FY2018 – FY2023

Long Range Financial Forecast

Office of the Chief Financial Officer

Article 2: Report 7a and 9

Article 19: FY18 Tax Levy

Introduction

A financial forecast projects revenues and expenditures over a determined period of time, using assumptions about costs, future spending needs, current and future economic conditions. We use the forecast to plan both capital and operating expenditures; to estimate the tax levy needed for future years; and to estimate the spending needs for existing services.

As in previous forecasts, our estimated expenses out-pace out estimated revenues; although the near term looks manageable. As we close the spending gap on current years, the out year shortfalls decrease. Again, this is an estimate of spending needs, not an edict or a pronouncement for an operating override. It explains the extent to which we need to make changes to live within our means.

As we have said in the last three financial forecasts and in the initial FY15 forecast that set out the three year budget plan: in FY18 we revert back to a 2.5% annual levy increase for the foreseeable future.

There are three major financial issues directly affect the sustainability of our financial future; we need to address these issues now and in the near term:

- School costs are overwhelming our ability to pay; education is by far the largest spending item in the budget. The Framingham School District General Fund appropriation has grown by more than $48 million, or 60% since 2007. In fact we have increased the School District budget 20% in the last three years alone.
- Substantial annual increases in state aid, specifically Chapter 70 education aid, has fueled the multi-million dollar increases in the School budget since FY13; however, we have now caught up with our Chapter 70 shortfall; which means no more substantial annual increases.
- Our capital investment needs, especially for buildings and roads, total hundreds of millions of dollars; but we cannot afford to nor can we physically manage to do it all according to the long term capital plan. Current priorities such as the new School and the Memorial Building renovation will require continued investment of free cash into capital reserves and a debt exclusion; disposal of assets for both working capital and reduction of maintenance cost should be encouraged.

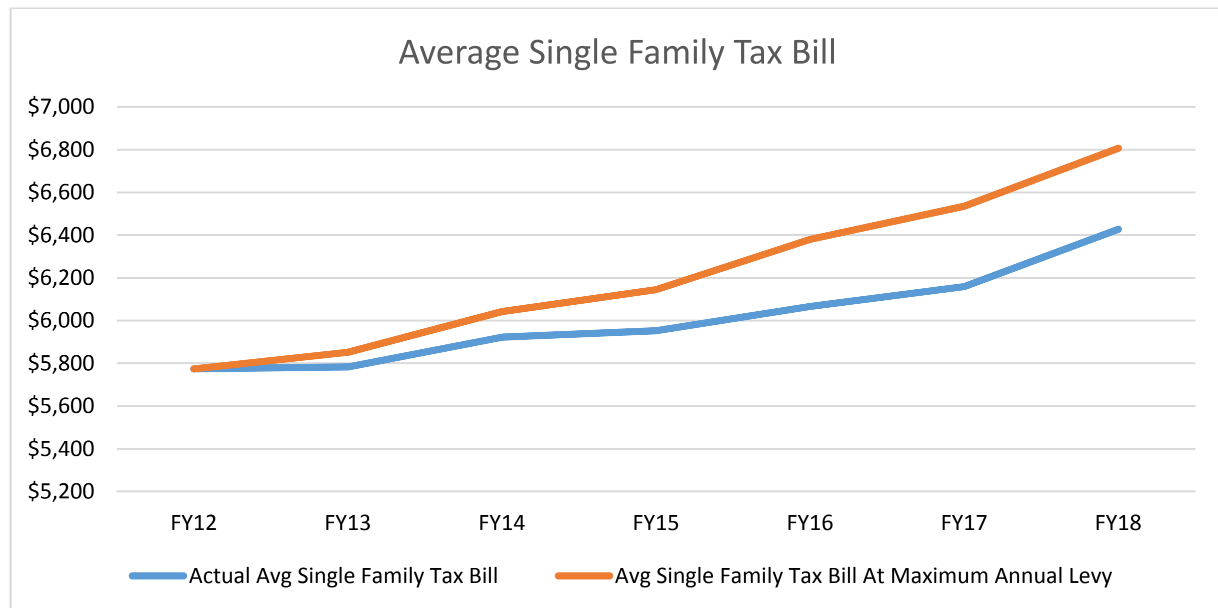
We have seen in the last several years that the budgets built from the long range forecast is part of a comprehensive strategy to limit the growth of taxes by taking advantage of alternative revenues and savings in health insurance. Moving forward we should use this forecast to plan expenditures in a different revenue environment that includes limitations in state aid and the tax levy. We need to encourage measured and targeted development and redevelopment of taxable property in Town to expand the tax base. As indicated in all of the previous forecasts, this document provides insight into our ability to live within our means.

Where Have We Been? – The Results of the Three Year Budget Plan

From FY15 to the current fiscal year (FY17), we have five goals: Moderate the tax bill; avoid shifting shares of the tax burden beyond 60% for residential taxpayers and 40% for commercial taxpayers; hit our highest spending priorities, like education and public safety; prepare for major capital projects by creating and funding reserves; and make the plan sustainable.

