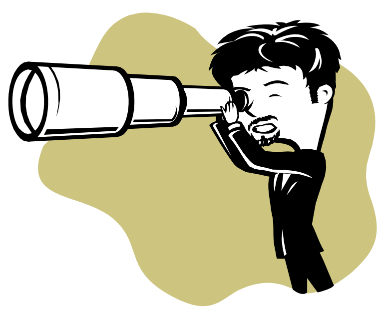
Town of Framingham

Long Range Financial Forecast

FY2016-FY2020



Special Town Meeting

October 21, 2014

Article 1: Reports 1a and 6

Office of the Chief Financial Officer

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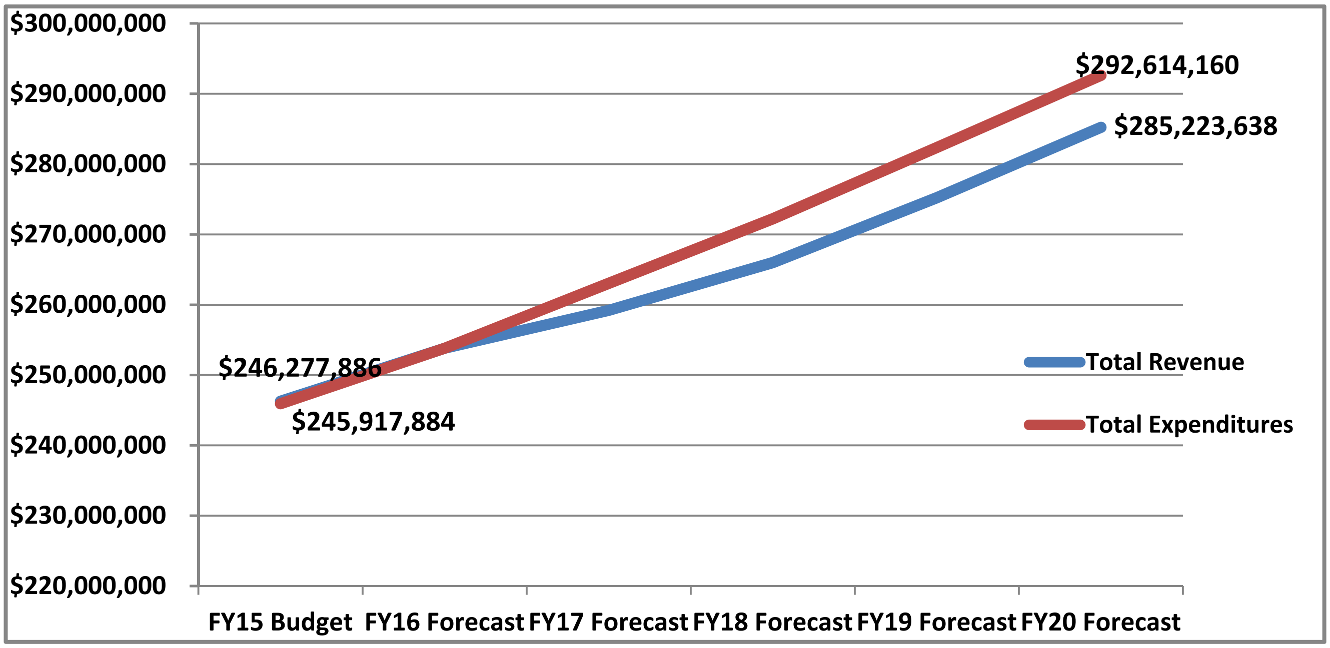
Executive Summary

The long range financial outlook for the Town of Framingham is an improving. Revenue growth ranges from 2.1% (FY17) to 3.6% (FY20). Expenditure growth spans 3.2% (FY16) to 3.7% (FY20). The budget projection for FY16 is in balance but future years are projected to be in deficit. However, the deficits are not as dire as previous forecasts: projected deficits range from $3.8 million in FY17 to $7.4 million in FY20. In relative terms expenditures outpace revenues from 1.5% to 2.5%.



The operating budget can be managed in the near term as we position ourselves for the financing of a large capital project: a new school. The finances related to the building of a new school assume the School District receives 51% funding from the Massachusetts School Building Authority. It also assumes Town funding via debt exclusion, the debt cost specifically related to the school will be excluded from the tax levy limit. The estimated cost for this school building debt does not appear in this forecast until FY19 and FY20.

It is the goal of this forecast to provide relevant budget data to public officials and citizens of Framingham in order to make informed decisions about the future of the Town. The report sections that follow should provide an appropriate level of detail to understand the future financial outlook of the Town. However, if more is needed, simply ask the CFO’s Office.

Forecasting Overview

The definition of financial forecasting is to project revenues and expenditures, using future spending estimates, assumptions about economic conditions and other salient variables. The purpose is to (1) provide information for long range municipal and strategic planning and (2) determine the Town's financial capacity to accomplish certain long term goals.

The information provided here is NOT an approved budget. The Town Administration and Selectmen prepare an annual budget and presents it to Town Meeting for them to approve. The forecast takes existing revenues and expenditures, using FY15 as a base year, and applies rates of growth over a five year period. For revenues the rates differ by category, for example the tax levy is 1.25% for two years and 2.5% for three years. Chapter 70 aid is 7% per year. Local revenue (fees, permits and local taxes) change ranges from growth of 2.8% in FY16 to a decrease of 1.9% in FY18. More detail is in the revenue section below. Expenditures grow at differing rates both by spending category (salaries, operating, energy and small capital) and by department. Salaries grow by 3-4% per year and operating costs grow by 1-5% per year. More detail is in the expenditure section below.

There are also special revenue and spending components that require some more "intense" discussion. While these may change per year, there are two core topics-unfunded liabilities and health insurance. In this forecast we will add a discussion on Free Cash, specifically as a revenue source for tax levy moderation, reserves and unfunded liabilities. Building reserves is also discussed in detail.

