to the actual levy receipts, and therefore to the District's finances.

ADDENDUM

Technical Points

The various "values"
The value of a property represents a key component in the ultimate tax bill. The common assumption that the Cook County Assessor determines a property's value for taxing purposes is effectively correct - but the process and terminology involved can be very confusing.
The value of a property determined by the assessor is called the "Equalized Assessed Value" or "EAV". The EAV represents the starting point for a series of calculations. First, Cook County multiplies each property's EAV by 10%. The resulting number is called the "Assessed Value". Then the County multiplies the Assessed Value by a number called the "State Equalizer". The State Equalizer is the same for every property in Cook County for a given year, but it changes from year to year. After the Assessed Value has been multiplied by the State Equalizer, any exemptions for that individual property are subtracted, and the result is called the "Taxable Value". The County multiplies the Taxable Value by the Tax Rate and the result is the owner's tax bill (see the "Individual Taxpayer's Bill" section above for more on the Tax Rate).

This whole calculation can be summarized in a formula:

((Property EAV x 10%) x State Equalizer) - Property Exemptions)) x Tax Rate = Tax Bill

Quirky timing and year names
Many taxpayers are familiar with the quirky timing of their property tax bills. Each year's tax bill is paid in two installments in the next calendar year. As an example, property taxes for the 2016 Tax Year were due in April and August of 2017.

The "levy year" for a levy request is the year in which the District makes the request. When the District requested a levy in December of 2016, it was a "2016 levy year" request.
Because the District makes its request in December and the bills go out just a few months later, in February/March, the County does not reflect the December levy requests in the March bills. Rather, it bills taxpayers at 55% of the previous year's amount in March. Therefore, the March 2017 bill is 55% of the total 2016 bill. Levy requests change only the July tax bills directly.

After the District makes a levy request in December, it receives the requested funds in the next calendar year, with 55% of the previous year's levy arriving in March/April and the balance of the levy request coming in July/August. The District's fiscal year starts on July 1st each year.

Since the fiscal year straddles two calendar years, the naming of the fiscal year can be confusing. The District refers to fiscal year that starts on July 1, 2017 and ends on June 30, 2018 as the "Fiscal Year 2018." Putting all of these together, the levy for 2016 goes into the 2016 tax bills, which are paid in two installments in 2017; these payments affect the District's 2016-17 and 2017-2018 financials. Consequently, in the frequently-used shorthand terminology, the 2017 levy affects the District's Fiscal 2018 budget, which was approved in August.

LEVY UPDATE

Report 2 - District 39 Financial Philosophy Since 2011

Background

In a Report 1 this month called "The Levy Process: How it Works," the District describes the mechanics of the levy process that allows it to collect money from property owners. For readers unfamiliar with the levy process, reading the "How It Works" report first may make this report easier to understand.

District 39 has little input into how the levy process works. However, District 39 has significant control over its own practices related to budgeting, which impacts the levy. This report outlines what the Board's principles and the District's practices have been and some of the resulting outcomes.

The District's original referendum was in 1998. By 2010, D39's fund balances had declined to a level that the District and the Board found unacceptable. The District was forced to consider which programs it would have to cut if funding did not change. At the same time, the Board voted to put a referendum on the ballot, and in 2011 the voters of the District passed the referendum, providing additional funding to the District.

Four financial principles for D39's budget

Since the 2011 referendum, the District has carefully monitored its spending and financial efficiencies. One important indicator is the amount the District spends per pupil. All districts report this data to the state, and D39 developed a comparison group of 14 districts at the time of the referendum. Today, as was true in 2011, District 39 has one of the lowest operating costs per pupil (See Exhibit 1).

Also since 2011, the District and Board have developed and followed four principles in planning finances. These principles have not been explicitly stated or adopted, but they embody many of the themes that have been a consistent part of Board and District financial conversations.

1) Maintain or improve educational excellence while living within the District's financial means.
2) Target a minimum fund balance of 30% of total operating expenditures; approach that level gradually.
3) Budget conservatively, to enable flexibility in reacting to changes in state law and/or allocation and distribution of state funds.
4) Create a relationship between expenses and revenues to enhance financial stability.

These principles and their interactions can sometimes be contradictory. For instance, budgeting conservatively for potential state law changes has, for the last several years, kept the District's fund balance from approaching a 30%. Nonetheless, the District and Board have continued to be guided by these principles.

Principle #1: Maintain or improve educational excellence while living within our financial means

After the 2011 referendum, the Board and District were even more focused on living within the District's financial means, which generally was interpreted as operating without another referendum for as long as possible. In 2011, the Board had a stated goal that another referendum would not be necessary for at least five years – a goal that has now been achieved and surpassed.

The 2011 referendum also provided evidence that the community supports funding the District sufficiently to support the quality of education that D39 has provided for years. The referendum passed by a historically wide margin, with 63% of voters agreeing to the funding increase. Supporters argued against eliminating programs like K-8 foreign language, instrumental music, library programs, technology instruction and others (see Exhibit 2).

More than not cutting programs, the Board has strongly supported keeping District facilities and programs up-to-date. For example, since 2011 the District has, with strong Board support, built classrooms designed for and dedicated to 7th and 8th grade science, modernized libraries not updated for many decades, upgraded infrastructure and programs to better support STEM learning, and increased foreign language offerings.

Principle #2: Target a minimum fund balance of 30%; approach with a "shallow" trajectory

Fiscal responsibility requires ongoing rebalancing. Too much funding for the District wastes taxpayer dollars, while too little funding puts at risk a quality education for the District's children. The Board uses operating fund balance as an important measure to steer the District toward long term financial health.

School districts report their fund balance as the balance in their operating fund accounts at the end of the fiscal year, divided by their operating expenses for the year. Measured as a percentage, it represents the fraction of a normal year for which a school district could pay its bills with no additional dollars. If the fund balance drops below 25%, a district’s bond rating and its Financial Profile review designation from the Illinois State Board of Education are negatively impacted. A low fund balance also reduces a district's options if its financial position deteriorates, potentially forcing drastic changes in its educational programs. Low and declining fund balances in 2010 forced District 39 to consider the program cuts listed in Exhibit 2.

With the significant problems resulting from a low fund balance, a school district might be inclined to simply keep a high fund balance, and many districts do. However, an excessive fund balance means a district is getting more tax dollars than necessary.

Before the 2011 referendum, the Board had a fund balance target of 40%. Neighboring school districts had much higher fund balances. Through the critical analysis of D39's finances, related to the decision to ask for a referendum, the Board decided that it was both possible and responsible to lower its fund balance target to 30%. Since then, the Board's fund balance target has remained at 30%.

