

Town of Lexington



Fall 2019 Fiscal Guidelines Summit

October 16, 2019



Town of Lexington

Fall Fiscal Guidelines Summit

Summit Agenda

- I. Review Principals of Sound Financial Condition
- II. Review of Fiscal Guideline Recommendations
 - A. Eliminating Use of Free Cash for the Operating Budget
 - B. Fiscal Reserves & Capital Stabilization Fund
 - C. Pension and OPEB Funding
 - D. Personal Property Tax New Growth
 - E. Taxing to the Levy Limit
 - F. Capital Budgeting and Prioritization
 - G. Debt Service Management
 - H. Revenue Allocation Model
- III. Next Steps & Future Meeting Dates



Principals of Sound Financial Condition

- Cash Solvency – the ability to pay bills in a timely fashion
- Budgetary Solvency – the ability to balance the budget annually
- Long-Term Solvency – the ability to pay future costs
- Service Level Solvency – the ability to provide needed and desired services



Recommendation (A): Eliminate the use of Free Cash to supplement operating revenues.

Current status:

- In FY2019 \$3.5M in Free Cash was utilized to supplement the operating budget.
- Beginning in FY2020 the Town implemented a 5-year plan to phase out the use of Free Cash by reducing the amount by \$700K per year.

| Fiscal Year | Free Cash in Operating Budget |
|-------------|-------------------------------|
| FY2019 | \$ 3,500,000 |
| FY2020 | \$ 2,800,000 |
| FY2021 | \$ 2,100,000 |
| FY2022 | \$ 1,400,000 |
| FY2023 | \$ 700,000 |
| FY2024 | \$ - |

Planning Ahead: The Free Cash being phased out of the operating budget will be set aside in the revenue allocation model and utilized for one-time purposes going forward. This may include cash capital, accelerated pay-down of debt or transfer into the Capital Stabilization Fund.



Recommendation (B-1): Increase reserves to reach 16.67% of General Fund operating revenues (equivalent of 2 months operations).

Current status: The Town has multiple reserve accounts including a General Stabilization Fund with a current balance of \$9.80M.

| | FY2017 | FY2018 | FY2019 | FY2020 |
|--|----------------------|----------------------|----------------------|----------------------|
| Operating Budget | \$ 178,949,235 | \$ 189,990,381 | \$ 208,028,555 | \$ 216,793,861 |
| Available Free Cash (as certified by DOR) | \$ 9,870,618 | \$ 13,269,721 | \$ 12,422,051 | \$ 13,401,094 |
| Less Free Cash Used in Operating Budget | \$ 3,900,000 | \$ 3,853,000 | \$ 3,700,000 | \$ 2,900,000 |
| Unrestricted Free Cash | \$ 5,970,618 | \$ 9,416,721 | \$ 8,722,051 | \$ 10,501,094 |
| General Stabilization Fund | \$ 9,251,859 | \$ 9,447,866 | \$ 9,649,865 | \$ 9,800,414 |
| Available Reserves | \$ 15,222,477 | \$ 18,864,587 | \$ 18,371,916 | \$ 20,301,509 |
| Reserves as a % of Operating Budget | 8.51% | 9.93% | 8.83% | 9.36% |
| Capital Stabilization Fund | \$ 16,725,947 | \$ 23,203,210 | \$ 28,597,934 | \$ 27,727,713 |
| Within Levy Debt and Cash Capital | \$ 9,942,966 | \$ 13,072,114 | \$ 15,646,677 | \$ 14,253,984 |
| Available Reserves with CSF | \$ 25,165,443 | \$ 31,936,701 | \$ 34,018,593 | \$ 34,555,493 |
| Reserves w/CSF as a % of Operating Budget | 14.06% | 16.81% | 16.35% | 15.94% |

Planning Ahead: The Town should reinstate annual set-asides into the General Stabilization Fund to meet the 16.67% target.



Recommendation (B-2): Increase appropriations into the Capital Stabilization Fund (CSF) to assist with future funding of the high school construction project.

