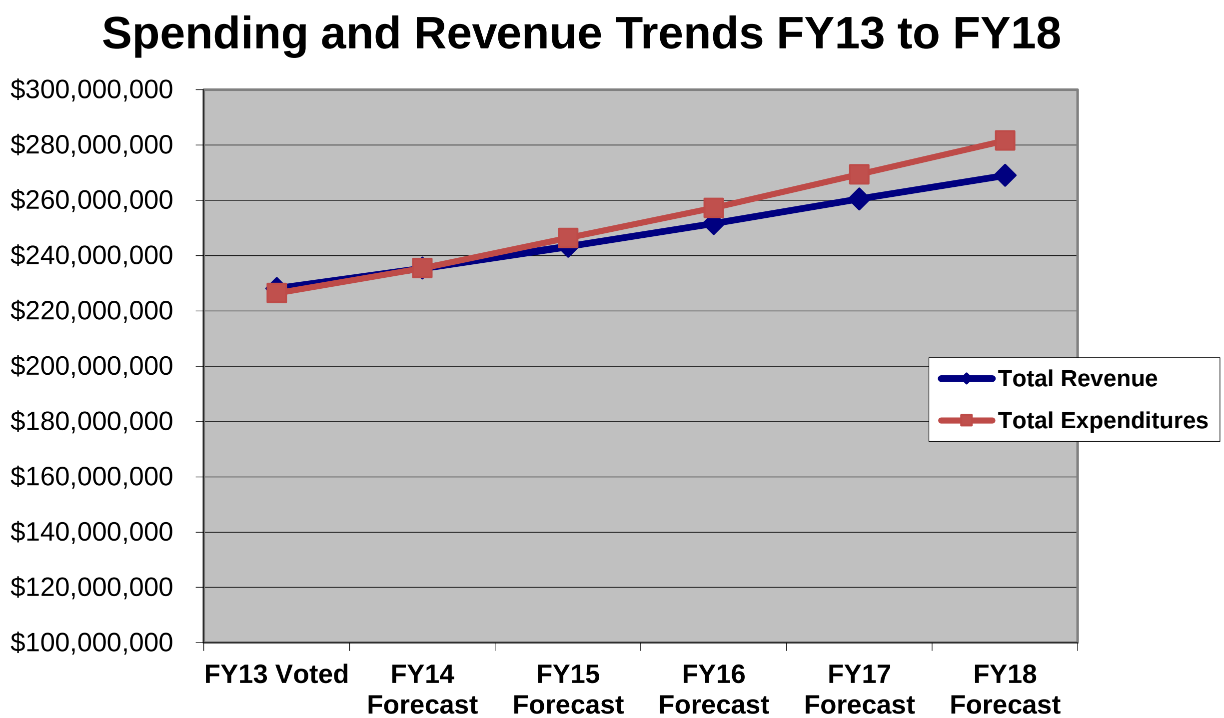
Town of Framingham

Long Range Financial Forecast

FY2014 to FY2018



Fall Special Town Meeting

October 16, 2012

Robert J. Halpin, Town Manager

Mary Ellen Kelley, Chief Financial Officer

Executive Summary

"The goal of forecasting is not to predict the future but to tell what you need to know to take meaningful action in the present."[1]

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[1]Saffo, P. (2007). Six Rules for Effective Forecasting. *Harvard Business Review*, 1-10.

The purpose of a Long Range Forecast is to provide Administrators, Committees, Town Meeting, and Taxpayers with important data regarding the finances of the Town. This forecast includes the General Fund which is funded by property taxes, state aid, local taxes, revenues from departments and other revenue. The expenditures included are all Town department operations (including education) and all fixed costs (insurances, retirement, debt service and state assessments). The forecast is a tool to aid in making decisions for future investment in operations, programs, services and infrastructure. It is not the budget; it is information to help make budget choices.

The Long Range Forecast (LRF) assumes growth of existing programs and services and existing revenues. There is no expansion of programs or services from the FY13 base, simply normal rates of growth. Revenues assume no new revenue sources or types; the only "new" revenue is new growth in property taxes due to new development. The new growth estimate is based on an overall level of development/redevelopment happening in Town. Revenues assume no increase in any particular fee.

For FY15 to FY18, there are still deficits. This forecast assumes a gradual reduction of the allocation of free cash to the operating budget. The substantial increase in education aid that occurred in FY13 is not expected to be repeated during this forecast. Significant changes to employee health insurance coverage effective March 1, 2012 have reduced that FY13 and FY14 cost. However, the annual rate of increase still outpaces the growth in revenue. Debt service is forecast based on the Town's long term Capital Budget. This assumes that all of the capital projects requested are approved; the reduction of capital authorizations has been a source of budget reduction that has often closed the operating budget gap from year to year.