Near Term Framingham Financial Goals

We began developing FY15 using a three year model because we knew a large capital expenditure was coming in the near future. Two critical budget components were especially favorable: health insurance would be greatly reduced due to the move to the Group Insurance Commission and certified Free Cash, the ending cash balance for FY13, was substantial. With these tools we set a number of goals for a three year budget plan:

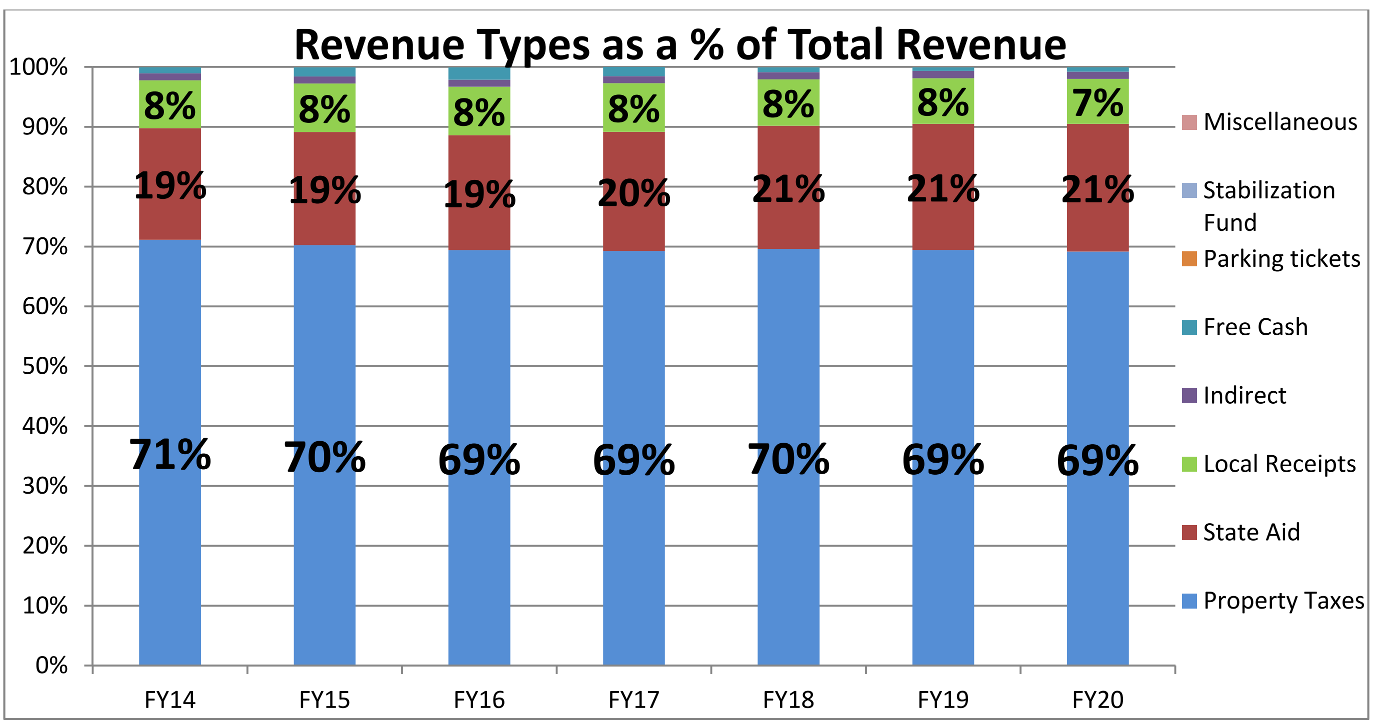
1. Moderate the tax bill – the goals is to keep the average single family property tax bill increase under $100 for each of the next three years: FY15-FY17
2. Balance the shares of tax burden at 60% residential and 40% commercial – this keeps the amount of total taxes paid by one class from swinging wildly to the other class.
3. Hit our highest spending priorities – school rebuilding, public safety, etc
4. Prepare for a large capital project – a new school – by creating capital reserves
5. Make this plan sustainable – these goals will last three years as we prepare for a debt exclusion to build the new school

The results of this forecast indicate that our goal FY16 is certainly achievable. FY17 presents more of a challenge.

Long Range Revenue Forecast

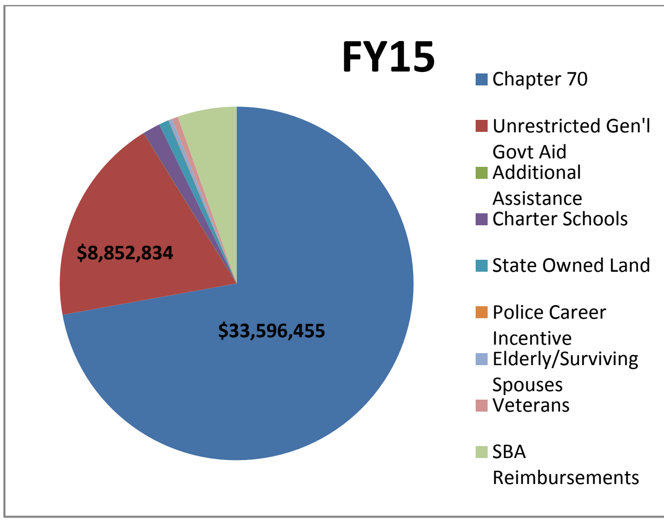
	FY15 Budget	FY16 Forecast	FY17 Forecast	FY18 Forecast	FY19 Forecast	FY20 Forecast
Revenue						
Property Taxes	$172,968,799	$176,167,340	$179,499,140	$185,195,407	$191,106,608	$197,229,655
State Aid	$46,555,679	$48,725,405	$51,555,661	$54,664,572	$57,982,807	$60,926,835
Local Receipts	$19,962,471	$20,522,980	$21,028,797	$20,624,434	$20,982,669	$21,381,352
Enterprise Indirect Trnsfr	$2,888,490	$2,975,145	$3,064,399	$3,186,975	$3,314,454	$3,447,033
Free Cash	$3,837,446	$5,350,933	$3,972,676	$2,249,036	$1,771,409	$2,173,763
Miscellaneous	$65,000	$65,000	$65,000	$65,000	$65,000	$65,000
Total Revenue	$246,277,886	$253,806,803	$259,185,674	$265,985,425	$275,222,948	$285,223,638
Revenue Growth Rate	*3.1%*	***3.1%***	*2.1%*	*2.6%*	*3.5%*	*3.6%*