Average Single Family Residential Tax Bill

In FY15 we set a goal to limit the annual increase in the average tax bill for a single family home to no more than $100. For the three year period that would be no more than $300. To accomplish this we planned to limit the base tax levy growth to 1.25% per year for three years versus the maximum 2.5%. In actuality the base levy increase for FY15 was 1%. In FY16 it was .65%. In FY17 the base levy increase is 1.75%. This is a 3.4% increase in the base levy versus the planned 3.75%.

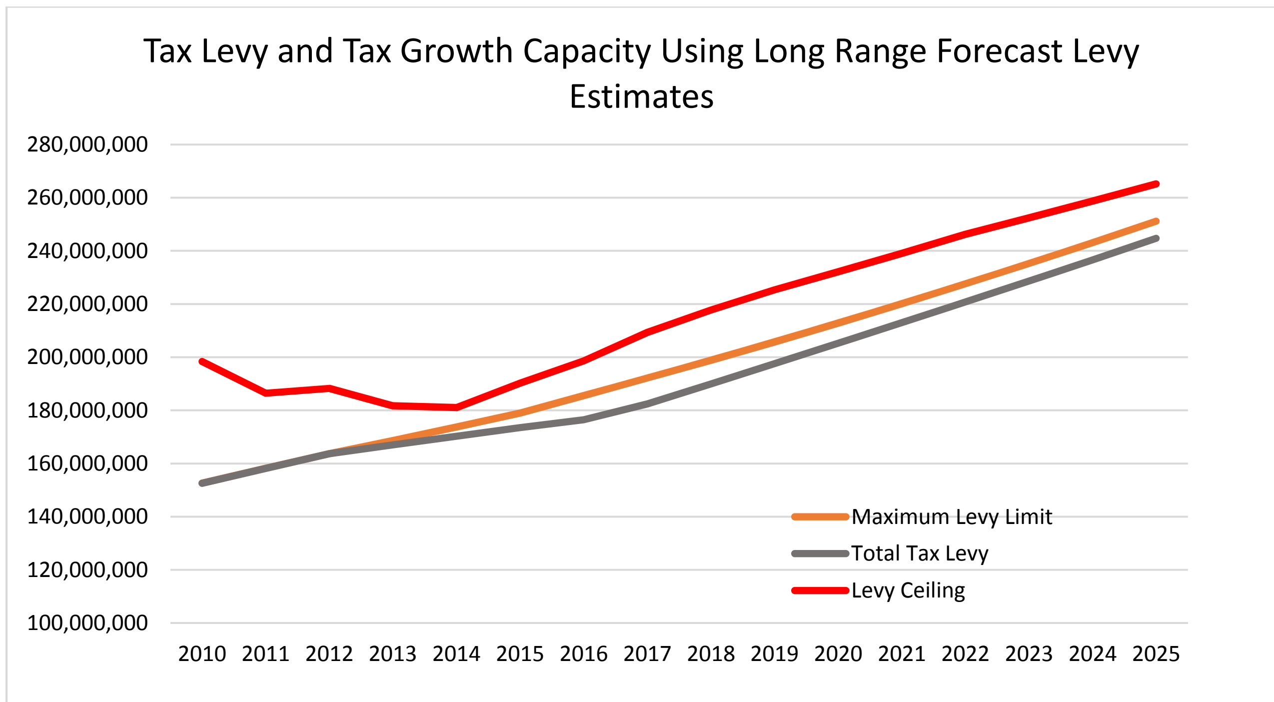


Excess Levy Capacity and Our Capacity to Tax

Each year the property tax levy is allowed to increase by 2.5%. If we don't increase our levy by 2.5% in the year the remaining levy increase carries forward into the future years. For every year that happens, whether planned or unplanned, we build up something called excess levy capacity.

Since FY13 we have not taxed to the maximum levy. This is due to several factors: state education aid has increased in an effort to "catch Framingham up" after years of underfunding; spending was reduced in many categories, including health insurance, trash removal and

recycling costs; the rate expense growth in municipal departments has been less than the rate of growth in revenue; and the planned near term use of free cash to offset the tax levy increase. In FY15 the Town Administration planned a three year levy increase of 1.25% per year or 3.75% for the three year period ending in FY17. What actually happened was a 1%-.65%-1.75% increase in the levy that total 3.4%; less than the planned 3.75%. As a result we have over $9 million in excess capacity. This is tax revenue that could have been charged and collected from taxpayers if we had gone to the maximum 2.5% levy increase each year.