Current status:

- The Town set aside significant funds into the CSF as a tool to mitigate excluded debt service associated with reconstruction of Hastings, the Fire Station and Lexington Children's Place.
- Funding in the CSF peaked in FY2018 at over \$28 million.
- For the next 5 years transfers out of the CSF were projected to exceed transfers into the CSF.

Planning Ahead:

- Continue to use the CSF to mitigate excluded debt service as planned.
- Recommend an increasing appropriation into the CSF each year for the next 5 years (set aside funds in the revenue allocation model).



Recommendation (C-1): Adjust annual appropriation to maintain current target of FY2024 to reach full funding. This recommendation is consistent with current practice.

Current status:

- The market value of the Pension Fund was \$175.5M as of 6/30/2019.
- The unfunded liability of the Pension fund was approximately \$24M as of 1/1/2018.
- The Pension Fund was approximately 87% funded as of 6/30/2019 and will be approximately 89% funded at the end of FY2020.
- The actuarial valuation for the Pension Fund will be updated again as of January 1, 2020 and any changes to actuarial assumptions, such as the 7.5% rate of return will impact the liability and funded status of the plan.

| | <u>January 1, 2016</u> | <u>January 1, 2018</u> |
|--------------------------------------|------------------------|------------------------|
| Actuarial Accrued Liability | \$169,564,366 | \$188,161,184 |
| Actuarial Assets | <u>144,699,520</u> | <u>163,999,576</u> |
| Unfunded Actuarial Accrued Liability | \$24,864,846 | \$24,161,608 |
| Funded Status | 85.3% | 87.2% |



Planning Ahead:

- The Town's projected appropriation into the pension fund is currently estimated to increase by \$350K per year until FY2024
- Future appropriations will be adjusted for the new 2020 funding schedule
- Reaching full funding will result in significant budgetary savings each year

Appropriation Forecast

| Fiscal Year | Employee Payroll* | Employee Contribution | Employer Normal Cost with Interest | Amortization Payments with Interest | Employer Total Cost with Interest | Employer Total Cost % of Payroll | Funded Ratio %** |
|-------------|-------------------|-----------------------|------------------------------------|-------------------------------------|-----------------------------------|----------------------------------|------------------|
| 2019 | \$38,607,665 | \$3,439,198 | \$1,494,975 | \$4,510,562 | \$6,005,537 | 15.6 | 87.1 |
| 2020 | 40,345,010 | 3,629,643 | 1,524,244 | 4,881,293 | 6,405,537 | 15.9 | 89.1 |
| 2021 | 42,160,535 | 3,830,264 | 1,553,121 | 5,202,416 | 6,755,537 | 16.0 | 91.1 |
| 2022 | 44,057,759 | 4,041,591 | 1,581,509 | 5,524,028 | 7,105,537 | 16.1 | 93.3 |
| 2023 | 46,040,359 | 4,264,181 | 1,609,308 | 5,846,229 | 7,455,537 | 16.2 | 95.6 |
| 2024 | 48,112,175 | 4,498,620 | 1,636,406 | 4,819,867 | 6,456,273 | 13.4 | 98.1 |
| 2025 | 50,277,223 | 4,745,523 | 1,662,683 | 0 | 1,662,683 | 3.3 | 100.0 |
| 2026 | 52,539,698 | 5,005,538 | 1,688,012 | 0 | 1,688,012 | 3.2 | 100.0 |

This Appropriation Forecast is from the Pension Fund's most recent Actuarial Valuation (1/1/2018) and represents the funding schedule adopted by the Lexington Retirement Board.



Recommendation (C-2): Maintain a consistent level of funding for OPEB, with a target of 35%-100% of the annual service cost. This recommendation is consistent with current guidelines.

