



Cheltenham Township Strategic Management Planning Program

Financial Condition Assessment and Trend Analysis

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Multi-year planning process

Public Financial Management (PFM) is developing a five-year financial plan for the Cheltenham Township with technical guidance and partial financial support from the Pennsylvania Department of Community and Economic Development and its Strategic Management Planning (STAMP) Program. There are three steps to develop the multi-year plan.

Financial condition assessment

- We first need to understand Township government's financial position and the critical underlying factors driving its performance. Then we project the Township's financial performance under a baseline *status quo* scenario to identify and quantify specific financial challenges. **This is what we are presenting today.**

Management review

- Township government does not exist for purely financial purposes. It exists to deliver critical services to the people who live, work, and visit the Township. Similarly, numbers alone won't tell the complete story. So we'll meet with department managers and other staff to discuss what their departments do, how they do it, and why they do it.

Initiative development and plan delivery

- Guided by the quantitative analysis in the financial condition assessment and the qualitative analysis in the management review, we will develop a series of recommendations (or initiatives) that connect back to a mission statement. Those initiatives will be organized into one coherent plan document that we'll deliver at the end of this process.

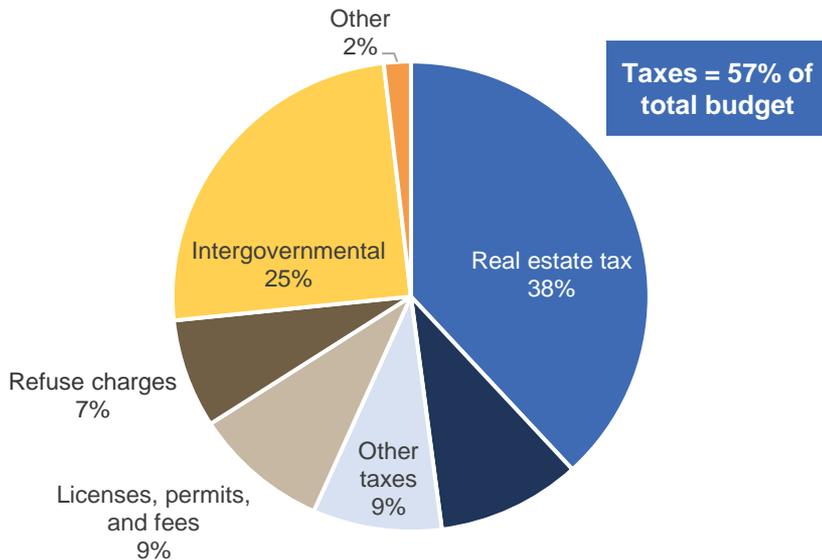


Revenues at a glance

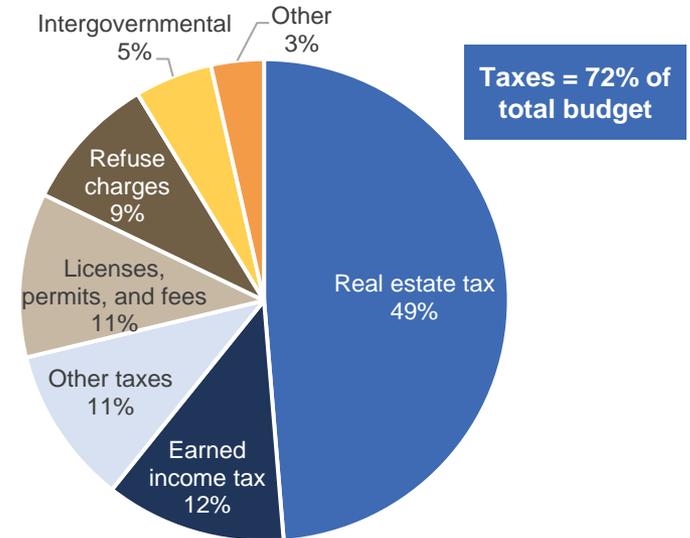
According to the 2020 proposed budget, over 70 percent of the Township's revenues come from taxes, primarily the real estate and earned income taxes. As shown in the charts below, the Township's reliance on these two taxes increased in the 2020 proposed budget because of the loss of sewer revenues beginning next year. The loss of sewer revenues reduced the Township's total General Fund revenues by \$9.4 million (20 percent of total revenues).