As compared to other local districts, 30% represents a very low target level. The New Trier feeder elementary school districts all target at least 50%, and the actual fund balances of all other Township districts are greater than 70% (FY 2016 data). Administrators in other districts have told our District that their boards would not allow a fund balance as low as 30%. By this measure, District 39's respect for public funding appears unparalleled among nearby school districts.

In addition to a specific fund balance target, the Board intends to reach that target level gradually. In other words, the District's fund balance should not drop significantly below 30% in a short period of time. This goal represents another balance of the tension between fiscal responsibility and delivering an excellent education. The District's financial projections have been subject to significant uncertainty (see the section below on Principle #4). Rapidly approaching a 30% fund balance creates a significant risk - if

the District miscalculated, the result would be a dangerously low fund balance. To protect the quality of the District's educational programs, the approach to a 30% target must be gradual, or "shallow".

Despite this principle, the District's fund balances have not approached 30%, an issue the Board continues to monitor. The reason for not approaching 30% has been the uncertainty related to Principle #3, which has recently dominated the District's financial planning.

Principle #3: Budget conservatively to enable flexibility in reacting to state law changes and/or allocation and distribution of state funds.

The State Legislature in Springfield has had great difficulty over the past three years in passing budgets. Over that time a large number of changes that would affect the District's finances have been discussed, proposed, voted upon, amended, and sometimes passed. Many of these changes could have tens of millions of dollars of impact over the District's typical five-year, long-term forecast. To tie the impact more directly to Principle #2, legislative changes discussed could impact the District's fund balance by more than 10 percentage points, potentially taking fund balance from above 40% to below 30% within a year or two, forcing the District to rapidly cut costs or raise revenue. For these reasons, the ideas contained in Principle #3 have been at the forefront of the Board's financial discussions for several years.

Planning for state legislative uncertainty has challenged the District and the Board. For long-term, or even same-year budgeting, accurately predicting which measures will become law appears impossible. Planning for measures that reduce the District's revenues, but don't become law, results in fund balances that do not decline to the 30% target. Not planning for measures that become law puts the District's education programs at risk.

The District and Board have followed this practice: if a measure would significantly reduce the District's revenues, has been submitted as a bill, and is reported that to have material support, the District should include the measure in its long-term planning. (There have been no proposed measures that would materially increase the District's revenues.)

While the District followed this practice for several years, there was no legislation passed in Springfield. Because the revenue reductions included in District projections did not occur, the District's fund balances have increased above its previous projections. (See Exhibit 3).

During the summer of 2017 the legislature passed both a budget and a school funding bill, removing some uncertainty from the District's assumptions. In line with its prior practice, the District is removing two assumptions from its projections that the legislation did not include: 1) House Bill 696 that would have frozen property taxes in 2017 and 2018, and 2) pension cost shift as previously proposed would have impacted the District over a five-year period totaling more than $2.5 million.

However, significant uncertainty remains: in late October House Bill Amendment #1 to Senate Bill 851 was introduced. The bill would freeze property taxes for two years. The District does not currently include any tax freeze in its baseline assumptions, but it has estimated the impact of such a freeze in some of its scenarios. In addition, there is continuing potential for legislation that would include some impact for pension cost shifts. Various scenarios are reviewed in Report 3 titled “The Levy Decision and its Impact.”

Principle #4: Create a relationship between expenses and revenues to enhance financial stability

The Board increasingly discussed this principle following the 2011 referendum, and it continues to be an important part of the Board's financial philosophy. Increases in expenditures at the same time there was low CPI growth contributed significantly to the decline in fund balance leading up to 2011. In 2011 roughly 83% of District 39's operating costs derived from salaries and benefits. Two significant union contracts, one with the WEA and one with the SSU, comprised the bulk of those increased expenditures costs.

In 2013, the Board and the WEA agreed on a new type of contract - one that related increases in teachers' salaries to increases in CPI, the major driver of the District's revenue increases. Subsequently, the Board and the SSU reached agreement on a contract with a similar structure, and the Board and WEA have signed a second similarly structured contract.

Additionally, although the administrators to do not collectively bargain with the Board, the District's philosophy for administrator compensation has echoed the CPI-based philosophy of the union contracts for the last six years.

The Board has generally held the belief that these contracts diminish the impact of CPI fluctuations on the District's fund balances. Moreover, by ensuring that salaries, the biggest contributor to District expenses, are consistently tied to revenues, the District maintains its deep commitment to living within its means.

Conclusion

Multiple external measures (test scores, academic awards, various rankings, alumni surveys) indicate that District 39 provides an excellent education to its students. Meanwhile, the District has maintained finances that have ensured the District's health and positioned the District to continue to provide high-quality education for years to come. In light of that record, the principles of past Boards are worth understanding and considering.

