Town of Marshfield

Board of Selectmen

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To: All Departments, Boards, Committees

From: John Clifford

Date: November 28, 2006

CC: Board of Selectmen

Re: Fiscal 2008 Budget Strategy

After an initial review of our revenue forecasts and draft budget submittals, we find ourselves facing a significant budget deficit for the second consecutive year. Having used all available cash reserves during the past four years to address similar shortfalls, we are now forced to consider a Proposition 2 ½ override to maintain essential services. The situation was essentially the same for Fiscal Year 2007, and last year, the Board of Selectmen, in the absence of any support to bring forward an override, elected to recommend staff and service cuts to this budget. Our current projections indicate that the situation for Fiscal Year 2008 would be substantially the same, and, absent any cash reserves to fall back on, voters would not have any meaningful choice but to approve budget cuts in the spring. The Board of Selectmen, having concluded that staff and service reductions similar to last year are likely, have voted to bring forward an override at the Annual Town Meeting and Annual Town Election, which gives the Town the opportunity to decide whether raise taxes or reduce services.

In order to develop a budget strategy going forward, we need to assess the means by which we have forecasted revenues and expenses during the past several years. I researched some of the projections and models that we have been using in our budget process. I went back to a model that was last updated in October, 2002 (attached) to determine the accuracy of some of our projection methods and the resulting data. I have also included the model that we are using for this year for comparison purposes. My goal in doing this analysis was to assess our revenue projection and budgeting practices, specifically to determine their soundness as we begin what will be the most difficult fiscal challenge faced by the Town in more than a decade. I would like to acknowledge the contributions of Nancy Holt and Lynne Barrett in building the models and analyzing the data. They have played key roles in developing the tools that allow us to better understand our fiscal situation and those tools will be critical as we craft a strategy going forward.

Revenues

State Aid – The average projected in 2002 for subsequent years was $14.05m, which is within 2% of the amount actually received in 2003, 2004, 2005, and 2006. As you are aware, we did receive a substantial increase for the 2007 budget, however, the average of the five years projected, even with the additional funds received this year, was within 5.7% of the projection.

Property Tax - The amount of property tax projected in 2002 has been within 1.5% of the amount received. These projections are based upon a projection of the 2.5% allowable growth under the statute, and a historical analysis of new growth. Of the major revenue categories, property tax has been the most consistent in terms of meeting projected performance. The statutory structure insulates these revenues from the fluctuation seen in other revenue categories, absent a significant decline in real estate values.

Free Cash – In 2002, it was projected that free cash would decline from the historic highs we had experienced in recent years. The amount of free cash certified did trend downward, but did not reach the projected $2.5m until 2006. The downward trend was projected because of decreased department "turnbacks," and by revenues received in excess of local receipt projections. Departments have been turning back smaller amounts because operational budgets have been reduced or have increased at a level that does not match increased costs. The revenue forecasts were admittedly very conservative from 2001 through 2005, however, we have increased the projections to try to offset the absence of other available revenues.

Stabilization Fund – Based upon spending and revenue projections completed in October, 2002, it was projected that the Stabilization Fund would be depleted during the FY07 budget process, primarily due to the rate of budget growth and the absence of new revenues to support that growth. In the process of building the FY07 budget, we utilized the remaining balance in the account, but were still left with a deficit of $1.7m. The amount of that deficit was due to the fact that the operational budget grew at a rate in excess of the projected 3%.

Local Receipts – Local receipts had been projected using a very conservative approach until FY07. Our method of projection was to calculate the five year average and then reduce that amount by 10%. This method, which was acknowledged to be conservative, was developed in response to declines in local receipts that occurred between 1989 and 1994. Our projection in FY04 going forward was $4.5m, and the actual performance had been in the range of $6m. The $1.5m in excess revenue has been the primary contributor to the free cash generated in recent years. The FY07 budget includes a projection of $5.9m, which is the amount actually received in FY05. For FY08 and beyond, we are projecting modest increases in local receipts, which may be optimistic, given the long term performance of this revenue source. Even assuming that we do achieve the projected amount in local receipts, it is highly unlikely that we will exceed the projections by any significant amount, which is one reason why we are projecting lower amounts of free cash going forward.