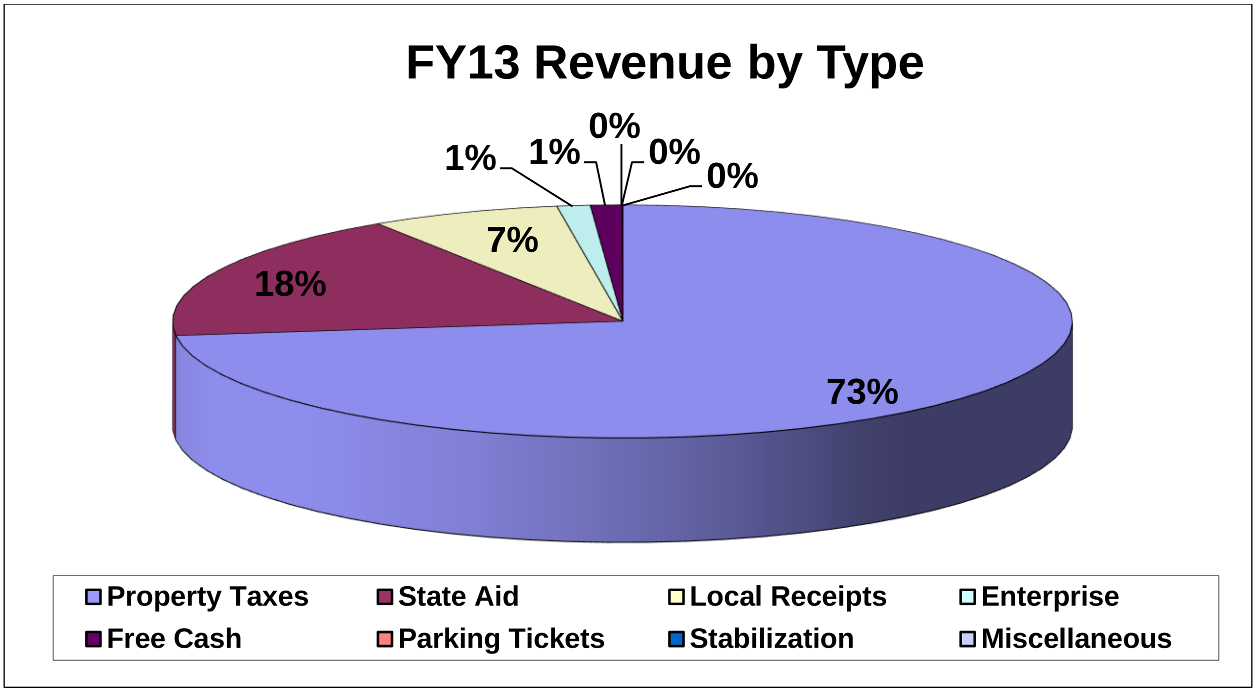
The Town's pension fund contribution must increase at a 5% annual rate to be fully funded by 2030. There is also the OPEB future benefits liability, which will require annual appropriations in the near term. Recent changes to the costs that fuel this liability should reduce the total unfunded liability. This forecast allocates funds from free cash to the OPEB trust fund.

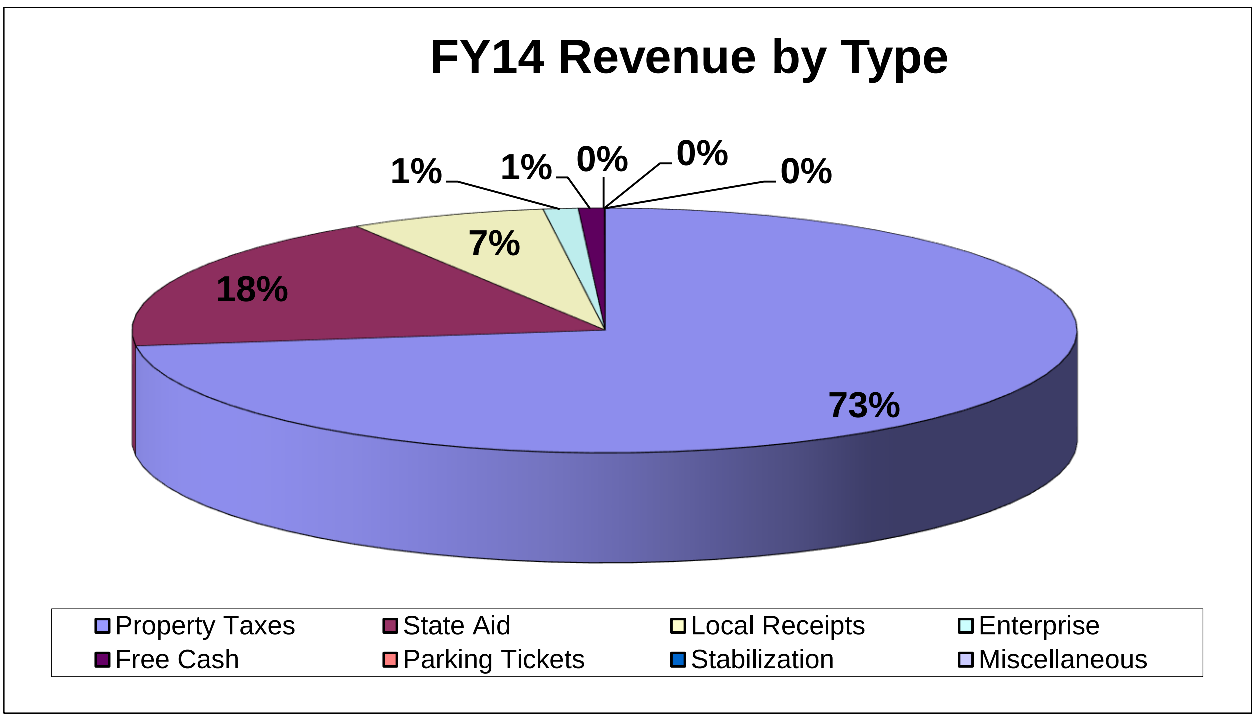
In addition to our known obligations, both funded and unfunded, the Town has an obligation to invest in its services. There are unmet needs in education and public safety, facility maintenance and economic development that must also fit into the finances of the Town.