Exhibit 1

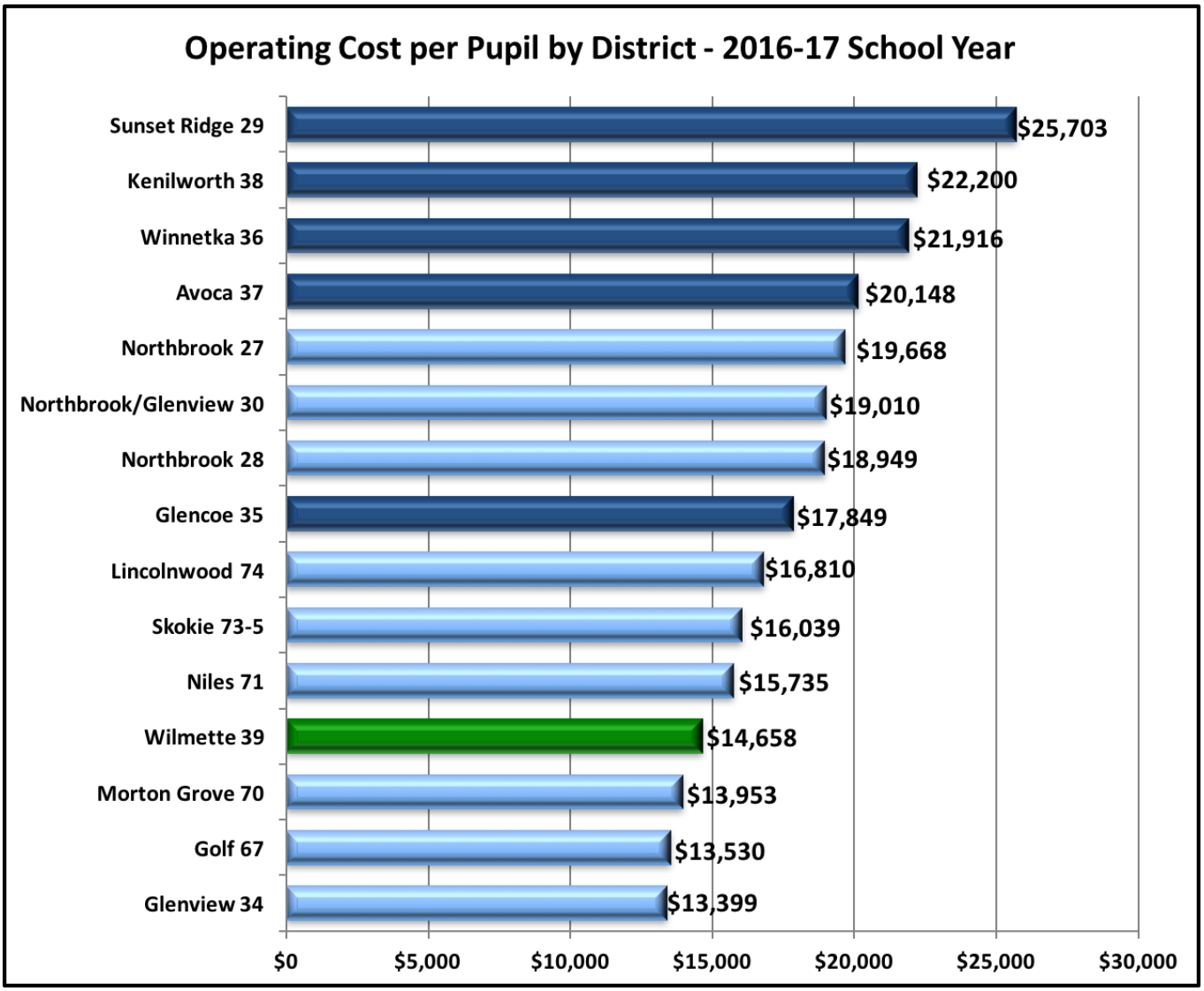

Operating Cost per Pupil by District - 2016-17 School Year
Sunset Ridge 29
$25,703
Kenilworth 38
$22,200
Winnetka 36
$21,916
Avoca 37
$20,148
Northbrook 27
$19,668
Northbrook/Glenview 30
$19,010
Northbrook 28
$18,949
Glencoe 35
$17,849
Lincolnwood 74
$16,810
Skokie 73-5
$16,039
Niles 71
$15,735
Wilmette 39
$14,658
Morton Grove 70
$13,953
Golf 67
$13,530
Glenview 34
$13,399
$0
$5,000
$10,000
$15,000
$20,000
$25,000
$30,000

Exhibit 2

This slide appeared in the District's presentation to the community prior to the 2011 referendum vote. These cuts were proposed, but were not implemented due to the successful referendum.

Additional cuts to close gap will significantly impact educational programs

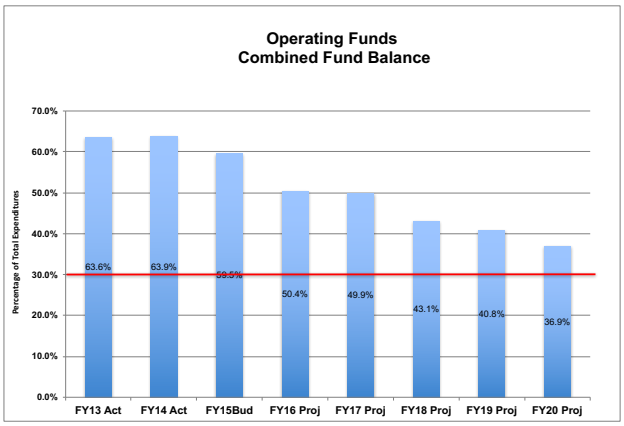
Program Reductions 2011-2012 ($3.7 million)	Program Elimination 2012-2013 ($2.7 million)
Music	Instrumental Music
Foreign Language	Foreign language (K-8)
Gifted support (differentiation)	Gifted support (differentiation)
Library	Library
Technology instruction	Technology instruction
Art	Reading Intervention (K-4)
Physical Ed	
Professional development	

TOTAL CUTS:
$6.4 million

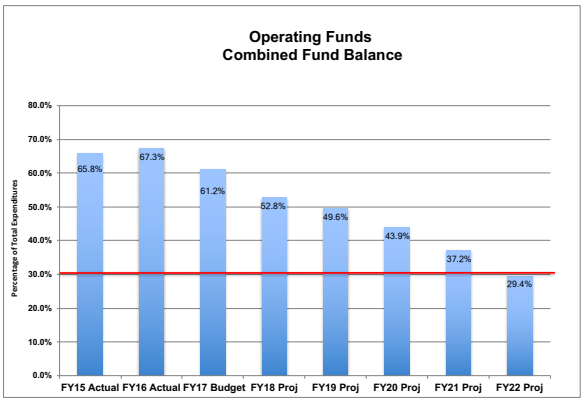
7

Exhibit 3 - Historic Fund Balance Projections

Projections made in 2014

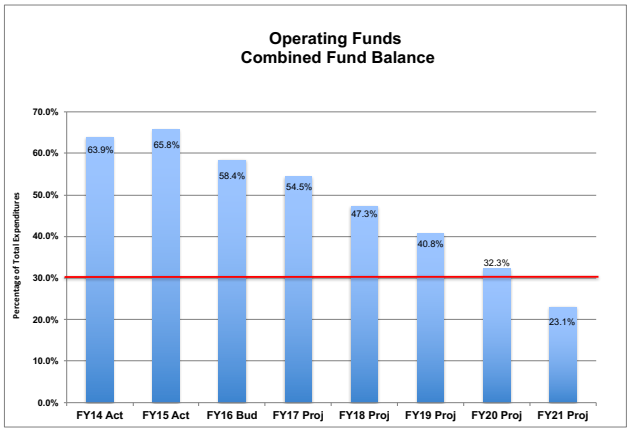


Projections made in 2015



Presented December 12, 2016

Projections made in 2016



LEVY UPDATE

Report 3 - The Levy Decision and its Impact

Introduction

Approximately 85% of the District's revenue comes from property taxes. The Board understands the community's universal reluctance to increase taxes. However, District 39, like other comparable districts, is dependent on property taxes. As costs increase, the District has no other revenue source to use.