The Township also collects \$3.4 million in refuse fees from a \$325 annual charge to each residential household. The Township increased the annual charge this year from \$286 to \$325.

**General Fund Revenues – 2019 Adopted Budget
(\$45.1 Million)**



**General Fund Revenues – 2020 Proposed Budget¹
(\$36.8 Million)**



¹ The 2020 proposed revenue budget also includes \$0.5 million in appropriated fund balance.



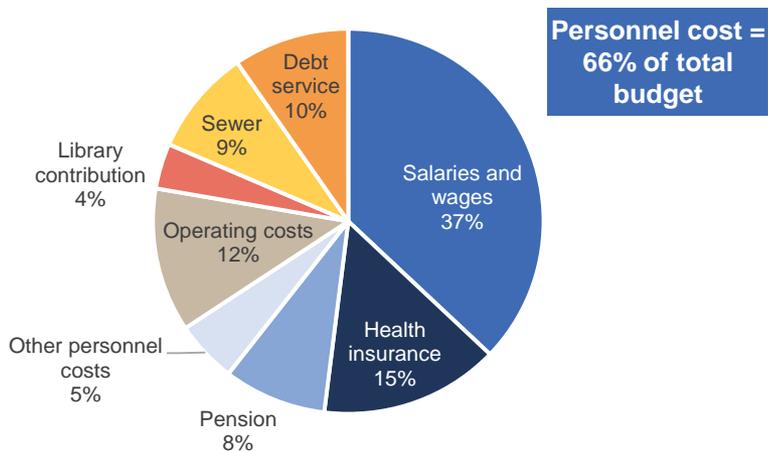
Expenditures at a glance

Municipal government is inherently labor intensive. Almost 80 percent (or \$29.4 million) of the Township's spending is on personnel costs – including base salaries, longevity, overtime, sick leave payout, active employees' health benefits, retirees' health benefits, pension contribution, uniform, FICA, workers' compensation, and unemployment.

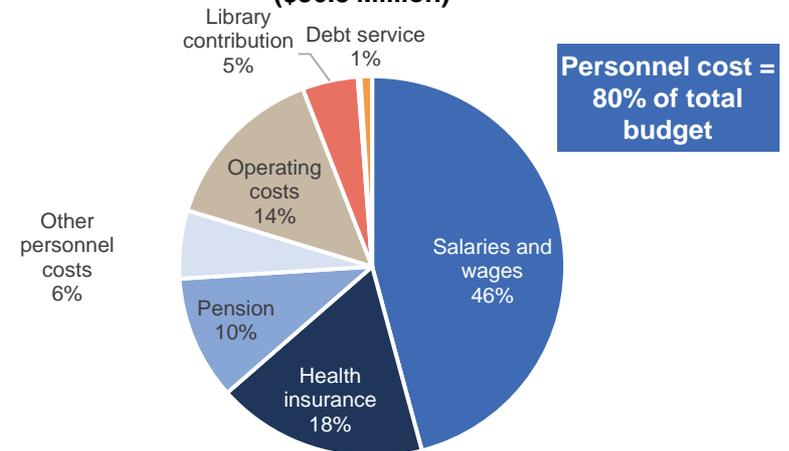
Another 14 percent of the 2020 proposed budget is on operating expenses, which include contracted services, maintenance, equipment, supplies, materials, utilities, and other fees and charges. The Township also makes an annual contribution to the library. That amount will remain at \$1.7 million in 2020, which equates to 1.9 percent annual growth since 2013. Because of the sale of the sewer system, the \$4.0 million in wastewater treatment cost and \$1.9 million in sewer-related debt service will be eliminated beginning in 2020.

After paying down the sewer-related debt and a portion of the GO debt, the General Fund still has \$0.4 million in remaining debt service payments next year. Beyond 2020, the amount of annual debt service will increase gradually to \$1.0 million by 2025 absent additional debt issuances.