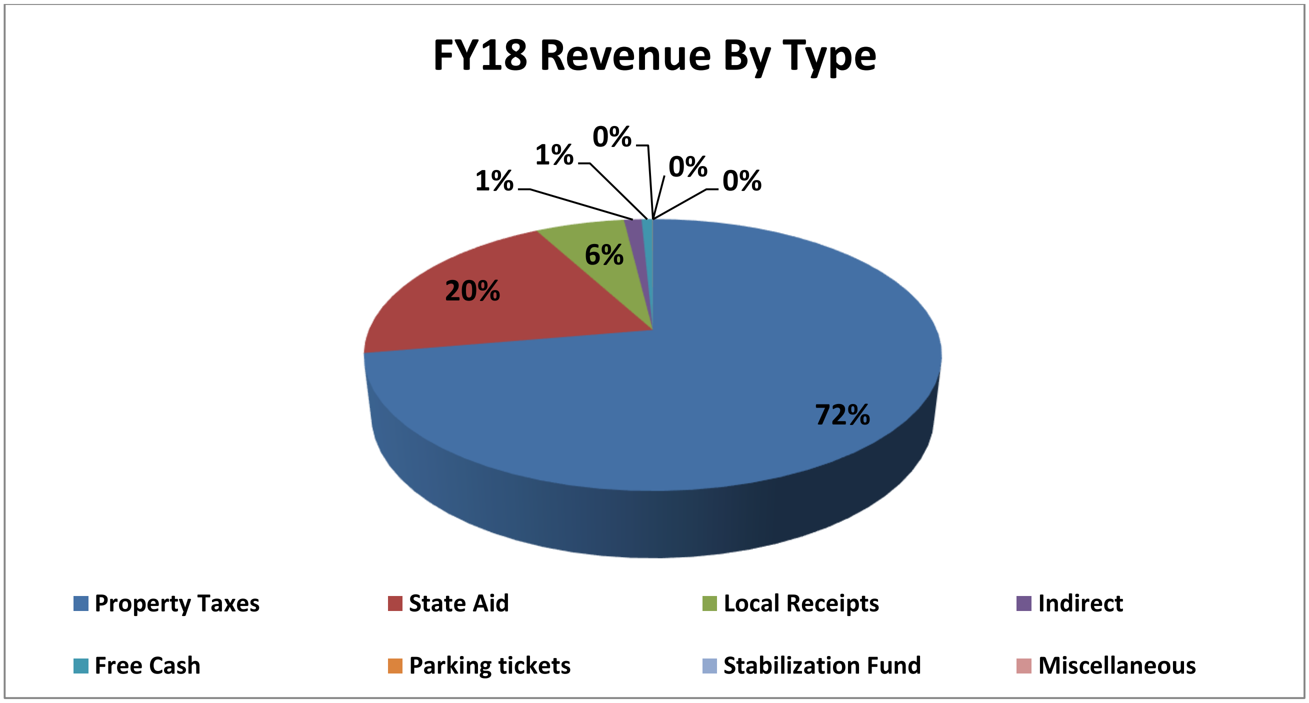
Future Revenue Projections: 2014 to 2018

A detailed table of the revenue forecast is included on Chart 2, page 16. It lists each revenue source by major category, broken down into subcategories. Each subcategory has a rate of growth listed to the right of the individual source.

Global General Fund revenue is projected to increase in the 3% range for the term of this forecast. The increase is 3.2% in FY14 and as high as 3.5% in FY17. The components of revenue and its share of the total "pie" are presented in the following pie charts:


FY13 Revenue by Type
1%
1%
0%
0%
0%
7%
18%
73%
Property Taxes
State Aid
Local Receipts
Enterprise
Free Cash
Parking Tickets
Stabilization
Miscellaneous


FY14 Revenue by Type
1%
1%
0%
0%
0%
7%
18%
73%
Property Taxes
State Aid
Local Receipts
Enterprise
Free Cash
Parking Tickets
Stabilization
Miscellaneous



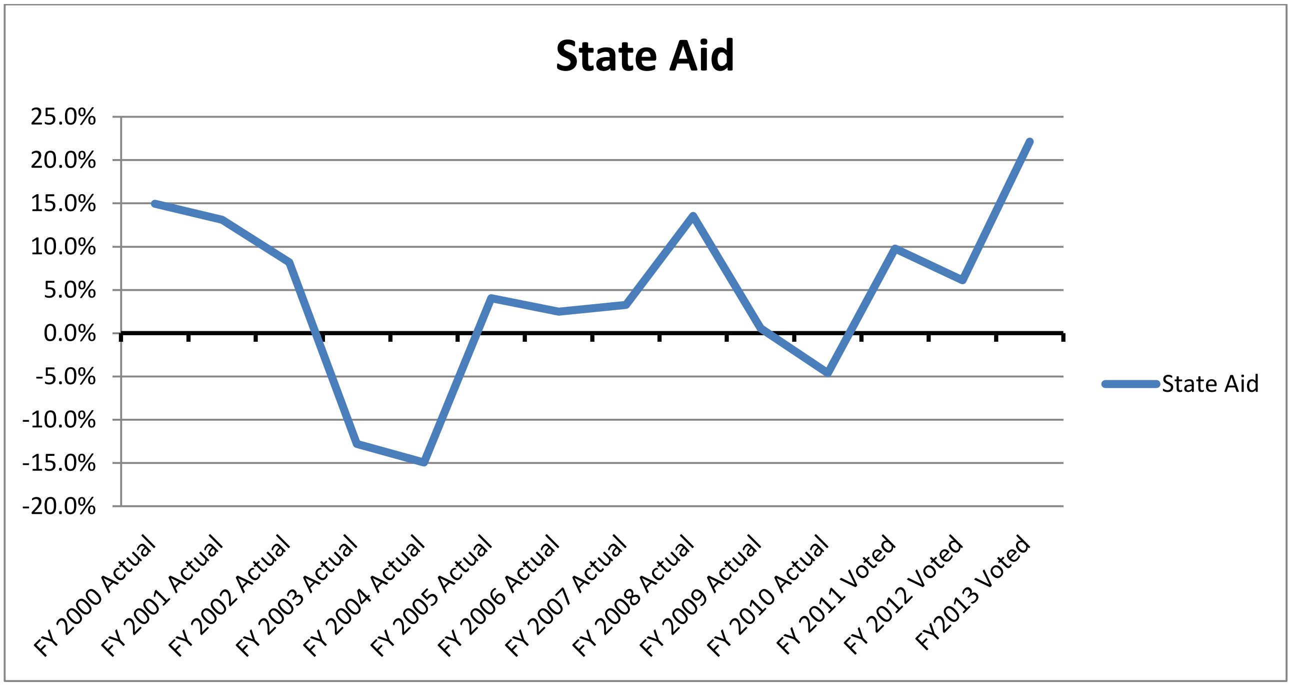
Property taxes

Property taxes are projected to increase by 2.5% per year as restricted by Proposition 2 1/2. The rule is that the total tax levy from the prior year is multiplied by 2.5% to get the maximum next year levy. The total levy of the prior year includes the base tax levy, plus the taxable amount of new growth in value. The 2.5% increase for FY14 is from the FY13 base which increased by only 1.5% from FY12. There remains a 1% difference between what is the maximum taxable levy and what the Town has actually built into the budget for taxes in FY13. That excess levy capacity from FY13 is NOT built into any other fiscal year. For the term of the forecast beyond FY14 the projected revenue assumes going to the maximum levy increase (2.5%) *every single year, and still we will have a deficit.* New growth, those taxes generated by new development, is added on top of the tax levy in its initial year and then folded into the base levy in subsequent years. For the next few years there appears to be growth only in Technology Park and redevelopment at the TJX property. Therefore, new growth is reduced for the beginning of this forecast, growing by 4% for the next two years. However, there is increased growth of 9% and 7% in FY16 and FY17 anticipating the completion of redevelopment at TJX and the decrease in that Tax Increment Financing (TIF) agreement in subsequent years.