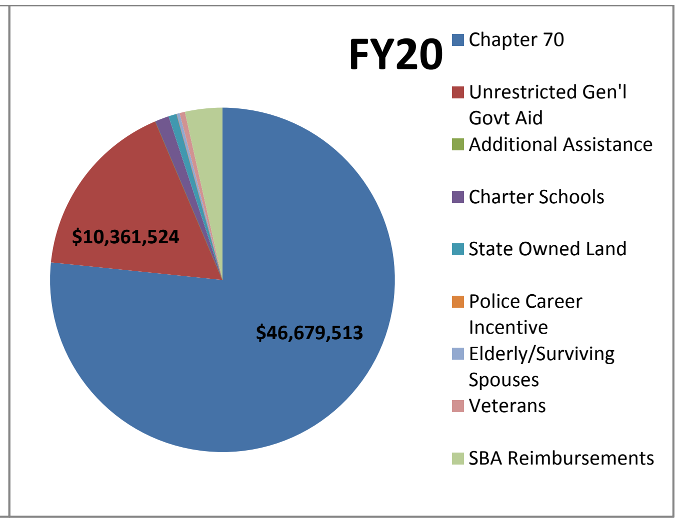
As displayed in the chart above, total revenue is expected to increase between 2.1% (in FY17) and 3.6% (in FY20). The major revenue sources are property taxes, state aid and local receipts (a number of locally generated revenues). Additional revenue comes from overhead charges assessed to the Water and Sewer Enterprise Funds (called Enterprise Indirect); free cash; and parking and consumer protection fees. Historically, property taxes have provided more than 75% of revenue with state aid providing 15% and local revenues at 9%. That began to change in FY07 with an effort to re-align the Chapter 70 formula to take local wealth into consideration. This provided a substantial increase for Framingham, which was the most aggrieved by the original formula. Although that realignment is far from finished seven years later, it has made a favorable impact on the share of property taxes. Local receipts have dropped slightly due to the decline in certain state payments and the decline in local excise taxes and investment income. Excise taxes are rebounding and we have adopted the small meals tax.



For the first two years of the forecast, FY16 and 17, tax revenue is built on 1.25% annual property tax levy growth followed by three years of a 2.5% annual tax levy increase. New tax revenue from new property development is estimated at $1.04 million in FY16 and grows to $1.3 million in FY20. There are a number of major development, expansion and redevelopment projects in process during the term of this forecast, both commercial and residential. This amount gets included in the base of the tax levy each year and becomes part of the growth rate (up to 2.5% per year). Total tax revenue is expected to grow by less than 2% in FY16 and FY17, due to the lower levy increase. Total tax revenue increases by 3.2% each year after that; the effect of the 2.5% base levy increase plus new growth revenue.

State aid increases between 4.7% and 6% per year. The primary components of state aid are Chapter 70 Aid and Unrestricted General Government Aid. As seen in the pie charts below, Chapter 70 aid is the predominant state aid source, representing more than 72% of state aid. Yet at $33.6 million it funds less than 31% of the school General Fund appropriation. By FY20, it is expected to fund 34% of the school GF appropriation, assuming it grows at 7% per year.





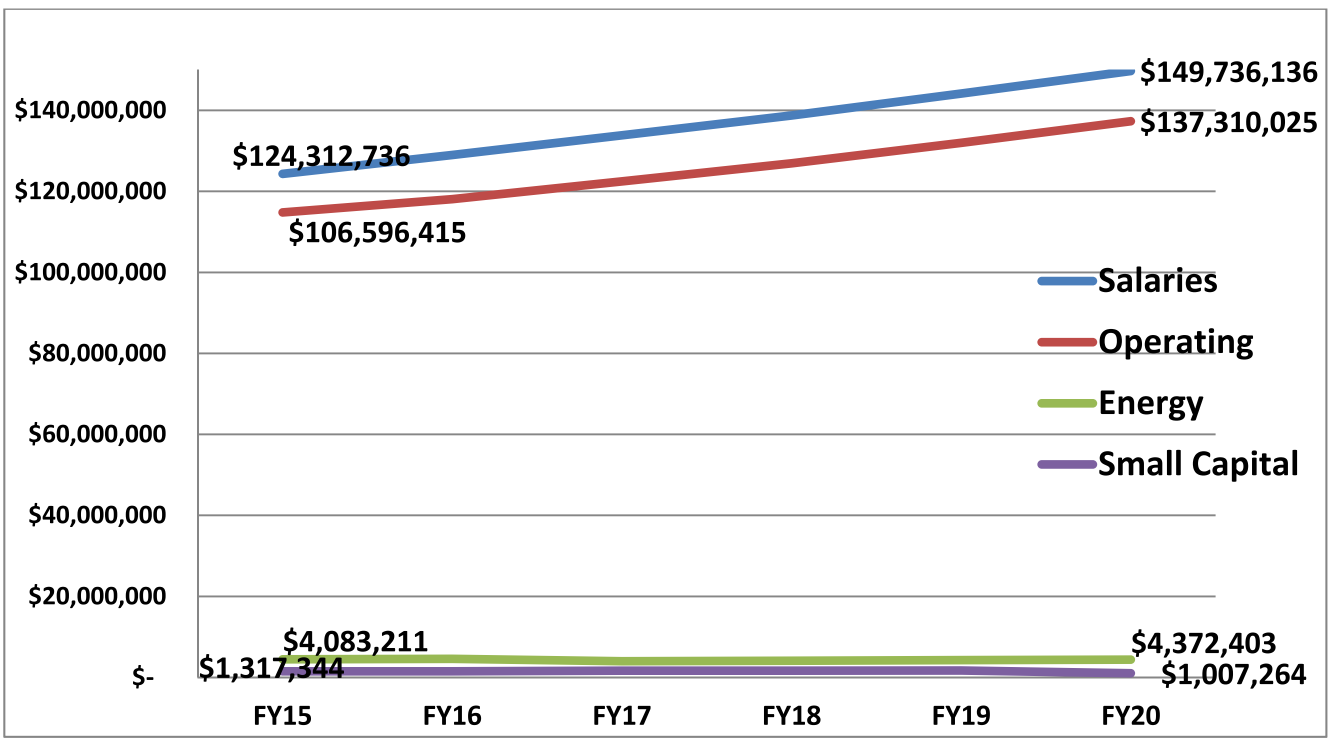
Local revenue, also called local receipts, changes at a pace between a decline of 1.9% to growth of 2.8%. The decline, in FY18, is the loss of the Farley school rental income. The major components of local receipts are excise and meals taxes, permits and licenses, and penalties and interest. Excise and meals taxes combined are expected to grow between 1% and 1.8% from the larger FY15 base. Excise needs a very active auto market to maintain level taxes. The tax base value declines automatically and the tax rate does not change, therefore a lot of new cars need to be purchased to keep the base value the same. Building permits is the second most active local revenue; growth is projected between 2% and 5.3%. There are a number of major building projects in Town- the timing of when they pull permits may adjust this revenue stream, but a number of these projects should be active in FY16 and FY17.