When deciding how much to levy, a basic question is: how much revenue does the District need and how can that be balanced with fairness to taxpayers? Determining "need" is complex: the Board of Education has considerable leeway in deciding on programs, prioritizing strategic projects, and implementing the community's wishes, all of which impact the District's finances. Additionally, many factors add uncertainty to the District's forecasts including pending legislation, state budget decisions, and indecision regarding state revenue. This is detailed in Report 2, "District 39 Financial Philosophy since 2011 (see financial principle #3). Because of this uncertainty, "need" is partly a question of risk tolerance: how much consideration should the Board give to scenarios where assumptions about unknowns point to an outcome that would cause harm to the education the District provides for students? Deciding the subjective answer to how much the District needs is one of the primary responsibilities of Board members.

Using Operating Fund Balance as a financial metric

To guide its financial decisions, the Board has historically used long-term operating fund balance, often called "fund balance," as a key metric. Because of the margin of safety that the Board uses in planning its financial health, a single-year, moderate change in levy will not usually cause the District financial distress in the next year, but *can* cause changes in long-term financial health, strategic options, and even the next year's programs and services. Consequently, the long-term fund balance is an appropriate metric to address the question of the proper levy level.

In 2011, the Board established a minimum fund balance target of 30%, meaning that its goal was to ensure that the District's fund balance was at least 30% of operating expenditures. Report 2, "District 39 Financial Philosophy since 2011," provides additional information on the Board's fund balance target. This report uses impact on fund balance as a metric for several of the uncertainties discussed.

Baseline forecast

Based on the current assumptions reviewed by the Board, the District has prepared a preliminary five-year forecast. As is typical, this forecast will not be finalized until the December Board meeting. This "baseline" forecast, and the resulting fund balances presented in Exhibit 1, use the assumption that revenue increases at a rate that includes CPI and "new construction" growth for all of the years included in the forecast, as has been the District's past practice; Exhibit 2 shows the impact of changes in key assumptions.

In the baseline forecast (Exhibit 1), the fund balance declines over the five-year horizon to 37.7%. The cumulative revenue for fiscal years 2019-2023 is $391 million, the cumulative expense is $400 million, which results in a cumulative deficit of $9 million. As an aid to deciding how much the District should

levy, the estimated impact from the two major sources of revenue and are presented together along with possible tax freeze decisions in Exhibit 2.

External sources of uncertainty

As previously described, there is uncertainty in the assumptions used to calculate the baseline forecast. In this section, we examine some of the most significant sources of uncertainty, factors over which the Board and District have essentially no control.

CPI

The U.S. Bureau of Labor Statistics calculates and publishes the urban consumer price index, referred to as "CPI" in this report. CPI level limits the revenue growth for the District by law, and currently affects the salary increases for the District's employees. Due to the agreements the Board has reached with its unionized employees, the impact of changing CPI is diminished, but not eliminated. Changes in CPI can have significant impact on revenue.

Since 1992, CPI growth in a single year has ranged from 0.10% to 4.10%. It is highly unlikely that CPI would stay at very a low or high rate for five years consecutively, based on historical data.

New Construction Growth

As listed in Exhibit 1, the baseline forecast projections assume $2 million in revenue from new construction, cumulatively over the next five years. The amount is based on a five-year historical average plus known increases such as Mallinckrodt or the Residence Inn.

Like CPI, new construction is part of the amount the District's funding can increase each year, but the amount of new construction varies. In addition, it is unknown at the time of the levy request, and an estimate must be used. Since 2003, new construction has added much as $0.9 million or as little as $0.2 million to the District's funding (see Exhibit 3), however the $0.9 million occurred in 2005, and this was much higher than the other years. The five-year average over that time, excluding 2005, ranged from $0.25 million to $0.47 million per year.

Two-year property tax freeze

In the past twelve months, several different versions of a property tax freeze have been discussed or introduced in the Illinois State Legislature. Last spring, both a two year and a four year freeze were considered. Subsequent to the school funding bill signed in August, the House passed House Amendment #1 to Senate Bill 851, which would create a property tax freeze for the 2018 and 2019 levy years. Although it is difficult to interpret or predict the outcome of pending legislation, the District currently believes that if Senate Bill 851 passed, as amended by the House, the District could not increase its funding at all for two years (i.e., neither with a CPI increase nor with funds from new construction).

Exhibit 4 gives the impact of a 2018 and 2019 property tax freeze, as currently interpreted, on the five year fund balance forecast. In this scenario, District expenses would not be directly impacted, but total revenues over five years would decrease by $13.6 million, causing the District to deficit-spend at a higher rate.

Pension cost shift

The Illinois legislature has also proposed shifting the cost of employee pensions, which are currently a state obligation, to individual school districts. The District believes this proposal will likely be eventually enacted, but has no perspective on timing. Moreover, although several different proposals have been made, it appears unlikely that existing pension costs will be shifted, but rather only new obligations will fall on the local districts. To be clear: these are best guesses of what Springfield will do, made to facilitate long-term planning; the District does not believe it can reliably predict future legislation, but can make provisions in long-term forecasts to maintain the District's financial health.

In its current long-term baseline forecast, the District assumes it will begin to carry the responsibility for pension costs at a rate of 0.5 percentage point per year (accumulating) for fiscal years 2019 and 2020 and then remain flat. If no pension cost shift is enacted, the District's expenses would decline by $1.4 million, cumulatively, over the forecast. A pension cost shift has no direct impact on the District's revenues.

Number of students

The number of students enrolled in D39 impacts the District's costs, but significant impact only occurs when enrollment changes for longer periods of time. Since 2000, enrollment figures have fluctuated by as much as 3%, however the overall enrollment in 2017 is just 3% higher than in 2000 (the peak in 2015 was 7.5% higher than 2000). The trend has been down in the past two years, but it is unclear whether that trend will continue.

"Housing" is the number students who go to school in D39 buildings (some students, especially some who receive special services, are enrolled, but not housed). Housing creates an additional challenge for D39, because the age and geographical distribution of the buildings must match that of the students. As an example, the Highcrest population of students has been above 850 in five of the last six years. Prior to that time, it had only reached that level once, in 2006-07. As a result, the District is in the process considering adding classrooms to Highcrest to address overcrowding.

Although the number of D39 students can increase or decrease its costs, the District has not estimated costs directly associated with the student population, except in the case of capital costs for reconfiguring Highcrest and the potential for a Kindergarten enrichment program (both these options are discussed below).

Other new mandates

The District must comply with legal mandates, including life safety requirements, reports, specific training, or training hours, etc. Although the District has included regular costs and capital in its baseline plan, including a commitment to $2.2M to life safety projects, it has not estimated any additional cost (or revenue) associated with other potential mandates.