There is no assumption of changes to telecommunication tax exemptions. The state has not closed the loophole for telecommunication equipment. If the loophole was closed, Framingham would gain $1.5 million in personal property taxes.

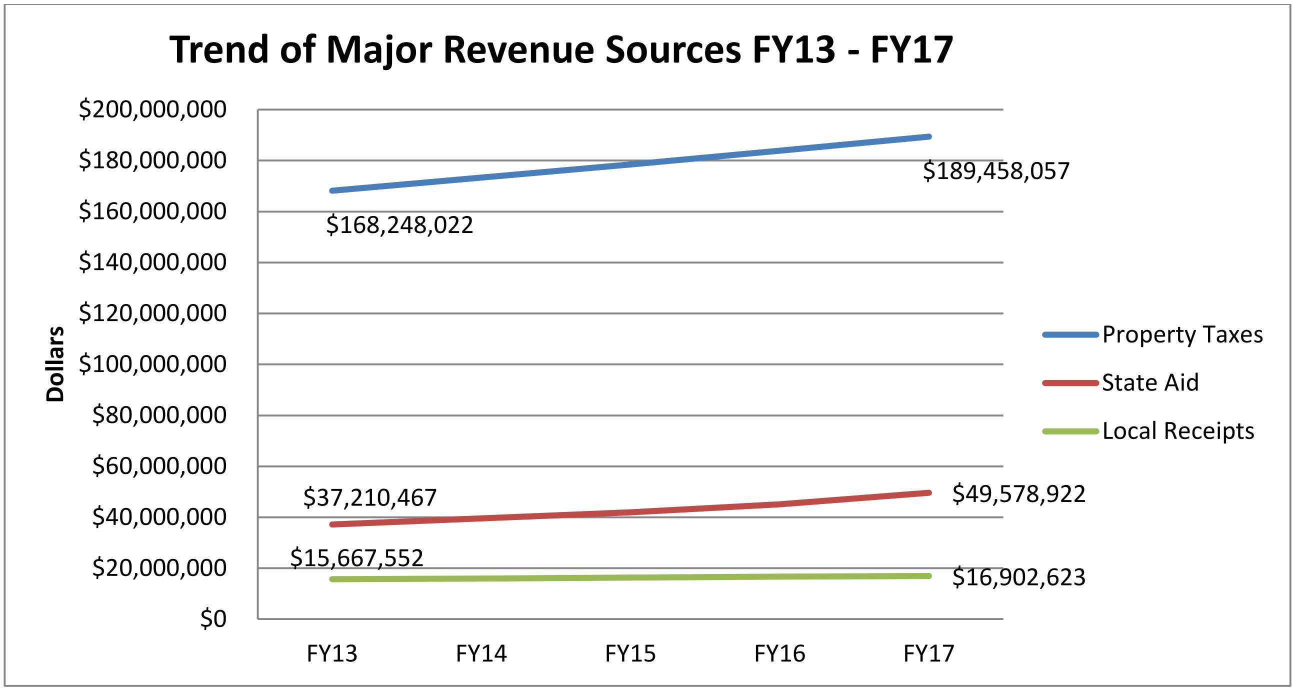
State Aid

State aid is the least predictable of the revenue sources. From FY11 to FY12 it increase just under $1.9 million; yet from FY12 to FY13 it increase $6.7 million. The amount of funding depends upon state revenue amounts and is distributed via complicated state formulas. It is also subject to political manipulation; reallocating funds to politically powerful cities and towns at the expense of less powerful ones. State Aid for Framingham consists of Chapter 70 Education Aid, the largest component; Unrestricted General Government Aid, Charter School Reimbursements, payments for loss of property tax for state owned land, and reimbursements for tax exemptions for Veterans, the elderly and surviving spouses of each. In Framingham, it also includes reimbursement of debt service by the School Building Authority in the amount of $2,510,995 for the next five years. The forecast assumes an increase in Chapter 70 aid ranging from 8% in FY14 to 7% in FY18. This is a lower rate of growth from the prior forecast primarily because the state legislature increased Chapter 70 aid by 21% in FY13 in an effort to rectify formula shortfalls more quickly. This means that future years will see smaller increases. As you can see from the graph below the health of the overall economy, which affects state revenue collections, also has an influence on the amount of state aid. General Government Aid increases by little over 1% in FY14-FY16 and 5% in FY17 and FY18. State owned land payments increase by 2% for the first three years of the forecast and 5% for the remaining. The remaining components of state aid stay level for the term of the forecast.



Local Receipts

Local receipts are fees, user charges, local taxes, rent, investment income and fines created and/or controlled by the municipality. The Town collects three taxes: motor vehicle excise, 6% room tax and .75% meals tax. The excise tax actually decreases over time. The room and meals tax will hold steady. Just .5% growth in this revenue type is projected for FY14 while growth in the subsequent years is 1%. User fees, penalties and fines and licenses and permits grow at 3%, 2% and 4% respectively. Investment income is projected to increase by 4% this year after a severe reduction last year. The remaining revenue sources within Local Receipts remain steady for FY13 and beyond with the exception of rentals and pilot. Over the course of the forecast total local receipts grow by a mere 1.7% in FY14 and *decreases* by 3.3% in FY18 due to the anticipated drop in rental and pilot revenue from Mass Bay Community College as the lease of the Farley School comes to an end.



Overhead Charges to Enterprise Funds

State regulation allows a municipality to charge other funds for the overhead costs to manage the programs and the finances of the specific fund. The charges must be proportional to the level of effort spent by staff and managers and the direct costs of overhead expenses. The Town created a computer model that calculates salaries, operating costs, insurances and legal costs that are dedicated to managing the water and sewer departments. This model is reviewed periodically for accuracy and the amounts adjusted for the annual increase in costs. The rate of growth for this forecast is 3%. The indirect charges provide $2.8 million in revenue to the General Fund in FY14 and grow to almost $3.2 million in FY18.