Smaller revenue sources include Enterprise Indirect charges which is the overhead assessed to the Enterprise funds for General Fund expenses. The total revenue ranges from $2.97 million to $3.4 million-growing at 3-4% per year. Free cash is used to fund reserves such as the Stabilization Fund, Capital Stabilization fund and OPEB Trust. In FY16 and FY17 is it used specifically to keep the levy growth to 1.25% per year. The amount used in the budget ranges from $1.77 million to $5.3 million. Please see a more detailed discussion on free cash in the Free Cash Section further along in this report.

Long Range Expenditure Forecast

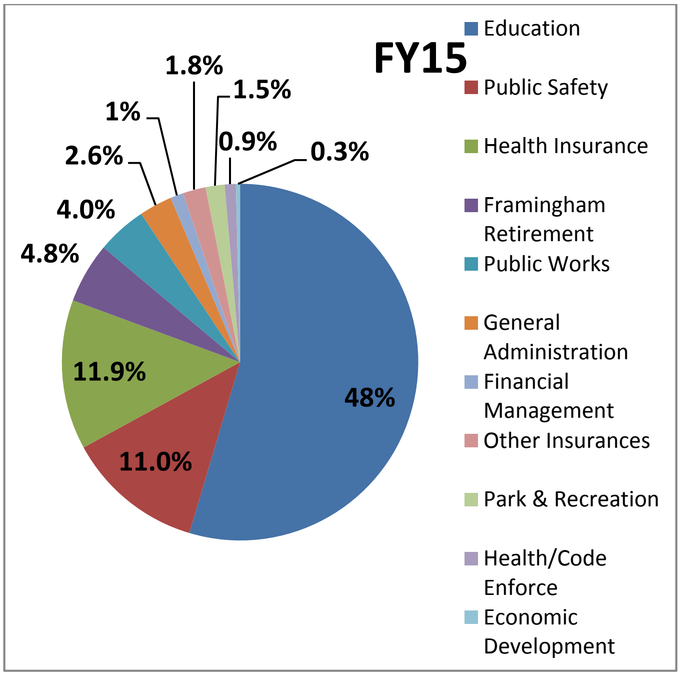
Expenditures	FY15 Budget	FY16 Forecast	FY17 Forecast	FY18 Forecast	FY19 Forecast	FY20 Forecast
Municipal Departments	$57,365,944	$58,792,673	$60,827,845	$62,615,114	$64,974,322	$66,879,622
Framingham School District	$109,453,801	$114,931,953	$119,529,231	$124,310,400	$129,282,816	$134,454,129
Keefe Technical Assessmnt	$8,638,850	$8,941,210	$9,209,446	$9,531,777	$9,865,389	$10,210,678
Group Health Insurance	$29,364,256	$29,751,864	$30,346,901	$31,409,043	$32,633,996	$33,939,356
Other Insurances	$4,576,612	$4,691,900	$4,904,990	$5,149,369	$5,413,058	$5,697,805
Retirement	$11,845,247	$12,371,471	$12,989,500	$13,637,840	$14,250,921	$14,399,077
OPEB Trust	$913,678	$659,900	$428,935	$546,574	$473,630	$740,630
Debt Service	$12,074,669	$13,061,678	$13,835,112	$14,276,448	$14,488,995	$14,551,879
Stabilization/Reserves	$3,349,383	$1,516,649	$1,470,412	$1,629,133	$1,425,559	$1,760,912
Miscellaneous	$150,000	$0	$0	$0	$0	$0
Non Appropriations	$8,185,443	$9,087,730	$9,501,448	$9,127,035	$9,544,138	$9,980,073
Total Expenditures	$245,917,884	$253,807,027	$263,043,820	$272,232,733	$282,352,824	$292,614,160
Expenditure Growth Rate		***3.2%***	*3.6%*	*3.5%*	*3.7%*	*3.6%*

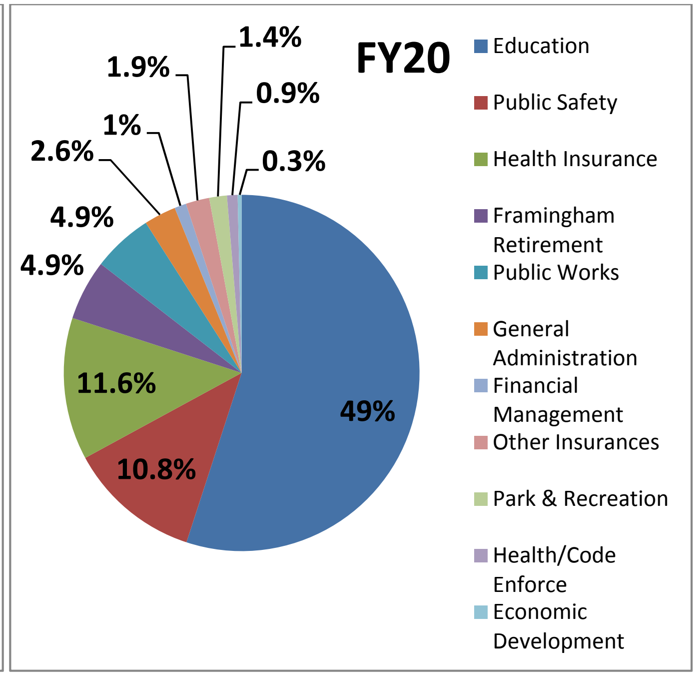
Total spending growth is pretty consistent year over year as seen in the chart above. However, some costs grow at a rate higher than others. Salaries are projected generally between 3% and 4% depending upon the department, existing salary schedules and seniority of employees. Operating costs increase by 1-5% per year, although School SPED costs, a subset of School operating costs, are factored up by 8%. Energy costs increase by 3% per year and small capital costs are zero based, or built from the ground up. The chart below shows how spending increases by cost type.



Total salaries represent 51% of the budget, while operating costs are 47%. Energy costs make up 2% and small capital the remaining fraction of a percent. These ratios stay consistent throughout the forecast.