Sources of uncertainty over which D39 can exercise some control

In addition to multiple sources of financial uncertainty over which the District and Board have no control, D39 can shape its spending in a number of ways.

The financial philosophy that has guided the Board since the 2011 referendum is detailed in a Report 2, "District 39 Financial Philosophy since 2011." Overall, the Board has been supportive of ensuring the District has sufficient funds to provide an excellent education for students. A sample of recent projects that demonstrate this support includes:

- Creating modern WJHS science classrooms
- Updating security with double entry access control and new visitor management systems
- Adding Mandarin as a foreign language choice
- Increasing technology tools with a 1:1 program and upgrading technology infrastructure
- Replacing and repairing roofs and boilers that were reaching end of lifetime
- Updating libraries that had previously been updated before Google existed
- 4 classroom addition at Romona to house the early childhood program in one building
- Reviewing and updating our science, math, English language Arts, and social studies curricula
- Aligning start times more closely with the recommendations of national pediatric organizations
- Adding buses routes to enable start times preferred by parents

Maintaining or improving educational quality will continue to be a priority, and will cost the District money, but the Board has discretion, to varying degrees, over how expenses are prioritized. Choices not yet made represent additional uncertainties in addition to the those over which the Board has no control.

Highcrest Middle School reconfiguration

As described in the "Number of Students" section above, the number of students Highcrest Middle School houses has increased over many years and remains near an all-time high. Highcrest's library has not been updated since it reopened over 20 years ago, and its size and configuration constrains certain program options, including making delivery of special education services more difficult.

The District has developed a phased approach to potential projects related to HMS. These amounts are included in the District's baseline forecast:

- Phase 1: Four classroom addition, secure entrance, and reconfigure office space ($5.2M)
- Phase 1: Fire alarm system for HMS ($0.1M)
- Phase 2: Learning Commons update and addition ($3.4M)
- Phase 3: Art/Drama and Special Education renovations ($1.9M)
- Phase 4: Music and Kitchen renovations; courtyard infill ($2.9M)

The total, if the Board decided to construct all of the phases of the Highcrest reconfiguration, is currently estimated to be $13.4M. However, the Board has divided the project in to four distinct phases, with each requiring approval. The completion of one phase does not mean that the following phases will be approved.

Regular maintenance capital spending

The District is committed to providing buildings that are safe and functional, which requires regular capital spending. Nonetheless, the Board has some discretion in the timing of ongoing maintenance that requires capital. As needed, these projects are built into the budget forecast.

Revenue Impact

The Tax Levy

The actual tax levy, meaning the specific dollars received, is a source of uncertainty. The amount of new property growth is not known when the District requests a levy in December, and therefore the District does not know how much it will receive. Report 1, "The Levy Process: How it Works," discusses the levy process and addresses the levy request in more detail. If the District wants to receive the maximum amount it is entitled to, it typically asks for more than what it believes is the maximum, and budgets for an actual estimate of that maximum. If the District chooses to ask for an amount that is likely less than the maximum amount, it may not receive the amount it requests because the mechanics of the calculation still include the unknown property values and new construction growth amount.

Unchanged levy for one year

The Board must vote in December to levy funds. If the Board votes not to follow past practice with a levy increase, and decides not to take a CPI increase for one year, the revenues for the next five years will be lower than the current forecast assumptions. The cumulative reduction over the five year period would reduce District 39 funding from the baseline by about $5.1M. Exhibit 5 shows the impact on fund balances.

Unchanged levy combined with legislative tax freeze

The Illinois House has proposed a two year tax freeze for 2018 and 2019, as described above. Similar proposals have been suggested and delayed before. As a result, one potential outcome is that a two year tax freeze is enacted for 2018 and 2019. The negative impact of such a freeze would be increased if the District voted not to take a CPI increase in 2017. Over five years, the District's revenue would be reduced by about $16.7M if the District did not take a CPI increase in 2017 and the legislature imposed a tax freeze for 2018 and 2019. The resulting fund balance estimates can be seen in Exhibit 6.

Supplies, buses, and other fees

District 39 has balanced public funding with some user fees for supplies, extracurricular activities, and transportation. Board members have debated the proper level of fees, and the Board could increase or decrease fees going forward. The revenue impact from a particular change is difficult to determine, since fee increases can alter demand, but if the District could increase the revenue from supplies, extracurricular, and transportation fees by 50% with no change in expenses, the impact would be an additional $1.04 million of revenue per year.

Kindergarten enrichment

The District has considered various versions of expanding the Kindergarten day for decades. Recently, the District decided to look again, this time at options for a fee-based Kindergarten enrichment program. To house a significant number of Kindergarten students for the full day would likely require additional space at some or all of the K-4 schools. There would also be increased operating costs. One

option the District is considering is a fee to offset all of the cost of additional Kindergarten space and programs. The District's ongoing study of the issue will provide more information, but the current high level of uncertainty has kept the District from estimating expenses for this possible program. Nonetheless, if Kindergarten enrichment requires funding (capital or operating), it will have to compete with many of the other priorities in this report.