Free Cash

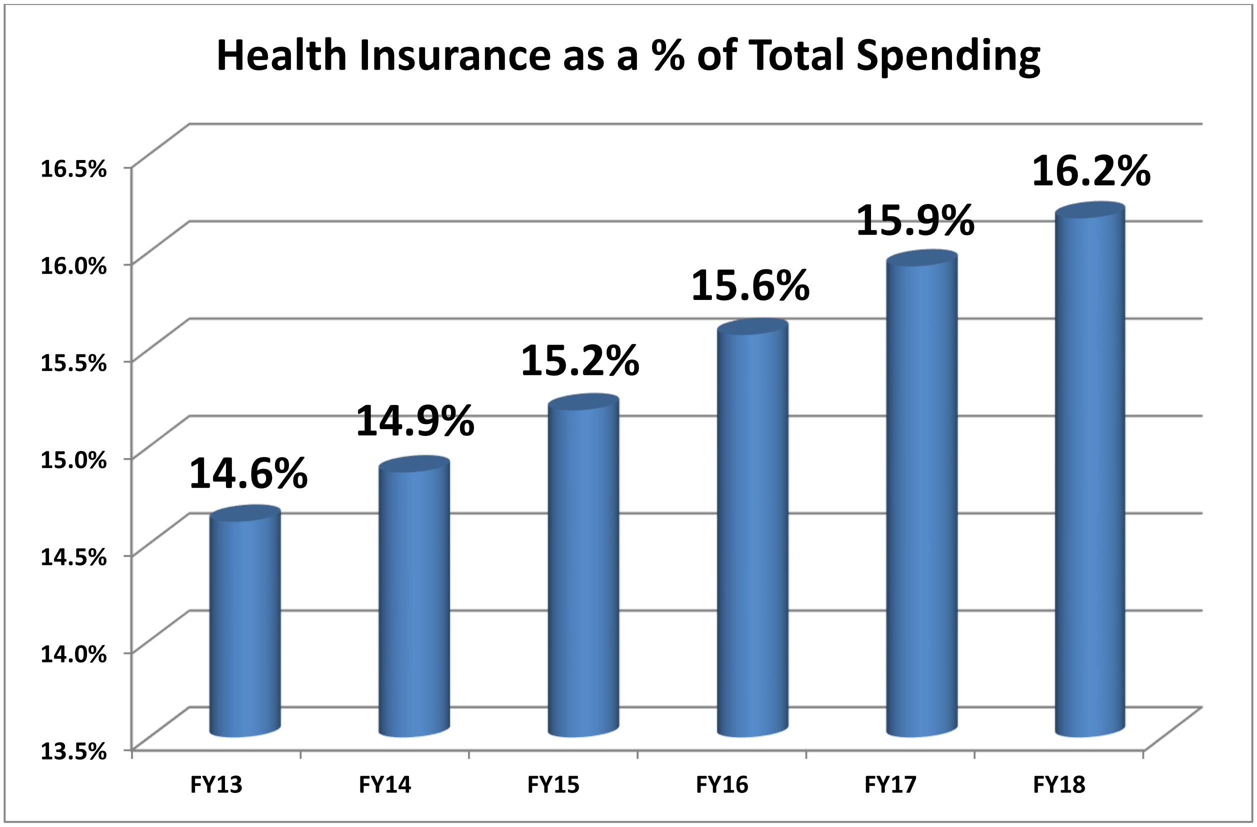
Free cash is the amount of money left over and unrestricted in the General Fund at the end of the fiscal year. The Town's policy for the use of free cash allows the use of up to $1.5 million for the operating budget in the next budget cycle (i.e. FY12 free cash is used in the FY14 budget). The remaining amount of free cash is then allocated to the Stabilization Fund (40%), capital projects (20%) and to remain in General Fund balance (40%). This does not necessarily mean there will be funds available for all of these allocations. *In FY09 there was only $1.2 million of free cash available, so no funds were allocated for the stabilization fund or capital projects or to remain in the fund balance, we used it all to fund the budget.* The most recent Moody's rating review stated that the Town's reliance on the use of free cash as a revenue source for the operating budget is a negative factor in its evaluation of the credit worthiness of the Town. In this forecast we begin the phase out of the use of free cash for general fund operations. The $1.5 million allocation is reduced by $200,000 per year, leaving $500,000 dedicated to the operating budget by FY18. The current policy allocates 20% to capital, 40% to the Stabilization Fund and 40% to remain in undesignated fund balance. This forecast recommends we allocate the funds toward the Capital Budget (20%), Stabilization Fund (25%) and OPEB Trust Fund (15%), with 40% remaining in undesignated fund balance. Total free cash is estimated at $2.6 million per year. This change is highlighted in the Revenue Detail chart, listed as Chart 2 on page 16.

Other Revenue

Miscellaneous revenue includes parking meter revenue and funds allocated from the consumer protection fund. These revenue sources total less than $100,000 per year and are estimated to be level for the term of the forecast.

Future Spending: 2014 to 2018

Expenditure growth is based on projecting the cost of ***existing services.*** *There are no added services or positions; this is the estimated future cost of the Town-wide services and operations we currently provide*. Basic assumptions for growth in spending are different depending upon the cost category and the specific cost. Overall total spending is projected to increase: 4% in FY14, 4.8% in FY15, 4.3% in FY16, 4.6% in FY17 and 4.4% in FY18. Since revenues are increasing in the low to mid 3% it is clear spending is outpacing revenue. In FY16 operating costs overtake salary costs as the biggest part of the expenditure budget. This is primarily due to fixed cost increases such as liability insurance, debt service, health insurance and special education tuition. The line graph on page 8 illustrates this point. The cost component with the greatest individual rate of growth is still health insurance. Health insurance is anticipated to increase a small percentage for FY13, carrying over savings from the last health insurance contract. Future growth in health insurance ranges from 7% to 8% per year. This assumes high claims experience for FY14 and reasonable claims experience in the out years. If claims increase dramatically, rates will have to be increased more than anticipated here. The health insurance spending assumes savings of $739,000 in FY14 but no other changes to future health insurance benefits at this time since this need to be bargained, even with the passage of health insurance reform. If savings are achieved over the next few months this will mitigate the deficit amounts for FY15 and the future. We continue to need to reduce the cost of health insurance as the rate of growth of cost outpaces our ability to raise revenue. As shown in the graph below, without further changes to reduce the cost of health insurance it will grow to more than 18% of the budget by FY18. This is less than previously projected, but still too high. Therefore until we find the right mix of plan coverage and employee/employer contribution that won't break the bank, we need to keep negotiating change.