Expenditures – The General Fund Budget

The projected rate of budget growth used in the October, 2002 model was 3% per year. The Town exceeded that rate of budget growth due to a variety of factors. The method of projecting the budget growth by percentage is fairly straightforward. In October, 2002, the focus was to get the Town budget down to a 3% growth rate, as the rates of growth for the fiscal years 2001-2003 were 13%, 9%, and 7% respectively. The projected 3% budget growth was not in fact a "projection" but rather a goal, which, unfortunately, we did not achieve. What we have done in the intervening years is to attempt to isolate certain variables within the budget. The "fixed" costs, or those that are non-discretionary, including health insurance, debt service, utilities, snow and ice removal, pension assessments, medicare, and, more recently fuel, have been isolated as having a significant budget impact because of their increasing cost. Our recent approach has been to isolate these costs at the beginning of the budget cycle to determine the amount available for the other operating budgets, which we are able to reduce in the absence of necessary revenues. For the purpose of long term projections, we have categorized these non-discretionary costs together in our growth rate projections. At the beginning of each budget process, however, we establish projections for these individual line items as a means of identifying the amount available for other operational budgets.

Debt service projections are based on established principal and interest costs, and have been accurate year to year. Health insurance projections have been based on a trend of 12% annual increases for the past three years, and those projections have also been accurate, in terms of the actual rate increases. We actually saw increases in excess of that amount from fiscal years 2001-2003, in part because of the rate increases, but also due to the increasing number of participating employees. While we have attempted to control the head count of active employees in the last two years, a high number of recent retirements forces us to carry the health care cost of the retirees as well as their replacements, thus increasing the amount of participants in the health insurance program. Workers compensation had been self-insured until 2003, but industry changes resulted the elimination of that option. We have been in a premium based program since that time, and, due to high claims for the last two years, our premiums increased significantly for FY07.

Conclusion

Analysis of major revenue category performance does shed some light on our overall budget approach. Using actual performance as a basis of future revenue projection has proven to be very reliable. Property taxes, local receipts, and state aid have all followed predictable trends and the methods used in the past should continue to be used in the future. Property taxes and local receipts have shown modest predictable growth for the past ten years and we can rely upon that growth in future projections. State aid did not change significantly from 2001 through 2006. The increase received this year should be viewed as an anomaly and not as a harbinger of future aid increases. Our projections for the coming years should, at best, be based upon receiving only the amount we received this year. That outlook is supported by the Massachusetts Taxpayers Foundation, which has, for many years, been the only rational voice on local aid at the state level. Absent a major change in the economy or in the formula used to distribute state aid, no increase should be projected for FY08 and beyond.

Free cash is normally frowned upon as a revenue source for operational budgets, primarily because it is unpredictable. As recently as 1992, the Town ran a deficit of $800,000, or, what is euphemistically called "negative free cash." That is generally caused by a combination of being overly optimistic in revenue projection and poor oversight of operational budgets. Great care should be taken in projecting free cash, particularly for use in operating budgets.

The Stabilization Fund as a revenue source, unlike the above categories, is controllable. We are not in a position to build a balance in the Fund at this time, however, use of future Fund reserves should follow a defined budget strategy and should not be based upon short term needs.

Free cash and the Stabilization Fund are the two primary cash reserves for the Town, and the depletion of those reserves is viewed negatively by bond rating agencies. Any long term budget strategy should include provisions to increase the balances in these accounts to levels that are consistent with the needs of a $70 million operation. A reasonable goal for the Stabilization Fund would be five percent (5%) of the total general fund operating budget, or about $3.5m, based on the current budget.

Expenditures fall into two major categories; fixed and discretionary. The fixed costs such as health insurance, pension costs, utilities, etc., should be budgeted using established trends. That does not preclude constant review of these budget items, and we should continue to be vigilant in pursuing methods of reducing those costs. All other operational budget items are discretionary and budgeting practices should reflect our revenue projections.

One area that will continue to have a major impact on our budget is collective bargaining. The past seven years have seen collective bargaining settlements that were reflective of the Town's strong financial position, particularly with regard to cash reserves. Our bargaining strategy reflected a philosophy that our employees should benefit from a positive economy, and the settlements reflected that philosophy. Given the drastic change in our financial position, the inverse must be true as well, and our current fiscal situation dictates that collective bargaining settlements are consistent with what the Town can afford. Recognizing that many of the cost items that are negatively impacting our budget also impact the personal finances of our employees (fuel, health care, etc.), we cannot ask employees to forego raises indefinitely, therefore, our budget must include funding for negotiated salary increases. We are projecting the amount to be modest, but fair to our employees, especially in light of our fiscal situation.