Other Programs

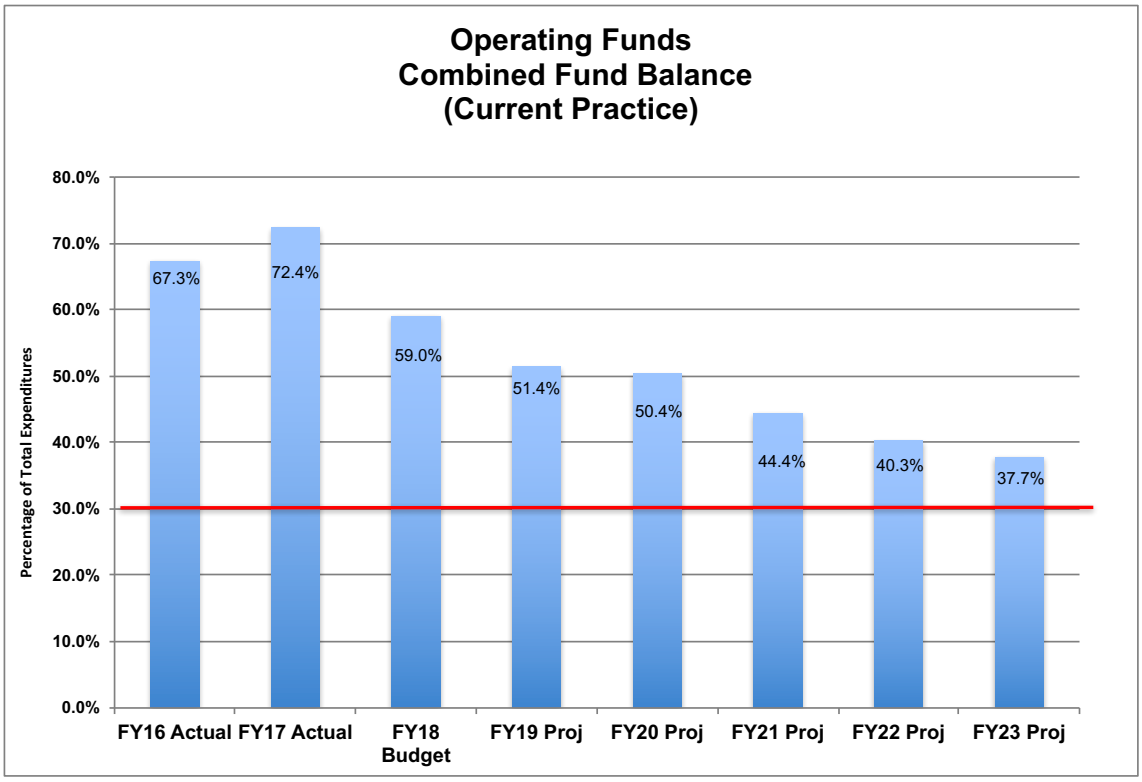
With decreasing fund balances in the two years prior to the 2011 referendum, the District made permanent cuts totaling $4.3 million in expenses and developed plans for potential additional cuts. Typically, the Board thinks of cutting programs as a last resort. The District has not yet tried to determine how it would cut costs from its educational program in the near future if necessary, but as a point of reference, the potential program cuts shown in Exhibit 7 were estimated to be a $6.3 million in annual savings in 2011.

Conclusion

As indicated at the beginning of this report, property taxes are the primary source of revenue for District 39. When deciding how much to levy, a basic question is: how much revenue does the District need, and how does that need impact taxpayers? Determining “need” is complex; as many external factors add uncertainty to the District's forecasts including pending legislation, state budget decisions, and indecision regarding state revenue. Because of this uncertainty, the Board reviews scenarios where assumptions about unknowns point to various outcomes. At the December meeting the Board will be asked to consider these scenarios and make a decision.

Exhibit 1 – Baseline Forecast

CPI 2.10%
NPG 0.88%



Assumptions:

- EAV will stay flat 0.0%
- CPI known at 2.1% for 2017 levy
- New Property Growth estimated based on a 12 year historical average plus known increases such as Mather Place and Village indicators of new construction
- Forecast includes $13.6M in capital projects as reflected on the list.
- Includes H/L/S projects of $2.2M

Capital Spending:

HMS Classroom Addition, Secure Entrance, and Office Space	$5,241,212
HMS Fire Alarm System	$124,365
HMS Learning Commons	$3,385,872
HMS Art/Drama & Special Education Class Renovation	$1,869,283
Harper Roof	$281,400
McKenzie Roof	$506,400
Romona Windows, WJHS Doors, HMS Unit Vents	$2,262,145

Exhibit 2 – Impact of changing assumptions

Operating Fund Balance as % of Expenditures

Scenarios	FY 18	FY 19	FY 20	FY 21	FY 22	FY 23
Baseline	59.0%	51.4%	50.4%	44.4%	40.3%	37.7%
One Yr Freeze 2017	58.4%	49.1%	46.5%	39.0%	33.3%	30.1%
Two Yr Freeze 2018 & 2019	59.0%	50.2%	45.4%	35.2%	**26.5%**	**21.6%**
Three Yr Freeze 2017-2019	58.4%	47.9%	42.0%	30.3%	**20.6%**	**13.7%**

Changes in Assumptions From Baseline

	Impact on Revenue $'s		Impact of Operating Fund Balance %	
	Low	High	Low	High
CPI*	(4.3M)	7.3M	-6.10%	10.40%
New Property Growth**	(0.8M)	4.0M	-1.10%	5.70%
One Yr Tax Freeze 2017	(5.2M)	-	-7.60%	-
Two Yr Freeze 2018 & 2019	(11.5M)	-	-16.10%	-
Three Yr Freeze 2017-2019	(16.7M)	-	-24.00%	-

*if CPI is lower than projected at 1.36% or higher than projected at 3.03%
** if New Property Growth is less than projected at $10.3 million or higher than projected at $20 million