Salary Expenditures

Spending on salaries is expected to be $115.99 million in FY14, increasing to $134.63 million by FY18. The projection rate for salaries is different depending upon the department but is either three percent or four percent per year. This assumes no additional positions in future years; staffing is the same as the FY13 base year. In general school salaries are increasing at a 4% rate and municipal departments are increasing at a 3% rate. Again, there is no added staff or additional programming in this projection. In FY13 salaries are 49% of the budget. By FY17 salaries are expected to decrease as a percent of the total budget to 48%. See the graph below.

Operating Costs

Operating costs for FY14 total $113.6 million or 48% of the total budget. Based on the growth of health insurance and special education out of district tuition, operating costs will overtake salary costs as a percent of the budget in FY16. School operating costs have an estimated annual rate of growth of 7%, matching the last two years of health insurance. Special education out of district tuition is a cost the state has a responsibility to help fund; they set the reimbursement and tuition rates. However, the state fails to keep pace; hence the rising Town cost. In the prior forecast operating costs would overtake salaries in FY14. The reduction in health insurance in FY13 has reset the base for the growth trend which delays when operating spending will outpace salaries to FY16. Operating spending will increase to $139.9 million by FY18 and take up 49% of the budget. The graph below shows this trend.

Energy spending

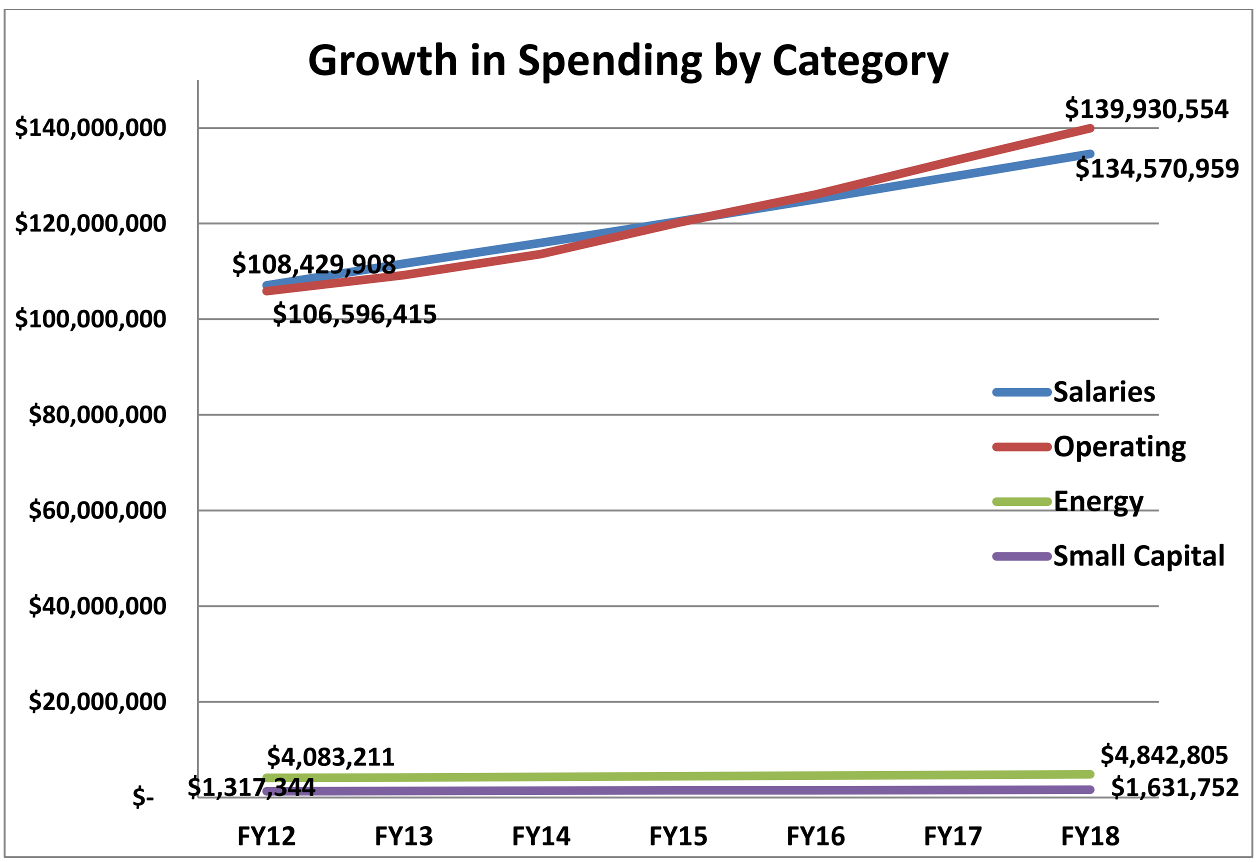
Town-wide energy costs for FY14 are expected to be $4.2 million or 1.8% of the total budget. The rate of growth is about 4% depending upon the year and the length of the energy usage contracts. By FY18 energy spending is forecast to be $4.8 million, dropping to 1.7% of the total budget. The annual Capital Budget has included a number of energy saving projects for almost all buildings, reducing our carbon footprint. In addition, the Town contracts for electricity and gas on a town-wide basis and has had favorable results in the recent bids. The town is entering into an energy audit to determine the next steps for energy consumption.

Small Capital projects and equipment

Repair and maintenance projects that do not rise to the definition of capital project are funded in the operating budget in the category called small capital. Total spending for small capital in FY14 is forecast at $1.48 million or less than 1% of the budget. Spending for this category is expected to be relatively static since they are one-time items. FY18 spending is forecast at $1.8 million. This budget category tends to be the area where budget cuts first hit. Unfortunately that means maintenance on physical assets is delayed and damage results.