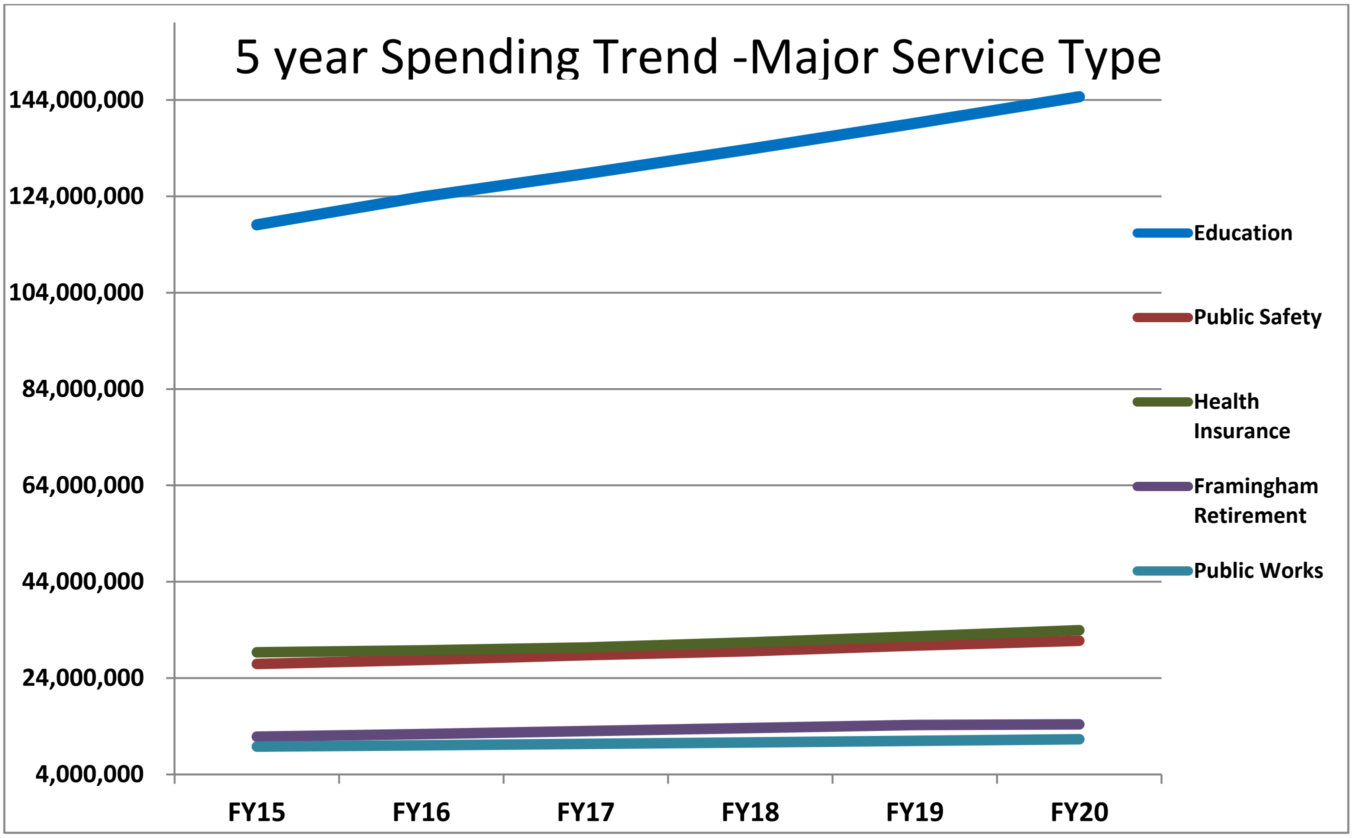
Another view of spending is by type of service provided. The two pie charts below show the shares of the budget spent on education, public safety, health insurance, retirement and other services. The first pie is the FY15 base year and the second is the last year of the forecast FY20. You can see the changing shares listed in the pieces of the pie.