Exhibit 3 - Historic revenue from new property growth

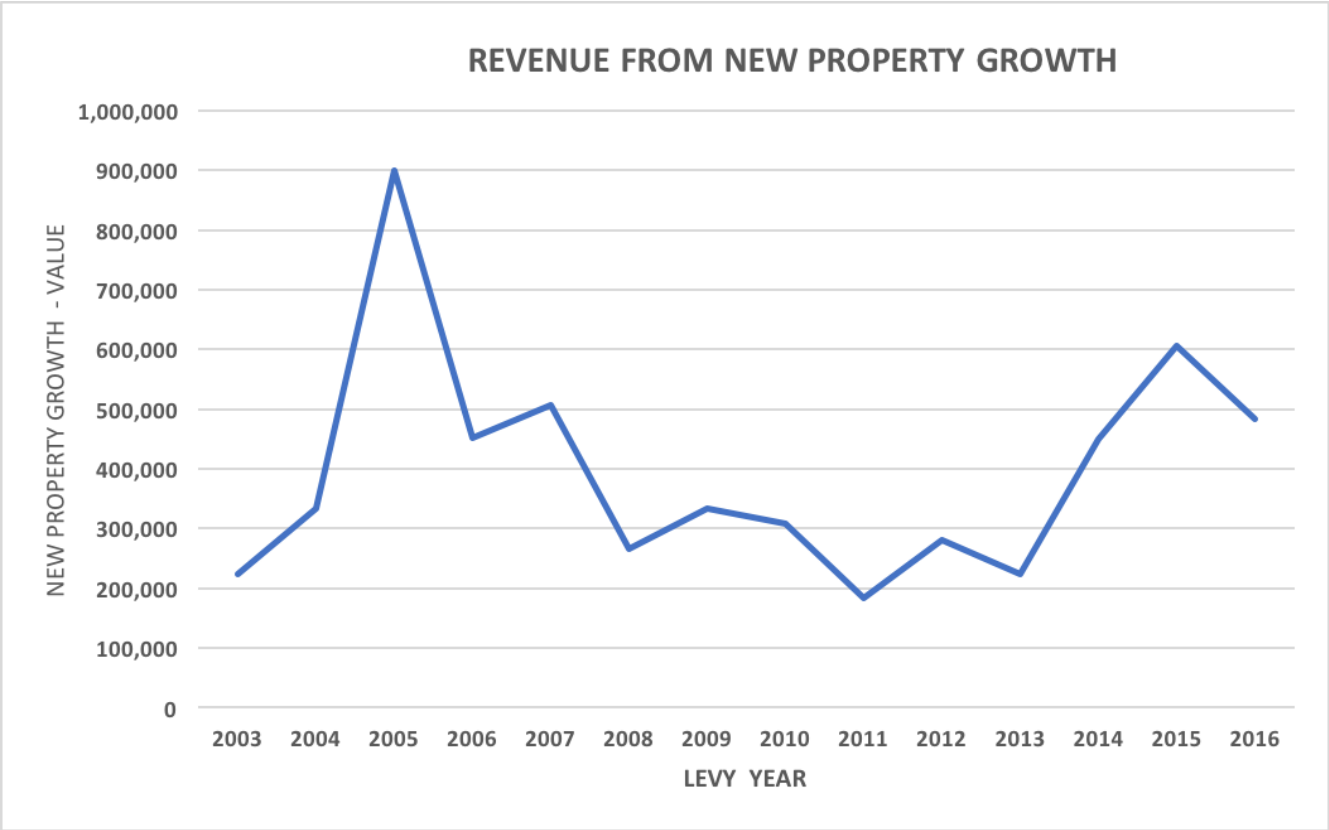


Exhibit 4

Property tax freeze for 2018 and 2019 levy years – all other assumptions remain as in the baseline forecast