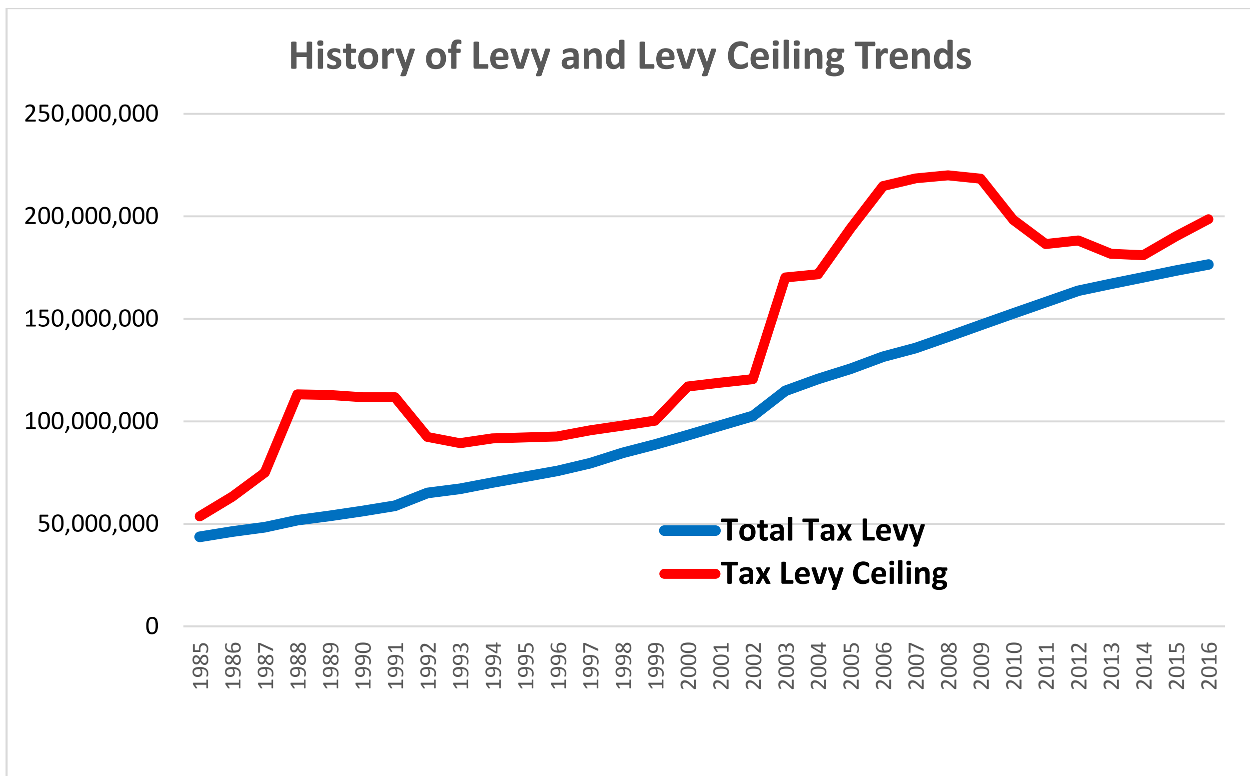


Proposition 2 1/2 has two caps: the one most people hear about is the annual levy increase capped at 2.5% of the prior year total levy, called the maximum levy; the second is the overall tax cap of 2.5% of the total taxable value of the Town, called the levy ceiling. In 2008, the recession caused taxable property assessments to decline – which happened in FY09 for residential and FY12 for commercial. When the total taxable value of the Town declines, so does the capacity to tax. In recent months there has been a lot of local public discussion about the tax burden and how close Framingham is to the levy ceiling. In FY16, the tax levy was 2.21% of total value, very close to the 2.5% cap. In FY17, we anticipate that tax burden to drop to 2.18%. This is due to two factors: three years of annual levy increases far less than 2.5% and the increase in taxable property value of more than 4% for those same three years.

This does not mean there is nothing to worry about. It does mean the Town Administration and elected officials need to encourage new development and redevelopment of taxable property

in the Town. This doesn't mean uncontrolled development, but it also does not mean no or little development. New development spreads the tax burden across a larger pool of taxpayers, easing the burden on all. But this also means that spending cannot grow at a faster pace than revenue. Since 70% of the General Fund revenue is property taxes that means that spending cannot grow faster than the 2.5% annual levy increase. The Town has the ability to exceed the 2.5% annual levy increase by a Town-wide vote