The primary goal should be to develop operational budgets that are sustainable with our available revenues. The budgets should be based upon consistent levels of service delivery, staying within our projections of available revenues. Going forward, budget projections will form the foundation of our long term financial strategy, particularly for the purpose of identifying the proper amount of a Proposition 2 ½ override. If we commit to a certain rate of budget growth as part of an override strategy, we will need to achieve those budget projections. Failure to budget within our defined growth targets will put us back into the unenviable position we now find ourselves in; having to ask voters to pass an override or to make significant reductions in service delivery.

The current system of funding local services, primarily through property taxes and a redistribution of state income tax in the form of local aid, creates structural budget deficits in every community. Lacking control over state aid, we, like municipal officials across the Commonwealth, are forced to rely more upon property taxes to sustain an acceptable level of staffing and basic services. This reliance on property taxes is most burdensome to senior citizens, who, for the most part, are forced to absorb the increased cost within a fixed income. While there is general agreement among state leaders that the current system is flawed, there has been little discussion of the sweeping changes that would be necessary to address those flaws.

Given the inherent structural shortfall in our budget, it is clear that we cannot consider significant staff increases or service enhancements as part of our long term budget philosophy. An override, as currently considered, would be an adjustment to our revenues to offset the structural deficit for a period of at least three years. The imposition of an override on taxpayers should only be taken under extraordinary circumstances, and Marshfield, having gone fifteen years without such a request, is facing such a circumstance now. Continuing with a conservative revenue forecasting philosophy, and strictly adhering to carefully defined budget parameters will enable us to minimize or avoid reliance upon overrides as a means of maintaining services.

A sustainable budget strategy should also acknowledge our shared mission as a community. The contributions of some smaller departments, while not always apparent to the electorate, are critical to support our core functions of education and public safety. To that end, Chairman Maresco is proposing a comprehensive override that will enable us to maintain an acceptable level of service in each department. In order to define an acceptable level of service, we have revisited the budget reductions that were made in the Fiscal Year 2007 budget, and, in some cases, those budget reductions have resulted in service delivery that is not optimal. The proposed override will fund restoration of certain staffing and service cuts, including three police officers, three firefighter/paramedic positions, two positions in the Department of Public Works, as well as restoration of some positions and services in the School Department. The School Committee and their administrative team are still working on a Fiscal Year 08 budget, and the details will be made available in the coming weeks.

Recommendation

As indicated in our budget models, this is not a shortfall that only impacts us for the coming year. Projections for subsequent years indicate that the deficit will actually be worse in FY2009 and beyond. Rather than propose an override that will only address our deficit short term, we are projecting an amount that will cover all projected costs for a three year period, beginning next year.

The projected details of the Proposition 2 ½ Override, as recommended by Chairman Maresco, are as follows:

- Projected amount $4 million to $4.5 million
- Projected impact on tax rate - $.90 to $.96 on the tax rate
- Projected cost to taxpayer:
    - $300,000 home (assessed value) - $270 - $290 per year *
    - $500,000 home - $450 - $480 per year *

      **The above projections are based on the Fiscal Year 2006 tax rate. The Fiscal Year 2007 tax rate will be set in early December.*

- This override will:
    - Restore essential staff/services eliminated in FY07 budget
    - Provide sufficient funding to sustain all services and staff in Fiscal Years 2008, 2009, and 2010.
    - Include funding for a modest wage increase for the years FY08 – FY10.

During the coming weeks, the Board of Selectmen and I will be reviewing the draft budgets to more clearly define the above numbers. The next step in the budget process will be to develop draft budgets that will be implemented should an override not be approved by voters. I am recommending that each of these budgets be presented at the Annual Town Meeting, so that we can present a clear distinction to voters of the true impact of an override vote.

While the amount and impact of the proposed override are substantial, they should be viewed in the context that we have, for fifteen years, worked with the revenues available, without having had to request an operational override. Each department has made sacrifices that enabled us to operate using only the revenue available to us, and we have attempted to provide a high level of service without having to resort to tax increases in the past. Virtually every nearby town has had to ask for overrides during that time, and we should take pride in the fact that we have lived within our means despite a revenue structure that makes it virtually impossible to operate without overrides. **The above recommendation was adopted by a unanimous vote of the Board of Selectmen on November 27, 2006.**

We look forward to working with you collaboratively as we go through this process. Please contact me if you have any questions or concerns.