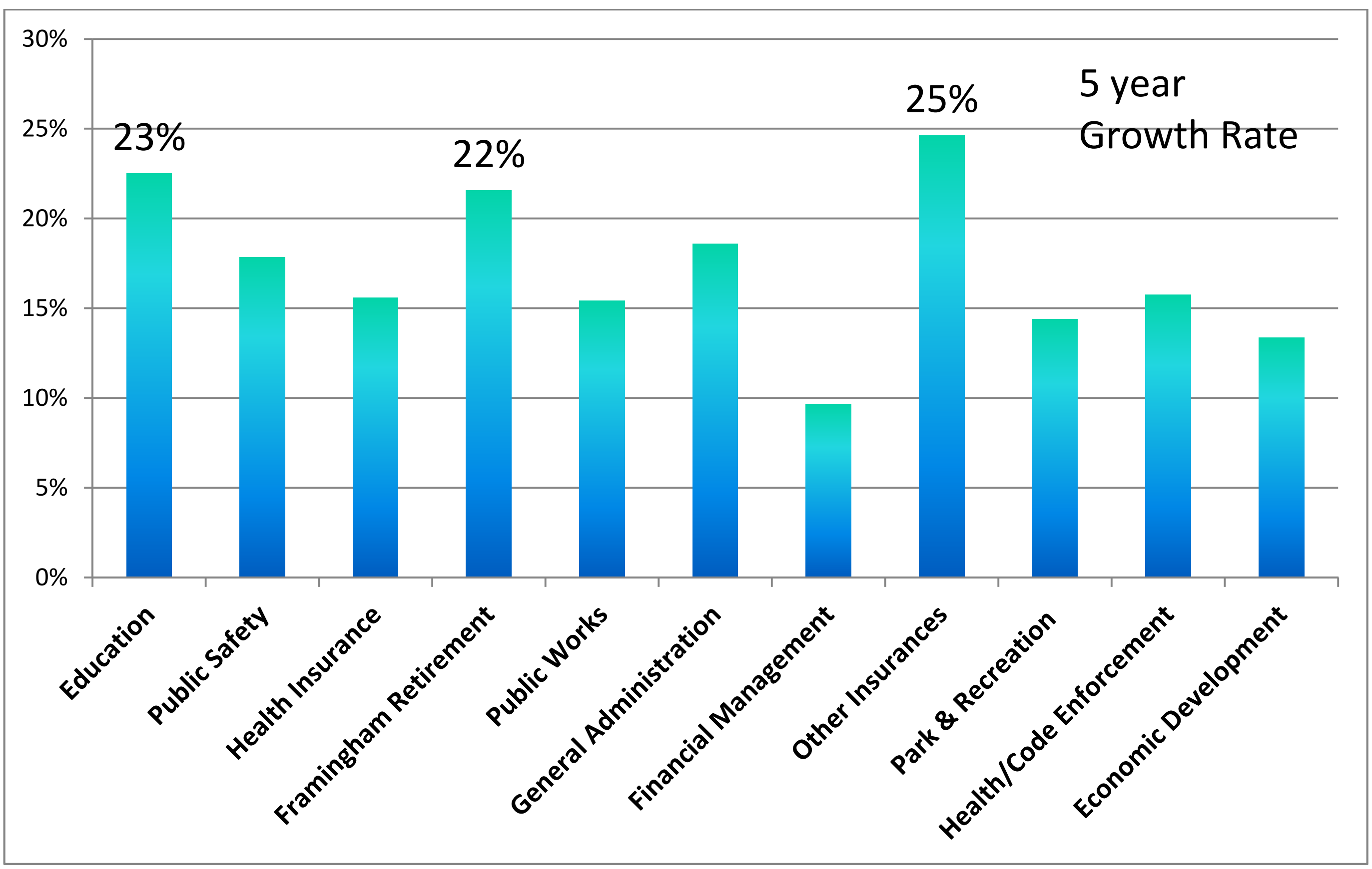


These percentages are based on the general fund appropriation only. They do not represent a full cost allocation of the service. For example, health insurance and retirement costs are not included in the departmental costs but are listed as a separate service type. Education includes the salary, operating, energy and building maintenance costs of the Framingham School district and the Keefe Technical Assessment only. Public Safety includes the Police Department, Fire Department, Emergency Management and Animal Control Department. Public Works is DPW Administration, Engineering, Conservation, Highway and Sanitation Departments. General Administration is the Town Managers office, Human Resources, Facilities Management, Veterans Services, Town Clerk and Elections Department. Other Insurances include liability insurance, unemployment, workers compensation, and Medicare tax. Park and Recreation includes the Park and Rec Department, Loring Arena, Council on Aging and Cemeteries. Financial Management is the Accounting and Assessing Departments, the Treasurer/Collector, Purchasing and CFO's Office. Health/Code Enforcement is the Board of Health and Building Inspections. Economic Development is the Community and Economic Development Department, the Zoning Board and the Planning Board.

Looking at the largest service types, there are multiple growth trends. Not all services increase at the same rate. The line graph below displays the different trends of major services.



The services with the greatest spending growth are Other Insurances at 25%, Education at 23% and Retirement at 23%. The bar graph below lists all the service types.



Building Reserves

In the last several years the Town of Framingham has focused on adequately funding its Stabilization Fund. The Town policy is to have a balance equal to 5% of the total annual budget in this fund. Through a disciplined use of locally approved meals taxes and the allocation of a significant amount of free cash, that goal was achieved in FY14. Moving forward this forecast assumes contributing free cash to the Stabilization Fund at a rate that maintains the 5% policy goal. This ranges from $200,000 to $500,000 per year as opposed to the $1.2 million we have added in the previous budgets.

With the impending need for a new school, it makes sense to reserve funds to help offset that new, significant investment. This is done by creating a Capital Stabilization Fund, which is part of the FY15 operating budget that was approved last May and is finalized in Article 6 of the fall Town Meeting warrant. The initial allocation is $2,284,194. In FY16 and FY17 a combined $1.6 million will be added, with another $1.9 million through FY20. These amounts are allocations of free cash, so they are dependent on limited free cash use for other spending or simply as general fund revenue (see below). By the time we need to appropriate funds for a new school project there should be more than $4.5 million in the Capital Stabilization Fund. This can be used to reduce the amount needed to borrow and reduce the amount of a debt exclusion request to voters.

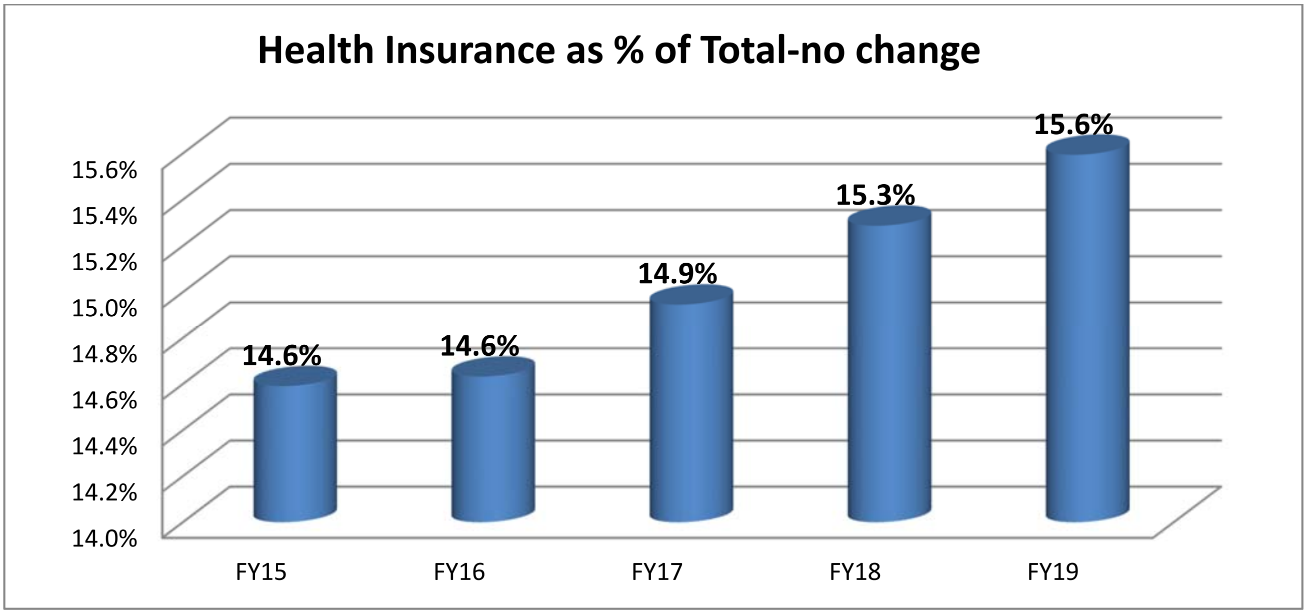
Another, less noticeable reserve is the excess tax levy capacity that is built up over our three year budget plan. The tax levy is allowed to increase 2.5% each year. If we tax to 1.25%, it doesn't mean the remaining 1.25% is eliminated. In the next year we could access that extra 1.25% and raise the levy 3.75% and still be within the levy limit. However, neither the three year budget plan, nor this forecast builds the unused levy into the tax base. The FY16 levy increase of 1.25% is built upon the 1.25% increase of FY15. At the end of the three year budget plan we expect to have unused levy capacity of more than 5%. Again, this is not built in to the FY18-FY20 tax base either.