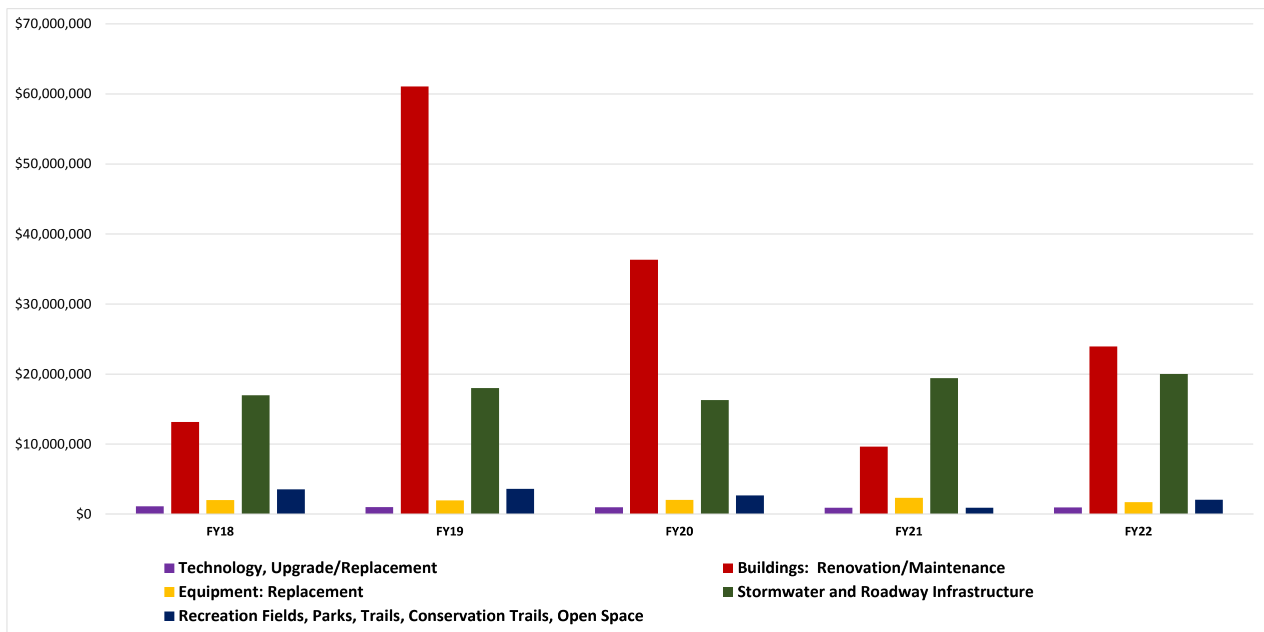
The graph below illustrates the how that ceiling moves with changes in the local and national economy, and the historic tracking of the actual tax levy. Note that the levy ceiling, the red line, is fluctuating in the same pattern as total taxable property in the Town. It is also affected by changes in the economy: the collapse of the "Massachusetts Miracle" is show in the downward curve in 1991 to 1993; the negative impact of 9/11 on the tourism sector in 2001 to 2002; and the effect of the "Great Recession" of 2008 is shown in the downward curve from the 2009 peak to bottom of the trough in 2014. We also can see the housing boom from 2002 to 2008. The blue line is the voted tax levy. If the levy increase was 2.5% every year, this line would be straight. But it is not. In 1991 and 2003 there were overrides, which changes the trajectory of the line higher. At the end of the blue line you can see the first two years of the lower levy of 2015 and 2016 where the trend of the line levels off.



Capital Investment

Our capital needs exceed our financial capacity to invest, therefore we can only pay for our highest priority capital projects. These include schools, town owned buildings, technology improvements, equipment replacements, parks, sports fields and open space. In the past ten years we have increased our capital investment significantly to make up for 30 years of deferred maintenance on many of our Town assets. It is now time to tighten that belt and spread that investment out over time. We have two major building projects in the immediate future: the replacement of the Fuller Middle School and renovations to the Memorial Building. Over the next five years over $150 million of building investment is needed. This includes everything from school roofs, another major school renovation, school and town building mechanicals, etc. We need almost $91 million in roadway repairs and storm water improvements. We need $12.8 million for recreation, conservation and open space capital projects; $10 million in equipment replacement, and $5 million in town-wide technology improvements. That ranges from $33 million to $105 million per year. We will be able to fund 25% to 30% of that over the next five years. And we can re-evaluate the next five years after that.

The chart below illustrates the demand for capital investment for FY18 through FY22. The spike in FY19 is the Fuller School replacement for which we have set aside $4.5 million. Competing needs are core building repairs, including a new fire station in Saxonville and the Memorial Building; roadway repairs, including Union Ave and Concord St in Downtown. There are assets we own that we should not. Selling surplus assets and continuing to fund the Capital Stabilization Fund will help offset this extraordinary cost.



The Fuller School replacement project shown above in FY19 will incur approximately $1.6 million to $1.8 million per year in debt service, the annual "loan" payment for the bonds we issue to pay for the project. The final cost of the project is not yet determined, but we estimate it at $48 million. The state, in the form of the MA School Building Authority, will pick up at least 51% of the cost and we will have saved $5 million to help pay for the project. We expect to have a debt exclusion for about $20 million.

A debt exclusion is a temporary override of the tax levy to pay for debt service of bonds for a specific voted project. A debt exclusion requires a town-wide vote, on a ballot, in an election. Many communities in Massachusetts fund school debt through a debt exclusion. Once the bonds have been paid off, for a school building that would be 20 years, the debt exclusion override goes away and the levy actually decreases. The last debt exclusion approved by the Town was for the High School renovation. In FY17 we add $352,727 to the tax levy which adds three cents to the tax rate. The amount of the High School debt exclusion will decrease every year until it is paid off in 2029. The Fuller School debt exclusion should not impact tax bills until at least 2020.

Financial Flexibility: Dedicated Reserves, Free Cash and Excess Levy Capacity

Since FY2010 the Town Administration has recommended increased investment in general and specific reserves. When we passed the local meals tax, that revenue was dedicated first to increase the Stabilization fund to its policy level of 5% of the budget. We now allocate a portion of certified free cash to keep the Stabilization fund at 5% of the total budget. For the term of this long range forecast that amount ranges from $247,000 to $397,000.

As part of the three year budget plan, and anticipating the large capital investment in the Fuller School renovation/replacement, we created a Capital Stabilization Fund. In FY15 through FY17 we have invested almost $4 million, allocated from Free Cash. The plan is to allocate $5 million to the Fuller School project. We will continue the allocation of free cash to the Capital Stabilization fund in order to allocate funds to the Memorial Building renovation project.