Strategic Investments

The expenditure picture presented in this forecast does not include any additional staff. That does not mean that additional resources are not needed. The School Department is looking to rebuild programs that have been reduced in tight budgets. Staff turnover in the next couple of years in the public safety departments presents us with a problem with both overtime and adequate staffing of shifts. In both Police and Fire we could see 20 employees retire each year; it takes about a year to backfill and train these civil service positions. Deferred maintenance on facilities, equipment and infrastructure will require investment via the capital and operating budgets, incurring more debt service and small capital spending. This will requires study of the different components of the budget, forecast here, to find ways to economize existing services to invest in greater priorities.



Unfunded Liabilities

Pension Fund

The Town pension fund contribution is increasing 5% per year based on the recently funding schedule (see pension fund schedule comparison, Chart 4, on page 19). Investment return recovery has been fairly aggressive allowing the Retirement Board to adopt a funding schedule that maintains the current date for achieving full funding (2030). The new funding schedule was recently adopted at the August Retirement Board Meeting after a lengthy discussion and data provided by the PERAC Actuary team. An actuarial valuation must be performed on the assets of the fund accounting for the demographics and salary data of the members, every two years. The economic downturn of 2008/9 did have an effect on the assets of the fund, reducing it value by 30% in 2008. However, prior to that the Board kept an aggressive funding schedule that shortened the full funding date from 2028 to 2026. This gave the fund some breathing room for the effects of investment loss. It was perfect timing. In 2010, the Retirement Board adopted a schedule that combined additional funding and deferred timing (2030, extend 4 years) so as not to overwhelm the budget but not skirt the unfunded liability. The 2012 funding schedule does not retreat from that 2010 goal; holding the line at a 2030 full funding timeline. This saves the Town $4.6 million versus deferring full funding to 2031. The chart on page 19 provides the details of the two options. Given the significance of this decision, the Town Manager, the Finance Committee and the Ways and Means Committee were invited and encouraged to attend and participate in the discussion.

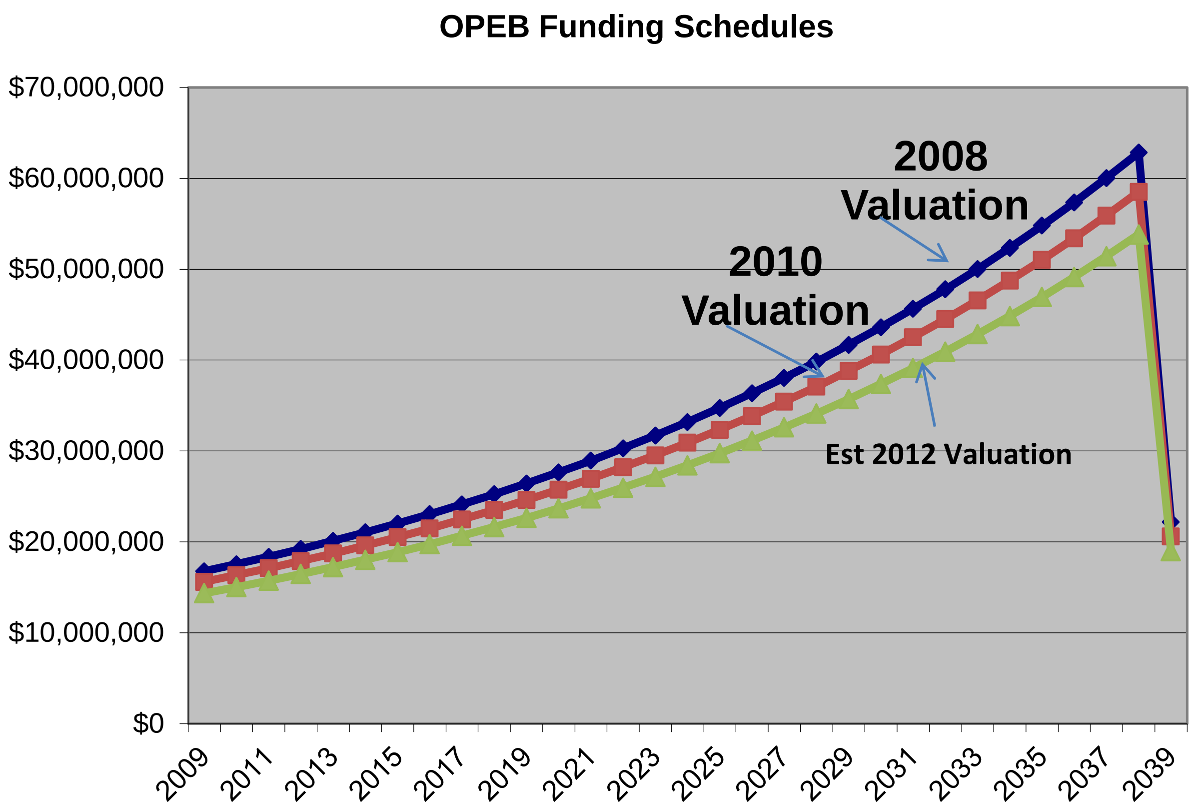
The Framingham Retirement System invests its pension fund with the state PRIT (Public Retirement Investment Trust) Fund. This fund covers pensions for all vested Framingham employees. The Framingham Retirement System (FRS) does not include Framingham teachers who are members of the Massachusetts Teachers Retirement System (MTRS). The FRS also includes as members employees of the Framingham Housing Authority and the MetroWest Regional Transit Authority. Both of those entities are responsible for contributing their own money into the pension fund; the Town is not responsible for any portion of their pension obligation. The average Framingham retiree pension is approximately $20,600. Employees contribute a portion of their pay into the pension fund at varying percentages. For those Group 1 (non-public safety) employees contributing 9% of their pay, they are fully funding their own pension. They are not creating any unfunded liability. The unfunded liability is due to the inadequate contribution by the employer for many years; and the inadequate percentage contributed by employees hired prior to 1986 who contributed as little as 5% of their pay. The two graphs on page 20 provide information on the average pensions of some comparable communities and the adopted full funding dates of those same communities. This data tells us that Framingham has a modest average pension and an aggressive full funding date. These are positive criteria for both the status of the fund and for the creditworthiness of the Town.