General Fund Expenditures – 2019 Adopted Budget
(\$45.1 Million)



General Fund Expenditures – 2020 Proposed Budget
(\$36.8 Million)





Six key financial trends

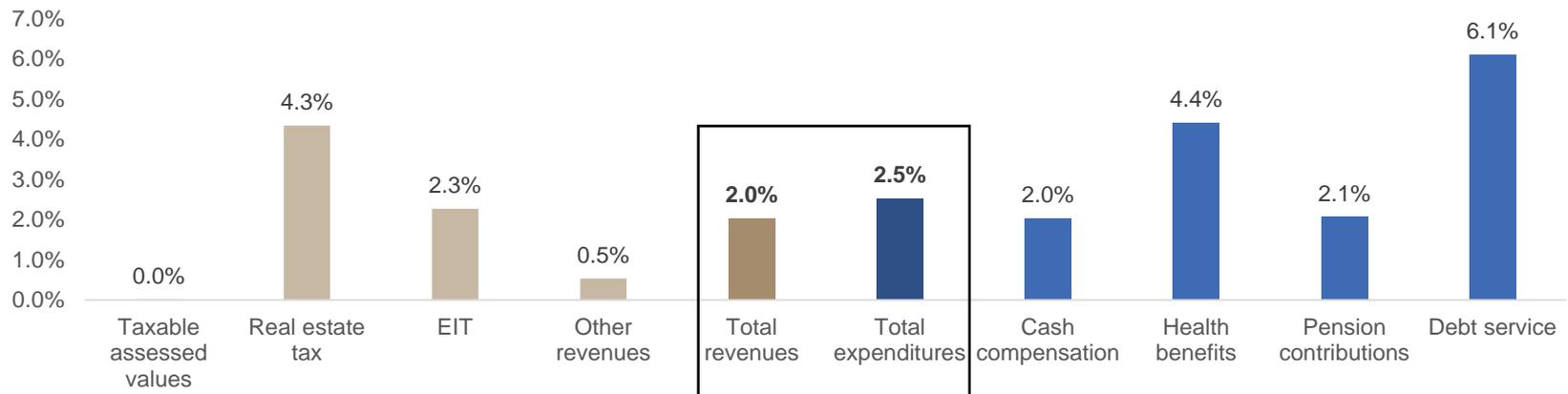
- 1. Real estate tax revenues grow only when tax rate increases.** Due to the flat assessed value, Cheltenham increased its real estate tax rate by 4.4 percent on an annual average basis from 2013 to 2018 and current year revenues grew by approximately the same amount (4.3 percent annually). The County's last reassessment was in 1996.
- 2. Earned income tax revenues have been growing at 2.3 percent annually.** From 2013 to 2017, Cheltenham's employment grew at an annual rate of 1.2 percent, and earnings also grew by one to two percent annually. The pace of wage growth is likely driven in part by the expansion phase of the business cycle.
- 3. As a result of the sewer sale, Cheltenham will lose the sewer revenues as well as the corresponding expenditures.** Next year, the Township will lose \$9.4 million in sewer revenues but will only eliminate \$5.9 million in sewer expenditures, including any sewer-related debt.
- 4. The Township has been controlling compensation growth through position control.** From 2013 to 2018, the Township's spending on salaries only grew by 1.7 percent on an annual basis despite average annual general wage adjustments of 2.5 percent for salaried employees, 3.2 percent for Teamsters, and 3.1 percent for police officers. Average annual inflationary growth during the same period was 0.9 percent in the Philadelphia MSA.
- 5. Required pension contributions have stabilized in the last few years,** and the Minimum Municipal Obligations (MMO) are projected to decline assuming no additional actuarial gains or losses, or changes in benefit terms or investment assumptions.
- 6. Capital improvements are primarily funded by bonded debt.** Over the last decade, Cheltenham issued between \$7 and \$10 million in municipal debt approximately every two years to fund capital improvement projects. Apart from a \$390,000 transfer from the General Fund in 2016, the Township generally has not made pay-as-you-go contributions for capital improvement projects. Moving forward, capital spending priorities are expected to adjust with the sale of the sewer system.