Current status:

- The Town has consistently funded the Trust over the last 7 years with a combination of funds from Free Cash and the Health Claims Trust Fund.
- The balance in Town's OPEB Trust as of 6/30/2019 was \$15.7M.
- The net OPEB liability was approximately \$138M, or 8.3% funded as of 6/30/2018.

| | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 |
|--------------------------------|-------------------|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Opening Balance | \$2,166,697 | \$3,069,273 | \$ 4,482,338 | \$ 5,798,656 | \$ 7,334,848 | \$ 9,869,875 | \$12,475,463 | \$15,773,900 |
| Additional Contributions | | | | | | | | |
| Tax Levy* | \$ - | \$ 250,000 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Health Claims Trust Fund* | \$ - | \$ - | \$ 1,000,000 | \$ 1,196,753 | \$ 1,200,000 | \$ 750,000 | \$ 750,000 | \$ 750,000 |
| Free Cash | \$ 500,000 | \$ 525,000 | \$ 119,000 | \$ 3,247 | \$ 312,318 | \$ 1,079,721 | \$ 1,079,721 | \$ 1,129,721 |
| Water/Sewer | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 13,174 | \$ 13,174 | \$ 5,765 |
| Total OPEB Contribution | \$ 500,000 | \$ 775,000 | \$ 1,119,000 | \$ 1,200,000 | \$ 1,512,318 | \$ 1,842,895 | \$ 1,842,895 | \$ 1,885,486 |
| Fund Gains/(Losses) | \$ 402,576 | \$ 638,065 | \$ 197,318 | \$ 336,192 | \$ 1,022,708 | \$ 762,693 | \$ 1,455,542 | \$ - |
| Ending Balance | \$3,069,273 | \$4,482,338 | \$ 5,798,656 | \$ 7,334,848 | \$ 9,869,875 | \$12,475,463 | \$15,773,900 | \$17,659,386 |



Planning Ahead:

- Fund between 35% and 100% of the annual service cost each year.

| | |
|------------------------------------|-----------|
| Service Cost (as of 6/30/18) | 4,498,108 |
| FY2020 OPEB Contribution | 1,885,486 |
| % of Service Cost Funded in FY2020 | 42% |

- Increase the Town's Free Cash appropriation into the OPEB Trust by \$50K per year until FY2024.

| | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 | FY2024 |
|--------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Tax Levy* | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 571,003 |
| Health Claims Trust Fund* | \$ 750,000 | \$ 750,000 | \$ 750,000 | \$ 750,000 | \$ 750,000 | \$ 178,997 |
| Free Cash | \$ 1,079,721 | \$ 1,129,721 | \$ 1,179,721 | \$ 1,229,721 | \$ 1,279,721 | \$ 1,329,721 |
| Water/Sewer | \$ 13,174 | \$ 5,765 | \$ 6,053 | \$ 6,356 | \$ 6,674 | \$ 7,007 |
| Total OPEB Contribution | \$ 1,842,895 | \$ 1,885,486 | \$ 1,935,774 | \$ 1,986,077 | \$ 2,036,395 | \$ 2,086,728 |

- Continue to utilize \$750K per year of the Health Claims Trust Fund until it is depleted in FY2024.
- In FY2024 consider diverting savings from Pension Fund to continue consistent funding of OPEB beyond FY2024.

| Health Claims Trust Fund | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 | FY2024 |
|--------------------------|---------------------|---------------------|---------------------|---------------------|-------------------|-------------------|--------------|
| Opening Balance | \$ 4,540,875 | \$ 3,851,400 | \$ 3,178,997 | \$ 2,428,997 | \$ 1,678,997 | \$ 928,997 | \$ 178,997 |
| Appropriations | \$ (750,000) | \$ (750,000) | \$ (750,000) | \$ (750,000) | \$ (750,000) | \$ (750,000) | \$ (178,997) |
| Revenue/Interest | \$ 60,525 | \$ 77,597 | \$ - | \$ - | \$ - | \$ - | \$ - |
| Ending Balance | \$ 3,851,400 | \$ 3,178,997 | \$ 2,428,997 | \$ 1,678,997 | \$ 928,997 | \$ 178,997 | \$ 0 |



Recommendation (D): Do not take any actions to address personal property new growth at this time.