Other Post Employment Benefits (OPEB)

OPEB is the future benefit cost of current and future retirees. OPEB is currently an unfunded liability, but it is not required by law to be funded. This liability must be recorded on the financial statements of the Town, which it has since 2008. A substantial number of communities have begun funding this cost, either in whole or in part. For FY13, Town Meeting voted to create an irrevocable trust fund to invest OPEB contributions. The FY13 budget includes allocating $1.5 million to fund a portion of what the annual required contribution. The full annual funding of this cost would be in the range of $14 to $16 million. This amount will change based on the progress we have made in reducing the cost of health insurance through negotiated plan design change, the allocation of eligible costs to Medicare, and the reduction of non-vested staff. For FY14 the OPEB contribution is funded by a combination of free cash and room and meals tax and totals $601,117. For future years a smaller contribution is incorporated into this forecast allocating an increasing portion of free cash, ranging from $225,000 to $315,000. As we identify additional savings or revenues, whether recurring or non-recurring (one-time) we should consider supplementing this funding schedule. Any dollars we contribute to the OPEB Trust Fund now is counted as a plan asset and reduces the overall liability and the amount of the liability we must record on the Town financial statements. There is no requirement to fully fund the required contribution, even if we are partially funding it now. However, the comptroller of the Commonwealth estimates we will be required to fund *something* in the next three to four years.

The Town pays a portion of health insurance for all employees who retire from Framingham either via the Framingham Retirement System, or in the Massachusetts Teachers Retirement System (MTRS). Several years ago the Town adopted the provision that all Medicare eligible retirees must enroll in Medicare Part B and then participate in a Medicare supplement plan. This saves the Town a significant amount of money since hospitalization expenditures are covered without cost to the Town. Every savings measure we take for health insurance also reduces this liability. Since the recording of this liability, the Town has reduced the liability from the 2008 valuation of $216.9 million to $202 million determined by the 2010 valuation. The annual difference is significant as depicted in the graph of the two recommended funding schedules show below. The next valuation is underway; it will include the significant savings achieved by the 2011 and 2012 changes in health insurance coverage and the reduction of employees in School busing. While we do not have an estimate of what these savings will be, the valuation will have an exact number. The study should be completed by the end of December and the report will be circulated to all Town officials, boards and committees. An estimate of the reduction to the OPEB liability and its corresponding funding schedule is included in the chart below.

Note: there is an additional report on the rules of the irrevocable trust fund, funding status and liability amounts created for Town Meeting under Article 1 item 2D. It is on the back table for the 2012 fall Special Town Meeting.



Stabilization Fund

Town policy requires, and state and financial rating agencies recommend that municipalities have a stabilization fund that is 5% of the total annual budget. Since FY2009, the plan has to allocate 40% of net free cash and the entire revenue from local room and meals taxes to the fund until it reaches the policy level. At the current rate that would be accomplished in FY14. This is a year earlier than projected because the free cash allocation in FY13 is $725,373, double what had been allocated in FY12. Combined with the room and meals tax of $1.5 million the contribution to the fund for FY13 is $2,236,727. This also means that the combination of free cash, room and meals tax for FY14 would require only $750,000 to reach the 5% target. The fall Special Town Meeting this year will have the option of adding additional revenue to the Stabilization Fund. This would bring the fund to its 5% goal in FY13 and allow a smaller allocation of revenue (just free cash) through FY18 to maintain the 5% requirement. If a smaller portion of revenue is allocated then we will continue to need an allocation of room and meals tax to maintain a 5% fund balance. The examples are listed in the tables below.

Option 1	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Voted/Projected Budget	$219,331,566	$227,310,902	$235,372,312	$246,558,006	$257,256,588	$269,175,740	$280,976,070
5% Target	$10,966,578	$11,365,545	$11,768,616	$12,327,900	$12,862,829	$13,458,787	$14,048,804
Free Cash + Room & Meals Tax FY12/13 Free Cash only FY14-18	$1,461,086	$2,236,727	$375,000	$375,000	$425,000	$475,000	$525,000
Additional Revenue Fall STM		$687,827					
New Balance	$8,920,903	$11,845,457	$12,220,457	$12,595,457	$13,020,457	$13,495,457	$14,020,457
Excess/shortfall	($2,045,676)	$479,912	$451,841	$267,557	$157,627	$36,670	($28,347)

Option 2	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Voted/Projected Budget	$219,331,566	$227,311,902	$235,372,312	$246,558,006	$257,256,588	$269,175,740	$280,976,070
5% Target	$10,966,578	$11,365,595	$11,768,616	$12,327,900	$12,862,829	$13,458,787	$14,048,804
Free Cash + Room & Meals Tax FY12/13 Free Cash only FY14-18	$1,461,086	$2,236,727	$390,000	$375,000	$425,000	$475,000	$525,000
Additional Revenue Fall STM		$207,965					
Room and Meals Tax needed			$13,021	$184,284	$109,929	$120,957	$65,016
New Balance	$8,920,903	$11,365,595	$11,768,616	$12,327,900	$12,862,830	$13,458,787	$14,048,804
Excess/shortfall	($2,045,676)	($0)	$0	$0	$0	$0	$0

The achievement of the 5% policy goal would allow the reallocation of targeted room and meals tax revenue away from the Stabilization Fund and have it replace free cash as a recurring revenue source. The amounts are the same: we use $1.5 million of free cash in the operating budget (refer to the Free Cash section on page 6 of this document and the Revenue Detail Chart 2 on page 16). The room and meals taxes total approximately $1.5 million annually. This would assign recurring revenues (taxes) to recurring expenditures and removed non-recurring revenue (free cash) from the recurring expenditures. As mentioned previously, the use of free cash as a recurring revenue source for the operating budget was a financial weakness cited in the latest Moody's credit rating review.

The following pages include charts and graphs that support and further explain the information in this forecast. If you have any questions regarding any of this data, do hesitate to call the Office of the Chief Financial Officer at (508) 532-5425, or e-mail directly at mek@framinghamma.gov.