Free Cash, which is the ending cash balance of the Town's General Fund, is not a recurring revenue source. The balance of free cash certified by DOR over the years has ranged from $1.2 million to 11.7 million. Clearly you cannot plan to spend $5 million annually when the balance is less than $5 million. So we allocate a small portion for operating budget expense if we have it available and we need it. However, the majority of free cash is placed in reserves and used for one-time payments that do not recur. In FY15 we began an initiative to use free cash to offset the increase in the levy (1.25% versus the statutory 2.5%) to create excess levy capacity and to create a Capital Stabilization Fund. We also continued to deposit funds in the general Stabilization Fund. Finally, our Town policy designates that 40% of free cash remain in the General fund, fund balance as an additional reserve. All of these actions created reserves that

improve our financial flexibility and provide the Town with the ability to weather financial downturns and upcoming major capital investment in Schools and Town buildings.

Future Financials: FY18 to FY23

Revenues

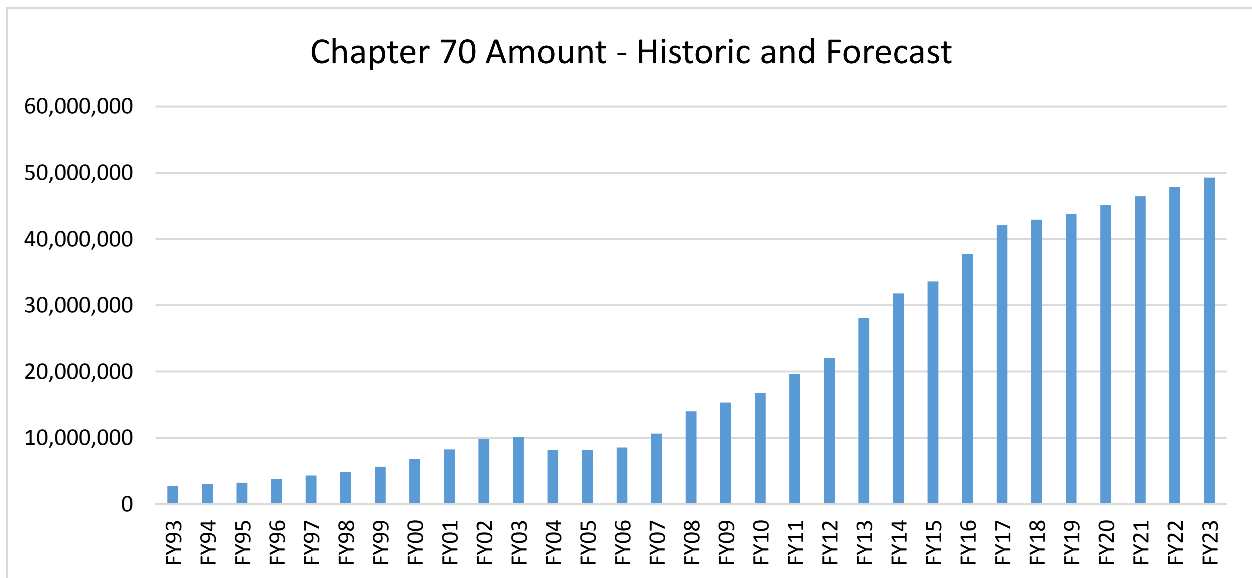
	FY17	%	FY18	%	FY19	%	FY20	%	FY21	%	FY22	%	FY23	%
Grand Total	$268,399,160	5.2%	$275,562,809	2.7%	$283,123,633	2.7%	$292,011,045	3.1%	$300,421,326	2.9%	$310,265,180	3.3%	$320,753,674	3.4%
Annual Dollar growth	$13,176,104		$7,163,649		$7,560,824		$8,887,412		$8,410,281		$9,843,855		$10,488,493	

Over the term of this forecast the annual increase in revenue ranges from 2.7% in FY18 to 3.4% in FY23. In FY17 revenue actually increases 5.2%, so why are these future percentages so much lower? The FY17 increase in Chapter 70 Education Aid was more than 11% which is $4.88 million. We expect Chapter 70 aid to increase only $841,000 in FY18, more on that below. Local revenue added a new revenue source- cable revenues of $740,000 in FY17, which grows by 3% in future years (less than $25,000). Finally, we used $3.5 million in free cash in FY17 but only $1.2 million in FY18 and less in future years. The strategy is to use less free cash in the operating budget and to dedicate it more to reserves and one-time expenses. The raise in the levy to 2.5% does not make up for that drop in revenue. There is potential for better growth in some revenue types. The current development pipeline may lead to sustained higher revenues for building permits over the next couple of years. If the vehicle market sales remain high we could see the same rate of growth in vehicle excise tax. Each source could be $100,000 more than forecast in this document. We won't have an indication of that trend until after the winter.