Current status:

- Each year the Town recognizes an amount of new growth in the tax levy that is attributable to personal property.
- Personal property new growth depreciates in value, often over a short period of time (unlike residential, commercial and industrial new growth).
- Over time the depreciated personal property new growth shifts to the other classes of the tax levy.

| Fiscal Year | Residential | Commercial/ Industrial | Personal | Total |
|--------------------|---------------------|-----------------------------------|--------------------|---------------------|
| FY2010 | \$1,206,197 | \$206,414 | \$1,058,669 | \$2,471,280 |
| FY2011 | \$1,112,487 | \$1,212,054 | \$1,105,704 | \$3,430,245 |
| FY2012 | \$1,222,142 | \$960,174 | \$1,164,220 | \$3,346,536 |
| FY2013 | \$1,400,099 | \$1,297,354 | \$841,492 | \$3,538,945 |
| FY2014 | \$1,451,904 | \$635,052 | \$930,379 | \$3,017,335 |
| FY2015 | \$1,686,061 | \$408,312 | \$802,610 | \$2,896,983 |
| FY2016 | \$1,712,987 | \$215,442 | \$743,704 | \$2,672,133 |
| FY2017 | \$1,858,460 | \$507,820 | \$943,064 | \$3,309,344 |
| FY2018 | \$1,908,536 | \$743,645 | \$704,954 | \$3,357,135 |
| FY2019 | \$2,022,777 | \$480,671 | \$766,558 | \$3,270,005 |
| Totals | \$15,581,650 | \$6,666,938 | \$9,061,354 | \$31,309,941 |



Planning Ahead:

- A number of communities have identified this as an issue, however the MA Division of Local Services is not aware of any community that has addressed it.
- Communities have accepted this as part of the Proposition 2½ calculation with the understanding that it may impact tax bills by slightly more than 2.5% each year.
- Staff will continue to monitor personal property new growth and will review this topic periodically.



Recommendation (E): Tax up to the levy limit and appropriate increasing amounts into the Capital Stabilization Fund or other reserves. This recommendation is consistent with current practice.

Current status: The Town has consistently followed the practice of taxing to the Proposition 2½ levy limit each fiscal year.

Positive Outcomes of Taxing to the Proposition 2½ Levy Limit:

- Maximize revenue for the Town and generate higher interest earnings
- Ability to stabilize growth in tax bills from year-to-year
- Allows the Town to maximize reserves
- Maximum flexibility in budgeting for Town Management and policy makers



Planning Ahead:

- Staff recommends setting aside an increasing amount each year into the Capital Stabilization Fund prior to allocating new revenue between Town and School departments.
- This will generate increasing capacity to absorb within levy debt in future years and prepare for the debt service generated by a high school construction project.
- The operating budget will be restricted to modest increases even though the Town is still taxing to the levy limit.

| | Appropriate to Capital Stabilization Fund | High School Debt Service |
|--|--|---------------------------------|
| FY2020 | \$ 2,200,000 | \$ - |
| FY2021 | \$ 3,700,000 | \$ - |
| FY2022 | \$ 5,200,000 | \$ - |
| FY2023 | \$ 6,700,000 | \$ - |
| FY2024 | \$ 8,200,000 | \$ - |
| FY2025 | \$ 9,700,000 | \$ - |
| FY2026 | \$ 11,200,000 | \$ - |
| FY2027 | \$ - | \$ 14,000,000 |
| Total Set Aside to CSF | \$ 44,700,000 | |
| Total within levy debt capacity | \$ 11,200,000 | |



Recommendations (F):

- Prioritize projects in the 5-year capital plan to stay within target ranges of cash capital and debt service.
- Develop an inventory and replacement schedule for all of the Town's capital assets to support long-term capital planning.

Current status:

- Every year Lexington funds a variety of one-time and continuing program capital projects that are funded from a combination of cash and debt.
- For FY2021 staff is piloting a new ranking system for one-time capital projects that will be funded from the General Fund.

| | FY2017 | FY2018 | FY2019 | FY2020 |
|---|----------------|----------------|----------------|----------------|
| Operating Budget | \$ 178,949,235 | \$ 189,990,381 | \$ 208,028,555 | \$ 216,793,861 |
| Cash Capital (Free Cash & Tax Levy) | \$ 5,699,429 | \$ 6,421,619 | \$ 7,546,138 | \$ 7,220,666 |
| Cash Capital as a % of Operating Budget | 3.18% | 3.38% | 3.63% | 3.33% |



Planning Ahead:

- Capital projects that fall into the continuing program category should be funded by tax levy or Free Cash.
- Short-lived capital assets and equipment should be cash financed.
- Cash capital should be funded at a level that meets the continuing programs (and a consistent percent of the Town's operating budget).