Key finding #1: Cheltenham has a structural problem

From 2013 to 2018, Cheltenham’s revenues only grew by 2.0 percent on an annual basis even though the Township had 4.4 percent in average annual increases in the real estate tax. Expenditures, on the other hand, grew at an annual rate of 2.5 percent due in part to the steep growth in debt service and increased health care costs. In part due to that structural imbalance, the Township finished 2018 with a deficit of \$0.6 million and total unrestricted fund balance dropped to 13.6 percent of operating revenues. The 2020 proposed budget anticipates using \$0.5 million in fund balance to balance the budget.

Average Annual Growth, 2013 - 2018



	2013 audit	2014 audit	2015 audit	2016 audit	2017 audit	2018 audit
Operating revenues	37,890,137	39,182,472	40,376,853	40,999,047	41,776,373	41,899,527
Operating expenditures	37,543,644	38,338,293	40,484,615	40,799,047	41,669,243	42,531,825
Net operating result¹	\$346,493	\$844,179	(\$107,762)	\$200,000	\$107,130	(\$632,298)
Unrestricted fund balance	5,081,774	6,010,970	6,033,906	6,233,906	6,341,036	5,708,738
Fund balance as a % of revenues	13.5%	15.3%	15.0%	15.2%	15.2%	13.6%

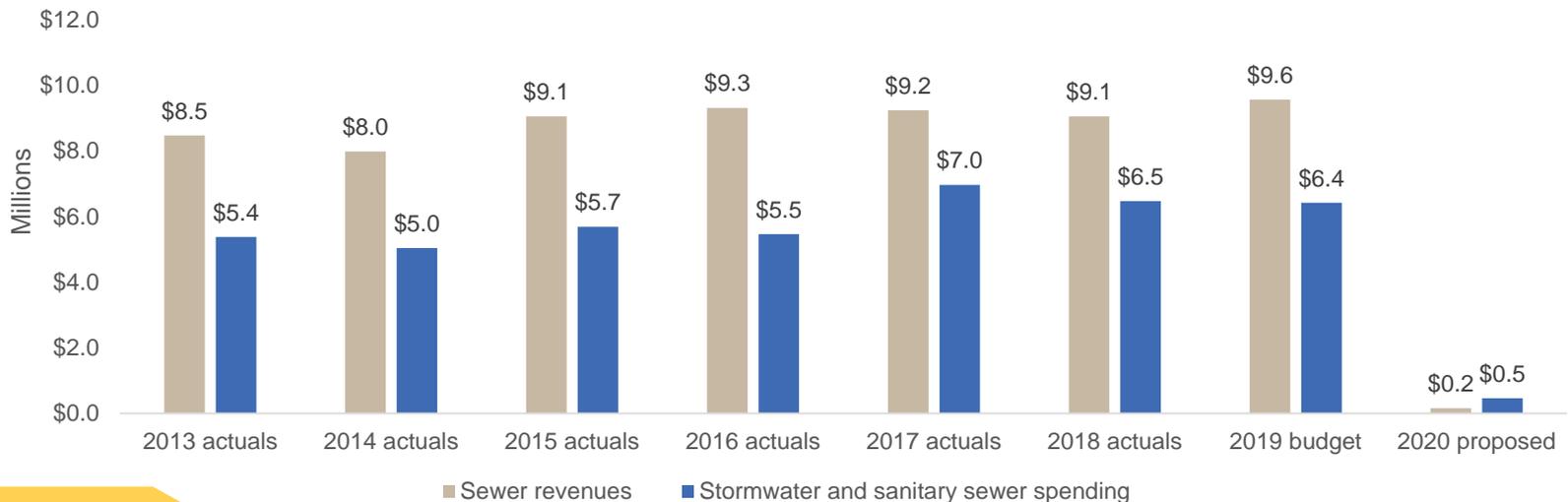


Key finding #2: The sale of the sewer system creates a budget deficit

In 2019, Cheltenham budgeted \$9.6 million in sewer revenues. At the same time, it projected spending \$6.4 million on stormwater and sanitary sewer management, the majority of which is a \$4.0 million payment to the Philadelphia Water Department (PWD) for wastewater treatment. Another \$1.9 million is debt service spending for sewer-related debt, and the remaining \$0.5 million is primarily the personnel and operating expenses of the Department, which has four full-time employees.