Chapter 70 aid has Caught Up – Means Less Growth in Revenue for Future Years

For years Framingham public officials have called for change to the chapter 70 Education Aid formula. Since its creation in 1993 the formula relied on property value only as the determinant of need for education aid. This was detrimental to Framingham most of all because the largest Town had substantial commercial and residential property value, but modest residential wealth. The formula was changed in 2007 to include residential wealth, but, the re-distribution of education aid across communities would have harmed too many to be changed in one year. A five year plan was developed, but the recession of 2008 prohibited the completion of the plan. Finally in FY11 the adjustments were begun. But Framingham was still $3.4 million from the state defined target aid. In FY16 and FY17 $3 million of that gap was closed. Now Framingham is on equal footing with most communities and will receive the annual increases most communities get: in FY17 that was about 1.6%. This forecast projects a 2% increase for FY18 and FY19, and bumps up to a 3% increase for FY20-23. The bar chart

below illustrates the historic and projected amounts of Chapter 70 aid received by Framingham. Note the drop in aid in FY04 and almost level funding through FY06.



Expenditures – FY18 and beyond

This forecast estimates growth based on historic trends, estimates inflation of certain operating budget components and established salary charts. The spending estimates in this report do not include any new programs, new staff or major changes to existing services. The rates of growth assume a number of existing factors, including current salary tables, inflation of energy costs, cost adjustments for service contracts and special education tuitions and estimated increases in commodities used in department operations.

As we have in previous years, we expect to build a budget in FY18 that is in balance. This forecast shows us that we have serious decisions to make in order to achieve that balance. In the FY17 we were also facing a shortfall in the $2 million range. However, increased state aid and new development taxes primarily filled the budget gap. Municipal department growth was less than projected at 1.7%, but the School budget was voted $1.8 million higher than was recommended in last year's Long Range Forecast and in the original budget submission to the Selectmen and Finance Committee.

Salaries represent 74% of total department spending (both Town and School Departments) but 51% of the total budget. School salary budgets are forecast at 4% growth. Municipal department salaries are forecast between 2% and 3%; depending upon current contracts and non-bargaining salary charts.

Operating costs are 46% of the total budget but 21-24% of departmental spending. This is because health insurance, pension costs, debt service and state assessments are all considered operating costs. Department operating cost growth is 0-3%. The School Department growth is 6%; which is developed from 8% Sped cost increase and 2% increase in other operating costs.

Energy costs are 1.7% of the total budget and 2.4% of departmental budgets (including School). The energy component increases by 3% per year. The final departmental budget piece is so-called Small Capital – this is one time replacement of assets that are generally less than $25,000, but primarily a life of less than 5 years.

Expenditures	FY17 Budget	FY18 Forecast	FY19 Forecast	FY20 Forecast	FY21 Forecast	FY22 Forecast	FY23 Forecast
Municipal Departments	$60,632,642	$62,551,679	$64,825,324	$67,030,192	$69,577,815	$71,353,244	$73,622,618
Framingham School District	$122,550,690	$128,065,471	$133,828,417	$139,850,696	$146,143,978	$152,437,259	$159,296,936
Keefe Technical Assessmnt	$8,997,424	$9,267,347	$9,591,704	$9,927,413	$10,274,873	$10,634,494	$11,006,701
Group Health Insurance	$30,763,428	$31,686,330	$32,795,352	$34,041,575	$35,335,155	$36,713,226	$38,145,042
Other Insurances	$4,867,512	$5,155,676	$5,456,271	$5,775,634	$6,098,386	$6,446,669	$6,823,371
Retirement	$12,982,123	$13,630,654	$14,243,412	$14,954,729	$15,701,586	$16,457,944	$17,279,909
OPEB Trust	$751,710	$522,873	$551,643	$560,638	$582,363	$600,948	$720,054
Debt Service	$13,839,340	$15,647,276	$15,479,220	$14,880,818	$13,473,997	$13,591,699	$12,884,357
Stabilization/Reserves	$2,043,193	$1,362,823	$1,465,723	$1,558,594	$1,592,518	$1,630,154	$1,875,902
Miscellaneous (EDIC Article)	$95,000	$0	$0	$0	$0	$0	$0
Non Appropriations	$9,953,121	$9,575,840	$9,910,873	$10,235,522	$10,572,470	$10,922,202	$11,285,223
Total Expenditures	$267,476,182	$277,465,969	$288,147,940	$298,815,813	$309,353,139	$320,787,839	$332,940,113
Expenditure Growth Rate	*5.0%*	*3.7%*	*3.8%*	*3.7%*	*3.5%*	*3.7%*	*3.8%*