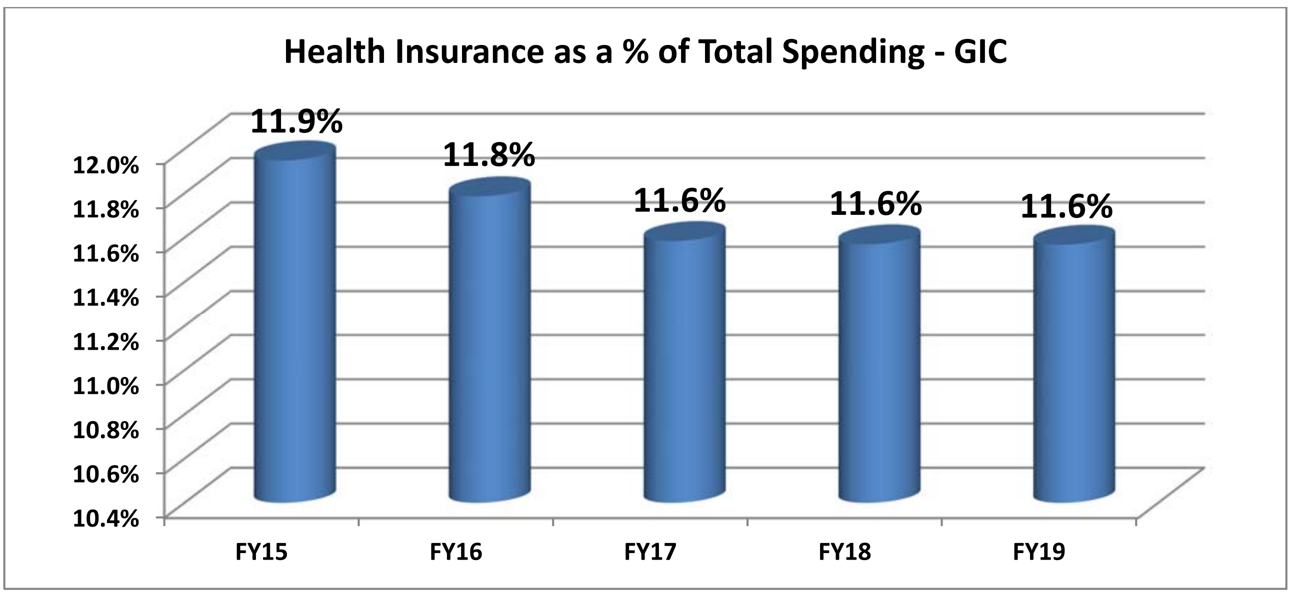
Using Free Cash

Free cash is neither free nor cash. It is the ending balance of the General Fund after all the revenues and expenses are finalized and any pending obligations or account shortfalls are deducted. Our free cash policy allows the prior year certified free cash to be used for certain purposes in the subsequent budget. For example the FY13 certified free cash may be used in the FY15 budget. Current policy still allows a small portion of free cash as general revenue, with a percentage of the net amount going to the Stabilization Fund, use in the capital budget and 40% remaining in general fund balance. However the priorities have changed in that we do not need large amounts to keep the Stabilization Fund at the 5% target. Credit rating changes are forcing attention on funding and a funding plan for the OPEB unfunded liability (see more on that below). We also need money to fund the school project. The use of the current percentage allocations when we have a large free cash amount overfunds some items and doesn't fund others. So we have rewritten the free cash policy to allocate a declining amount for general revenue, using $100,000 in FY20 and none in FY21 forward. We have reduced the amount to "an amount that will maintain the 5% policy amount". Specific amounts are listed for FY16 and FY17, and an allocation of no less than 15% of the certified free cash amount in future years. An allocation to the OPEB Trust is codified in the new policy, defining a future funding stream of no less than 15% of certified free cash. Finally, unchanged from the previous policy, 40% of free cash remains in General fund balance. The point of changing this policy is to be prudent in our use of free cash, which is an unpredictable revenue source over the long term. Certified free cash has ranges from a low of $1.2 million at the end of FY10 to a high of $11.7 million at the end of FY14. The FY16 and FY17 budget plans call for the use of a large amount of free cash to keep the levy limit at the 1.25% goal; and to fund the OPEB and Capital Stabilization Funds. Free cash also funds the tax burden stabilization reserve that manages the levy and balances the share of the tax levy borne by residential and commercial tax bases. And it is the prudent use of free cash in FY15 and FY16 that helped fund the rebuilding program for the Framingham School district. Since free cash is a non-recurring revenue, in that the amount is not predictable over time, it is not good financial policy to use it for recurring costs.

Health Insurance Changes and Savings

The Town of Framingham adopted section 19 of MGL Chapter 32 back in 1993 as a cost saving measure. This law pulls health insurance out of the collective bargaining process for wages and centralizes it into its own bargaining process with the combined union membership (called the Public Employee Committee or PEC). The State legislature amended Chapter 32 to speed up the bargaining process and to provide some bargaining leverage for management. If you can bargain for significant savings and stay locally funded then you have that opportunity. However, if your savings from a move to the state Group Insurance Commission (GIC) is more significant, then a municipality may join the GIC. The recently signed agreement transferred the Town's health plans to the GIC effective July 1, 2014. This presented savings of $17 million over a three year period. The savings are achieved from a first year drop in health insurance costs of almost $6 million from FY14 spending with smaller increase from the lower base. The original savings estimate assumed a 5% increase in premiums over the term of the contract. Year one increased only 2-3%, depending on the plan, with the most popular plan actually decreasing in year. Growth in FY16 is estimated at 2%. Growth in FY17 is 3%. FY18- FY20 assumes 4% growth, although at that point the current contract is expired. The two bar graphs below illustrate a common health insurance benchmark: health insurance cost as a percent of the total budget. The Town is aiming to reduce this ratio to 12% or less. If we had not changed our health plans the share would have increased over time to 15.6%. The move to the GIC has achieved the target range.