With the sale of the sewer system, the 2020 proposed budget eliminated almost all sewer revenues except \$0.2 million in delinquent sewer revenues. Meanwhile, only \$5.9 million in expenditures is eliminated (\$4.0 million payment to PWD and \$1.9 million in debt service), creating a budget hole of \$3.5 million. Using approximately \$17.0 million in sewer proceeds to pay down a portion of the general obligation debt and increasing the real estate tax by 4.3 percent helped close part of the budget gap, but the Township is still left with a \$0.5 million deficit next year.

Stormwater and Sewer Revenues and Expenditures





What is a baseline projection?

“For this engagement, we will develop an Excel-based multi-year financial projection model that covers the Township’s revenues and expenditures through the next five years as requested in the RFP.”

– Scope of Services for Five-Year Financial Management Plan, p. 10

There are two very important contextual points to understand the baseline projection:

- **The baseline projection presents a status quo scenario.**

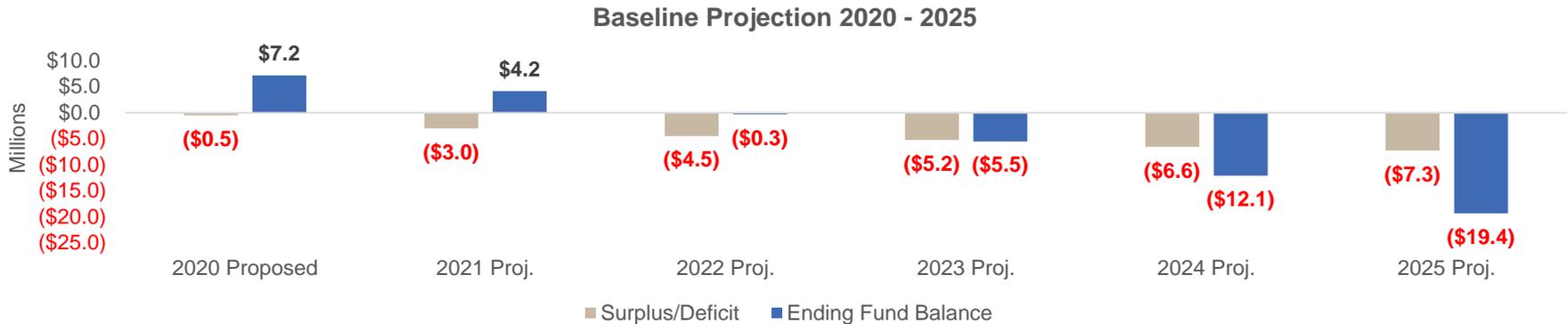
Conceptually, the baseline projection represents a “carry forward” or “current services” set of projections – such that no reduction or enhancement in services, headcount or tax rates are generally assumed, except in cases where already adopted into current law or consistent with existing policy.

- **The baseline projection is not a prescription for Township’s financial policies, nor is it a prediction of future annual results.**

The baseline projection shows Cheltenham’s finances absent corrective action. Practically speaking, the Township will have to take corrective action. The Township is statutorily required to pass a balanced budget each year and it could not sustain the projected deficits in the baseline without exhausting its reserves. However, it is critical to have a baseline projection in order to understand the magnitude and nature of budget challenges before developing appropriate corrective action.