Budget Balancing Challenges – Live Within Our Means

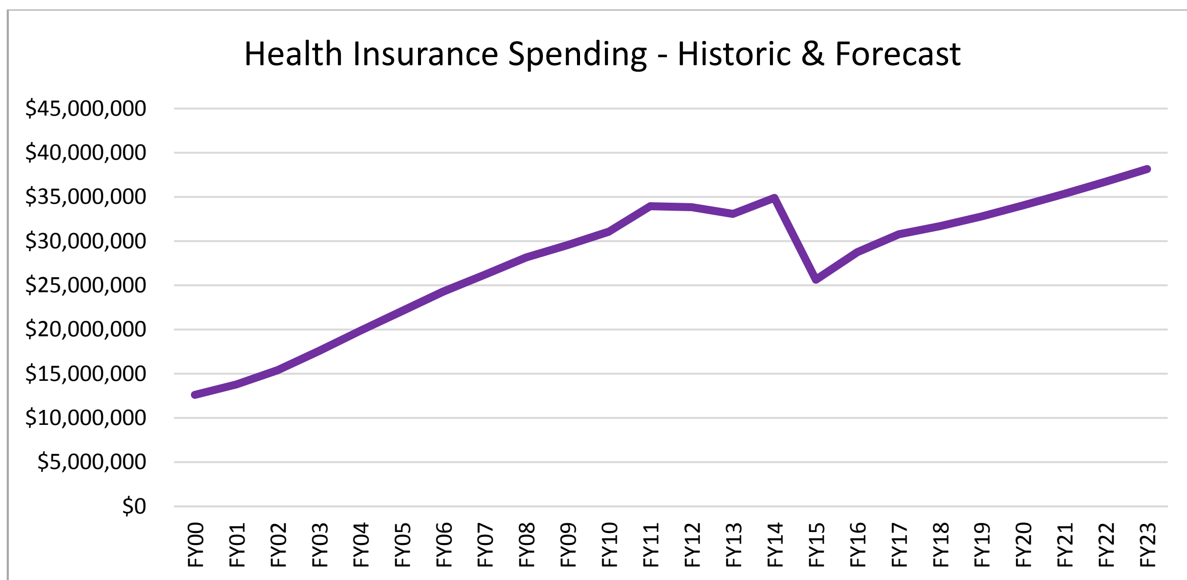
	FY17 Budget	FY18 Forecast	FY19 Forecast	FY20 Forecast	FY21 Forecast	FY22 Forecast	FY23 Forecast
Total Revenue	$268,399,160	$275,562,809	$283,123,633	$292,011,045	$300,421,326	$310,265,180	$320,753,674
Total Expenditures	$267,476,182	$277,465,969	$288,147,940	$298,815,813	$309,353,139	$320,787,839	$332,940,113
Projected Balance	922,978	(1,903,161)	(5,024,306)	(6,804,769)	(8,931,814)	(10,522,658)	(12,186,439)

Almost every year we are presented with budget shortfalls when we begin this process. Every year we make decisions to balance that budget. Every year we balance the budget, it makes the following years less challenging. The take away from looking forward is to make decisions today that don't overspend for the future. That is why we make capital decisions based on the debt service it incurs five years from now rather than our ability to spend debt service at a higher level in the current budget. It is the same process that guided our decision to collectively bargain for lower health insurance costs which is why we transferred to the state Group Insurance Commission (GIC). It is the same process that will guide us toward solving our education spending challenge.

Curtailing Expenditures

Controlling Health Insurance – Success

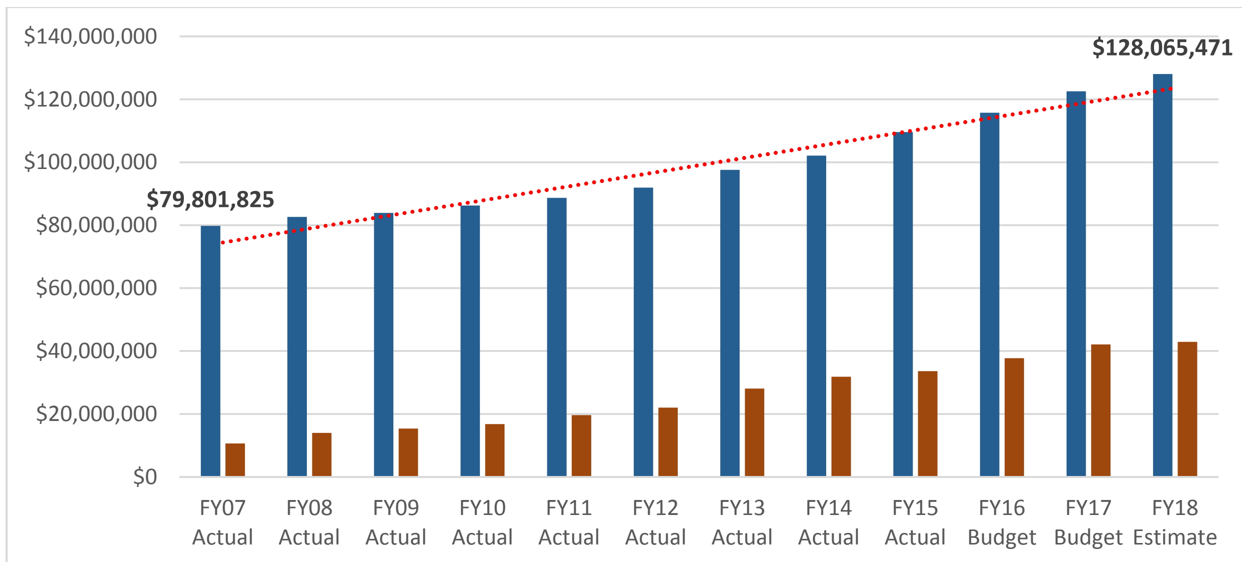
Health insurance was once on its way to becoming 25% of the total General Fund budget. Now it is less than 12%. In FY15, the Town Administration was able to use a new state law to move Town employees and retirees to health insurance coverage administered by the state Group Insurance Commission. The larger GIC enrollment spreads the cost of health care across more employees which reduces the overall cost to members of the system. Compared to what the Town would have spent for health insurance from FY15 through FY17, if health plans stated local, the Town will save $21 million for the three year period in the GIC. Prior to FY15 the average annual increase in health insurance costs was 7.8%. Future spending on health insurance is estimated to grow by 3% in FY18 and 3.5% in FY19 and beyond. This growth factor has some risk: increased enrollment in higher cost plans which would increase the cost to both the Town and employee; and/or overall premiums could increase more than 3-3.5%.