Unfunded Liabilities

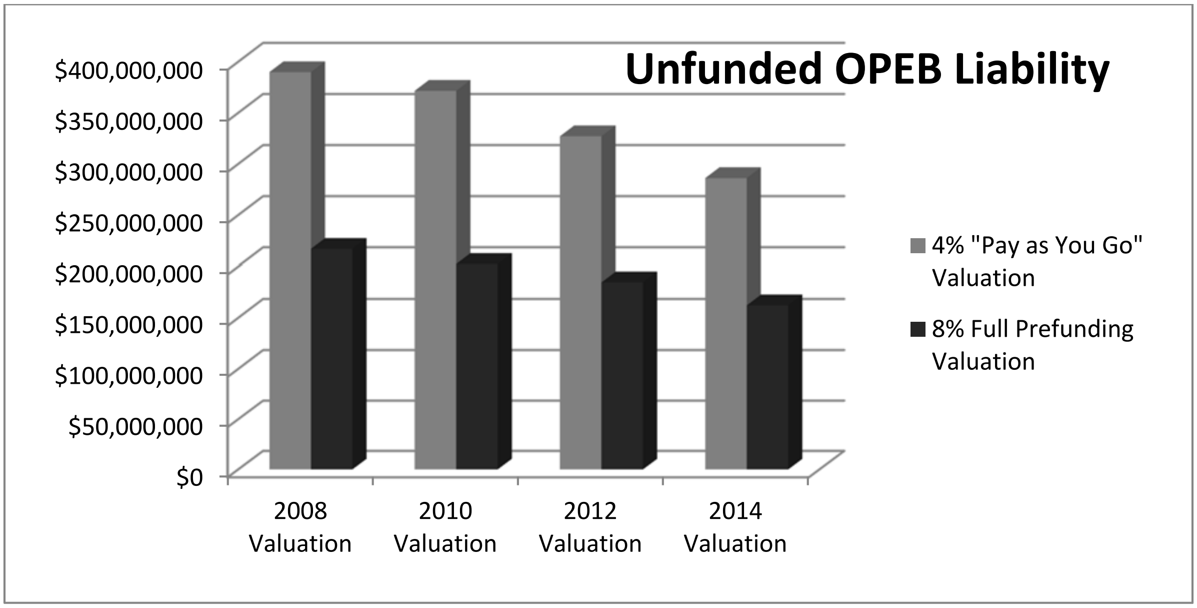
Framingham has two recorded unfunded liabilities: the pension fund and other post-employment benefits. The Framingham Retirement Trust Fund provides retirement monies to pay for the pensions for three member entities: the Town of Framingham (municipal employees and school non-teaching employees); the Framingham Housing Authority, and the MWRTA. Each member contributes the employer share to fund the defined benefit pension amounts for retirees. The member entities also contribute an amount to pay for the unfunded liability (the future cost of pensions) that was generated by years of not adding the full amount to pay for future pensions. Since 1988, Massachusetts has required retirement systems to determine its unfunded liability and to contribute annually to the reduction of that liability within a 30 year period. Not all states require this, and as most of you have read, most municipalities across the nation do NOT pay anything toward its unfunded pension liability. Framingham's unfunded pension liability is $101 million; of which $96.5 million is attributable to the Town (the remainder is the obligation of the Framingham Housing Authority and the MWRTA). The current funded ratio is 67.3% (as of January 2012- a new valuation will be done at the end of 2014) and we have a funding schedule that will bring us to full funding by 2030. Since 1986, the Framingham Retirement Fund has been invested with the State Pension fund, known as PRIT. The funding schedule we use assumes a rate of return of 8%. As of 2013, the 29 year rate of return is 9.55%. The average pension is $22,200.

The pension appropriations used for this forecast are based on the approved funding schedule and range from $12.3 million to $14.3 million.

OPEB (Other Post Employment Benefits) is the value of future non-pension benefit costs for retirees. In the case of Framingham, this means health and dental insurance. This includes all retired Framingham employees, regardless of which system they retire from. Municipal and non-teaching school employees retire via the Framingham Retirement System. Teachers employed by the Framingham School District retire via the state based MA Teachers Retirement System (MTRS). The state provides funding for the MTRS Trust Fund; the Town does not contribute dollars to that fund. However, the Town is responsible for funding the non-pension, or health insurance coverage benefit, for all Framingham School teacher retirees.

Health insurance coverage is bargaining collectively with a combined committee of union representatives called the Public Employee Committee (PEC). The health insurance agreements that result from bargaining with this committee directly affect the OPEB valuation. As we reduce the employer cost of health insurance cost for employees we also reduce the cost of the total OPEB liability, and by default the unfunded liability. Over the last seven years of negotiations with the PEC, plan designs have been changed, the Town has adopted moving eligible retirees to Medicare, and employees' contribution rates have increased. In July 2014, the health insurance coverage was moved to the state run Group Insurance Commission (GIC). All of these changes do two things (1) reduce the overall cost of health insurance and (2) reduce the employer share by shifting an increasing portion of the cost to users (employees). The changes in health insurance do not affect the OPEB valuation dollar for dollar, in some cases it's actually a geometric effect. The movement of retirees to Medicare reduced the liability by 3% because the majority of the health care cost was shifted to the federal government from the employer. Reducing the overall OPEB liability and contributing to the OPEB Trust is a two prong approach that will ultimately reduce the amount we need to fund on an annual basis once municipalities are mandated to fully fund the liability.

In 2012, the Town created an OPEB Trust Fund and deposited $1.5 million to the fund. In FY14 $700,565 from Free Cash was allocated. The actuarial value of the account as of July 1, 2014 is $2,516,635; a gain of $316,000 on the $2.2 million deposited over the last two years. In FY15 $913,678 will be transferred to the OPEB Trust after the fall Town Meeting bringing the balance to over $3.4 million. Allocations from free cash continue each year ranging from $428,935 to $740,630. The 2014 valuation was just completed indicating a reduction in the OPEB liability as a result of the transfer to the Group Insurance Commission. The charts below illustrate the progress made to reduce the OPEB liability.



	2008 Valuation	2010 Valuation	2012 Valuation	2014 Valuation
4% "Pay as You Go" Valuation	$389,842,640	$371,529,899	$327,066,655	$286,128,910
8% Full Prefunding Valuation	$216,902,994	$202,192,506	$184,614,666	$162,163,855

Estimated Impact on Taxes

Proposition 2 ½ limits the amount a municipality can increase the overall, annual property tax charges (the levy) to 2.5%. For example, the total levy for FY17 is $179,499,140 – a 2.5% increase would bring the FY18 base levy to $183,986,431. This raises $4,487,479 in additional base taxes. New taxes from new development would be added to that base. That is the maximum amount you can raise. So if property values increase the tax rate decreases to raise the $4,487,479. If property values decrease the tax rate increases to raise $4,487,479. We cannot increase the total tax amount any more than the 2.5% value. We can certainly raise less. We are not required to increase the levy by 2.5%, and in FY15-FY17 we propose to raise the levy by half of the maximum amount each year.

The three year budget plan has a specific focus to moderate the levy **and** the single family tax bill. The goal is to keep the annual tax increase for the average home to less than $100. This can be accomplished as planned in FY16 and with some challenges in FY17. These tax estimates assume limited change in the ratio between residential and commercial value in FY16 and FY17. There is no specific estimate on the average residential impact beyond FY17, as trying to forecast property values that far in advance would not be accurate.