Baseline projection (as of November 2019)



The baseline projection shows annual deficits growing from \$0.5 million in the 2020 to \$7.3 million by 2025. The \$7.2 million ending fund balance in 2020 is based on \$5.7 million in unrestricted fund balance as of the end of 2019¹ and estimated sewer proceeds of approximately \$2.0 million after paying down the sewer-related debt and additional GO debt. The Township anticipates using \$0.5 million in reserves to balance the 2020 budget, leaving \$7.2 million in fund balance at the end of 2020. According to the baseline projection, even with the deposit of \$2.0 million in sewer proceeds to the General Fund, the Township will exhaust its fund balance by 2022 absent corrective action.

On the revenue side, the baseline projection assumes no increase to the real estate tax rate or fees. Beginning in 2020, almost all sewer revenues and associated expenditures are eliminated. On the expenditure side, the baseline assumes wage increases according to the provisions in the existing labor agreements. Once the labor agreements expire, the baseline assumes wage increases to continue at the historical rates (3.5% for police and 3.0% for civilians). These wage increase patterns are not a recommendation, but rather reflective of the Township's historical trends absent corrective action.

The baseline also assumes that the Township will issue \$10 million in debt in 2020 and again in 2023. As a result of the debt issuances, the Township's annual debt service payment is projected to grow from \$0.4 million in 2020 to \$2.1 million in 2025.



So what?

- Absent corrective action, the Township's projected deficit will grow from \$0.5 million in the 2020 proposed budget to \$7.3 million by 2025 and the fund balance (including proceeds from the sewer sale) will be depleted by 2022. We will update the baseline projection after the Township adopts its 2020 budget, but that should not affect our key findings.
- **The projected deficits are primarily because Cheltenham has a structural problem.** The limited revenue growth (driven by flat assessments and two percent EIT growth) coupled with cash compensation and health benefits growth results in a growing structural deficit in the Township's operating budget. Even though using sewer proceeds to pay down a portion of the existing debt will reduce the Township's debt service, issuing \$10 million in debt to pay for capital projects every other year would increase the debt service level again, and the Township will eventually have to find new revenues to fund those increases.
- **The sale of the sewer system also created a budget gap.** The 2020 proposed budget eliminated almost all sewer revenues except \$0.2 million in delinquent sewer revenues. Meanwhile, only \$5.9 million in expenditures is eliminated, creating a budget hole of \$3.5 million. Using approximately \$17.0 million in sewer proceeds to pay down a portion of the General Obligation debt and increasing the real estate tax by 4.3 percent helped close part of the budget gap, but the Township is still left with a \$0.5 million deficit.
- To maintain long-term sustainability, the Township should direct one-time financial windfalls to areas where the investment would bring recurring savings or revenues, such as paying down its pension or debt obligations and/or investing in capital improvement to alleviate some long-term maintenance costs. [The sewer sale proceeds provide Cheltenham with such a once-in-a-generation lifetime opportunity and should be used strategically to provide fiscal stability in the future.](#)
- Cheltenham also needs an adequate level of fund balance to maintain cash flow flexibility and provide a buffer against unexpected revenue shortfalls or unbudgeted expenditures. The Government Finance Officers Association (GFOA) recommends maintaining a fund balance of no less than 16.7 percent (or two months) of operating revenues. That would be equivalent to \$6.0 million based on the Township's 2020 proposed budget.



Next steps

Once we have developed a financial condition assessment and financial trend analysis, we will begin the **management and mission audit** portion of the project. Before we can develop a strategic plan that supports your mission, we need your input on what that mission should be or, if one already exists, whether it still accurately reflects your current vision and circumstances. Using the Government Finance Officers Association's recommendations for strategic planning, we will facilitate a focused discussion to define the following:

- The **mission statement**, which is a clear, concise statement of purpose for Township government; and
 - **Critical challenges** that need to be addressed to achieve the mission
 - Specific **goals** for the next five years that account for both the Township's vision and resource limitations
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- Our next step is to schedule **interviews with your department heads** to discuss what services they currently provide, how resources are allocated to those activities, and how well those activities align with the mission statement. We will also discuss recent changes in service demand and staff ideas for responding to those challenges.
 - Through the management and mission audit, we will **integrate your financial, operational, and economic development goals** and develop a five-year plan with recommended initiatives that help close the projected budget gap while addressing your operational and policy goals and priorities.