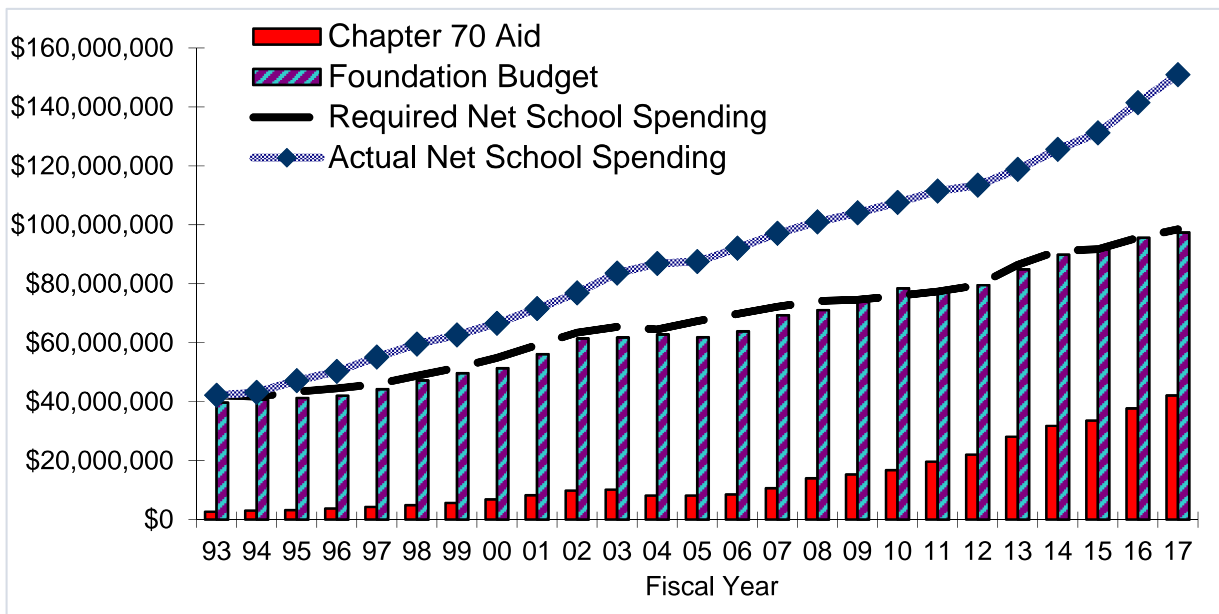
Controlling Education Costs – Not So Much

The School Department budget that is listed in the General Fund budget article every year has grown 60% or $48 million since FY07. The voted budgets listed in the chart below were not what was requested – that was significantly more. Annual increases in School General Fund appropriations that exceed 4.5% is unaffordable. That rate of growth costs $5.5 million in FY18 and increases to almost $7 million by FY23. When revenue growth is $7 to $10 million, there is not much left for Fire, Police, Recreation, trash removal or any other necessary service.

The chart below is not all we spend for School services. A portion of health insurance, pensions, debt service, unemployment and workers' compensation budgets are spent on behalf of School employees.



When the state reports School spending it includes all those costs. The chart below shows a combination of Chapter 70 aid, the state formulated Foundation budget, the state formulated minimum Net School Spending and the top line is what we actually spend. Even with the large infusion of Chapter 70 aid, the excess spending over the minimum has actually increased. The Chapter 70 aid increase was meant to help ease the burden of education on the tax levy. What we have voted has actually increased that burden. The state and federal government has imposed substantial regulation and requirements for education without the corresponding funds.



The state and federal governments impose ever changing education requirements which effect teaching methods, class size, facility configuration, curriculum design, technology infrastructure and technology use by students, classification of students and student needs that extend beyond the school day and school year. Most of these requirements are unfunded mandates and **all** are underfunded mandates. None of these requirements are made by the localities that have to fund the education costs. The Town is at a decision point where the solution is not to simply add money to the School budget, but to decide what education system we want as a municipality and what we can afford to fund.

Summation

The financial future of Framingham will always be a challenge – as is every local community. But we are on solid financial ground with our reserves for capital, stabilization fund and lower tax levy. We have balanced our budget every year and finished every balance sheet in the black. We are creating a financial capacity to make progress, albeit very slowly, repairing and maintaining the Town-wide capital assets for which we are responsible. But we have more need than we can support: education and building maintenance are the most significant. We will use this plan, and future financial forecast and reports to determine the best financial action plan for the future.