Continuing Programs as a Percent of Operating Budget

| | FY2020 | FY2021 | FY2022 | FY2023 | FY2024 |
|--|----------------------|----------------------|----------------------|----------------------|----------------------|
| General Fund Operating Budget | \$ 216,793,861 | \$ 222,214,000 | \$ 227,769,000 | \$ 233,463,000 | \$239,300,000 |
| Tax Levy Capital | \$ 2,820,666 | \$ 2,842,984 | \$ 2,865,860 | \$ 2,889,307 | \$ 2,913,341 |
| Free Cash | \$ 4,400,000 | | | | |
| Total Cash Capital | \$ 7,220,666 | \$ 2,842,984 | \$ 2,865,860 | \$ 2,889,307 | \$ 2,913,341 |
| Debt Financed Projects | \$ 3,029,088 | | | | |
| Total Continuing Programs | \$ 10,249,754 | \$ 11,576,521 | \$ 10,215,493 | \$ 15,769,920 | \$ 11,889,011 |
| Continuing Programs as a % of Operating Budget | 4.73% | 5.21% | 4.49% | 6.75% | 4.97% |

- Staff is exploring software and consulting options for creating a capital asset inventory.



Recommendations (G):

- Reduce debt financing of continuing programs and short-lived capital assets such as technology.
- Adopt and implement new debt management guidelines that is sustainable for the future.

Current status:

- One-time and continuing programs are financed with debt.
- Within levy debt service is limited to increase by 5% per year.
- Capital Stabilization Funds may be used to maintain the 5% limit.

| | FY2017 | FY2018 | FY2019 | FY2020 |
|---|----------------|----------------|----------------|----------------|
| Operating Budget | \$ 178,949,235 | \$ 189,990,381 | \$ 208,028,555 | \$ 216,793,861 |
| Within Levy Debt Service | \$ 7,037,701 | \$ 9,388,135 | \$ 10,896,432 | \$ 9,853,984 |
| Debt Service as a % of Operating Budget | 3.93% | 4.94% | 5.24% | 4.55% |

Planning Ahead: Staff will draft comprehensive guidelines for the Town's capital program that will be based on best practices and the needs of the community. Guidelines should be implemented for the FY2022 budget.



Recommendation (H): Continue to utilize the Town’s Revenue Allocation Model in future budget development.

Current status:

- The Town has a long-standing model for allocating new revenue between the Town and School budgets.
- The Town Manager and Superintendent of Schools agree the model is a useful tool for reducing budget contentiousness and creating unity in budgeting.

Revenue Allocation History

| | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 |
|--------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| 1 Total Revenue | \$180,117,971 | \$192,981,462 | \$197,586,175 | \$209,665,006 | \$221,900,289 | \$229,265,581 |
| 2 Revenue Increase | \$8,191,602 | \$12,863,491 | \$4,604,713 | \$12,078,831 | \$12,235,283 | \$7,365,292 |
| 3 % Revenue Increase | 4.8% | 7.1% | 2.4% | 6.1% | 5.8% | 3.3% |
| 4 Total Allocation | \$8,829,666 | \$10,095,549 | \$8,999,119 | \$8,723,038 | \$9,444,671 | \$7,945,246 |
| 5 % of Prior Year Budget | 7.9% | 8.5% | 7.2% | 6.6% | 6.9% | 5.4% |
| 6 Used - School | 86.9% | 81.9% | 85.9% | 70.8% | 98.9% | |
| 7 Used - Town | 57.0% | 59.6% | 39.2% | 34.8% | 90.7% | |
| 8 Give Back | \$1,883,592 | \$2,432,273 | \$2,389,769 | \$3,368,777 | \$302,249 | |
| 9 % Unused | 21.3% | 24.1% | 26.6% | 38.6% | 3.2% | |

Planning Ahead: Set aside increasing revenues into the Capital Stabilization fund ahead of allocating new revenue.