CPI 2.10%
NPG 0.88%

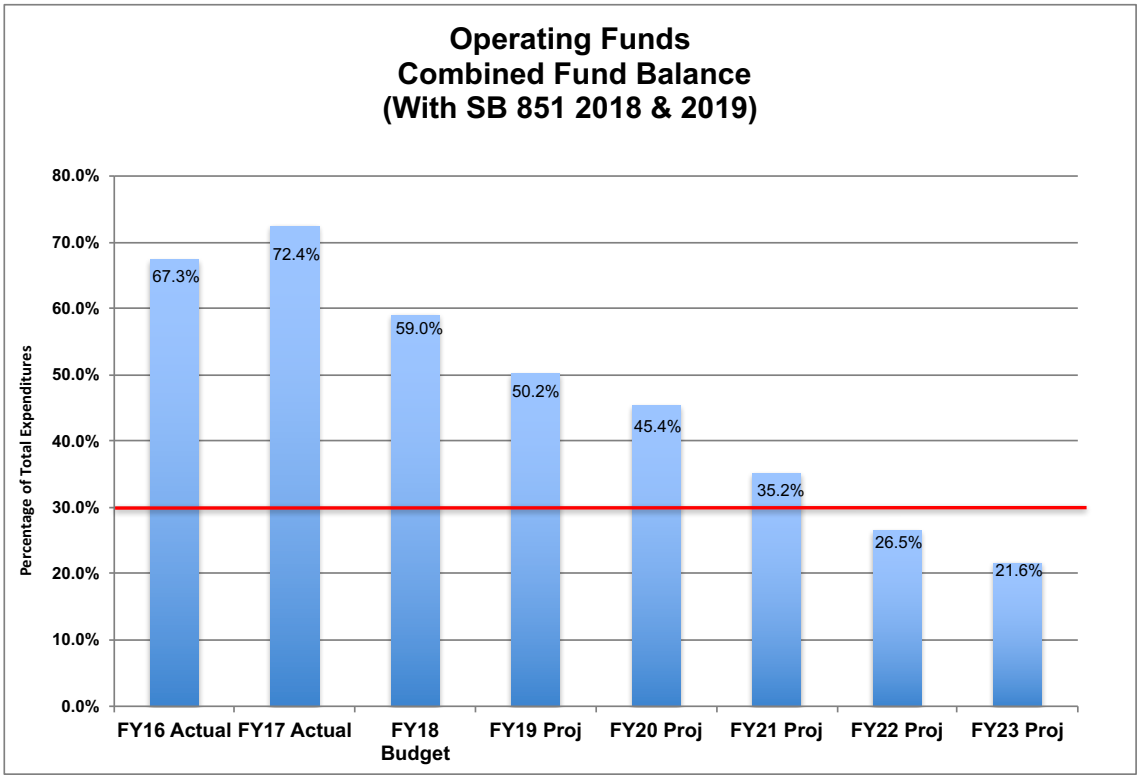


Exhibit 5

No CPI increase in 2017 – all other assumption as in baseline

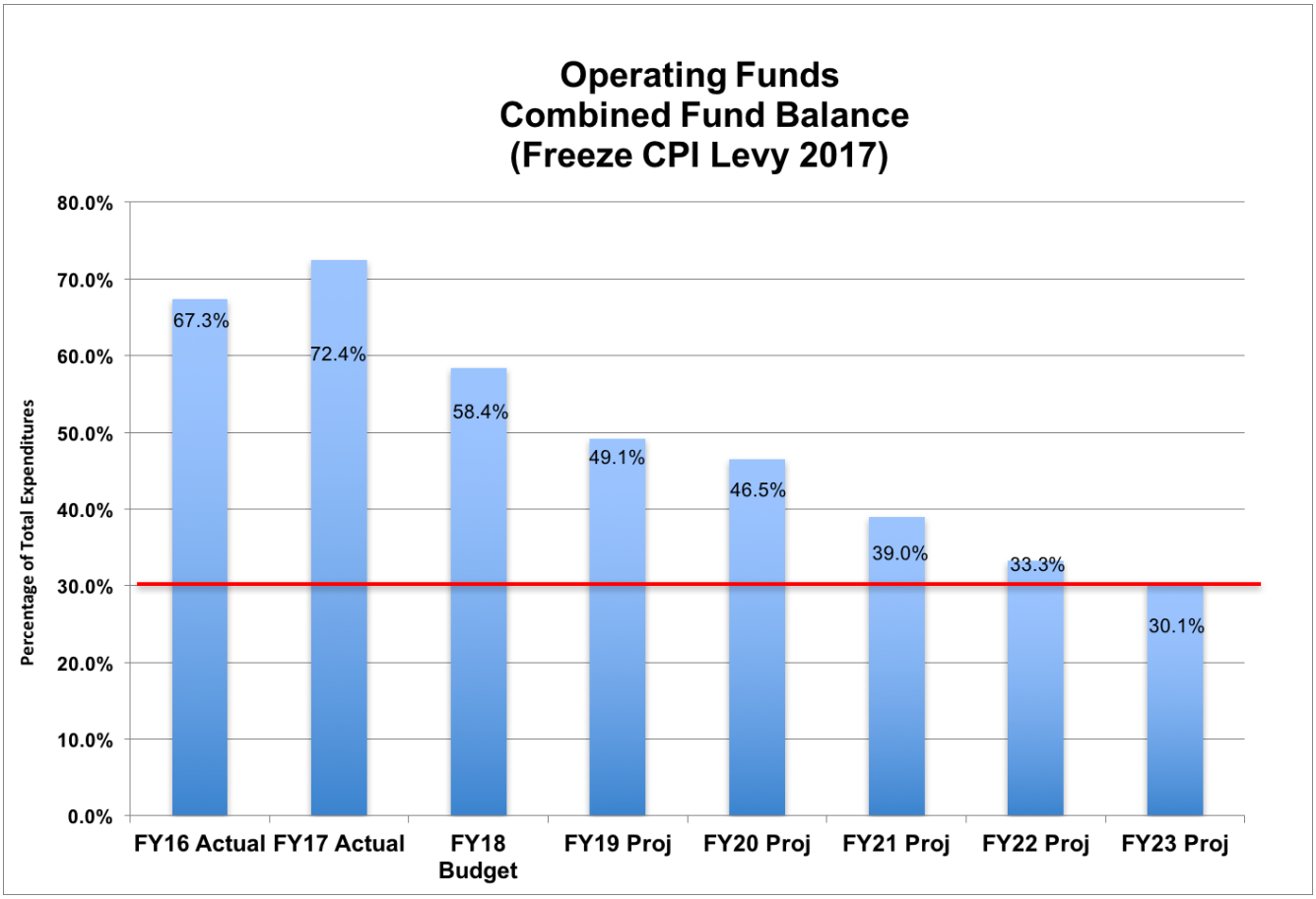


Exhibit 6

No CPI increase in 2017 and property tax freeze in 2018 and 2019, all other assumptions as in baseline forecast

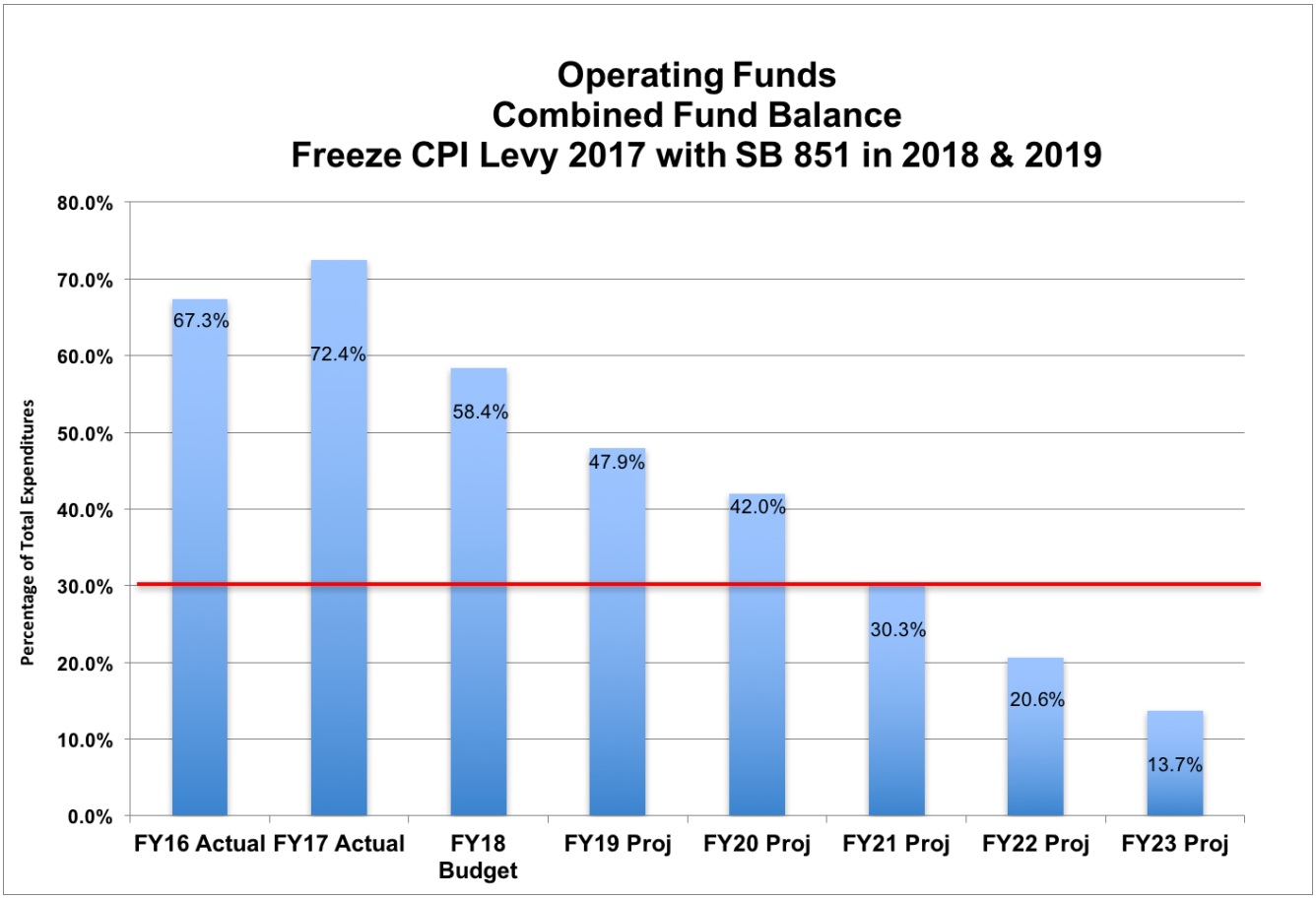


Exhibit 7

This slide appeared in the District's presentation to the community prior to the 2011 referendum vote. These cuts were proposed, but were not implemented due to the successful referendum.

Additional cuts to close gap will significantly impact educational programs

Program Reductions 2011-2012 ($3.7 million)	Program Elimination 2012-2013 ($2.7 million)
Music	Instrumental Music
Foreign Language	Foreign language (K-8)
Gifted support (differentiation)	Gifted support (differentiation)
Library	Library
Technology instruction	Technology instruction
Art	Reading Intervention (K-4)
Physical Ed	
Professional development	

TOTAL CUTS:
$6.4 million

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