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Revenue Allocation Model (cont.)

| \$229,266 | | Projected FY2020 Revenue | | | |
|-----------|--------------|--------------------------|-------------|---------------------------|---|
| | | Shared | Municipal | School | (\$s in 000s) |
| (1) | \$ (108,111) | \$ — | \$ — | \$ (108,111) | FY2019 school budget |
| (2) | \$ (38,270) | \$ — | \$ (38,270) | \$ — | FY2019 municipal budget |
| (3) | \$ (214) | \$ — | \$ (214) | \$ — | Tax Levy Support of Community Center (Article 5) |
| (4) | \$ (2,504) | \$ (2,504) | \$ — | \$ — | FY2020 Minuteman |
| (5) | \$ (6,406) | \$ (6,406) | \$ — | \$ — | FY2020 Contributory Retirement |
| (6) | \$ (15) | \$ (15) | \$ — | \$ — | FY2020 Non-Contributory Retirement |
| (7) | \$ (28,723) | \$ (28,723) | \$ — | \$ — | FY2020 Benefits |
| (8) | \$ (200) | \$ (200) | \$ — | \$ — | FY2020 Unemployment |
| (9) | \$ (875) | \$ (875) | \$ — | \$ — | FY2020 Workers' comp |
| (10) | \$ (882) | \$ (882) | \$ — | \$ — | FY2020 Property and Liability Insurance |
| (11) | \$ (250) | \$ (250) | \$ — | \$ — | FY2020 Uninsured Losses |
| (12) | \$ (410) | \$ (410) | \$ — | \$ — | FY2020 Solar Production Payment |
| (13) | \$ (7,575) | \$ (7,575) | \$ — | \$ — | FY2020 Debt Service |
| (14) | \$ (900) | \$ (900) | \$ — | \$ — | FY2020 Reserve Fund |
| (15) | \$ (11,431) | \$ (11,431) | \$ — | \$ — | FY2020 Facilities Department Budget |
| (16) | \$ (196) | \$ (196) | \$ — | \$ — | Facilities PIRs for Painting and Security |
| (17) | \$ (14,359) | \$ (1,000) | \$ — | \$ — | Set-Aside for as yet identified needs; |
| | | \$ (200) | \$ — | \$ — | Unanticipated Current Fiscal Year Needs; |
| | | \$ (225) | \$ — | \$ — | Debt Service Mitigation |
| | | \$ (1,600) | \$ — | \$ — | Capital Stabilization Fund |
| | | \$ (700) | \$ — | \$ — | Transition Free Cash out of Operating Budget - 1st of 5 years |
| | | \$ (2,235) | \$ — | \$ — | Pay Down Principal for Land Purchases |
| | | \$ (3,700) | \$ — | \$ — | Cash Capital |
| | | \$ (1,880) | \$ — | \$ — | OPEB |
| | | \$ (2,617) | \$ — | \$ — | Street Improvement Program |
| | \$ (203) | \$ — | \$ — | Building Envelope Program | |
| (18) | \$ (221,321) | \$ (74,726) | \$ (38,484) | \$ (108,111) | Base Budget - Used for Allocation |
| | | | 26.3% | 73.7% | Percentage - Municipal and School Only |
| (19) | \$ 7,944 | | \$ 2,086 | \$ 5,859 | Incremental Revenue |
| | | | 5.4% | 5.4% | Percent of Current Budget |



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Questions & Discussion



Next Steps:

- These guidelines will be incorporated into the FY2020 budget adjustments for Fall STM and the FY2021 budget development process.
- Revenue projections and a preliminary Revenue Allocation Model will be presented at the upcoming Budget Summit.
- Staff will prepare the FY2020 Tax Recap and proposed tax rates based on these recommendations.

Future Meeting Dates:

- **Budget Summit I – October 30, 2019**
- Fall Special Town Meeting – November 12-13, 2019
- **Budget Summit II – November 21, 2019**
- Set the FY2020 Tax Rate – December 2, 2019
- Begin FY2021 Budget Hearings – December 3, 2019
- **Budget Summit III (White Book) – January 16, 2020**