

Town of Lexington



Spring Budget Summit

Financial Policies and Planning

May 15, 2019



- I. Anticipated Summit Outcomes & Fiscal Policy Roadmap
- II. Review Lexington's Financial Goals and Objectives
- III. Discussion of Particular Policy Items
 - a. Eliminating Use of Free Cash for the Operating Budget
 - b. Tax to the Levy Limit vs. Creating Excess Levy Capacity
 - c. Personal Property Tax New Growth
 - d. Funding and Use of Stabilization Funds
- IV. Other Financial Topics
 - a. Strategy and Commitment for Funding OPEB
 - b. Ongoing Capital Financing Plan – Debt Management
 - c. Police Station Construction, Future Use of Debt Exclusions
- V. Next Steps and Timeline



Anticipated Fiscal Policy Summit Outcomes

Policy makers provide staff with input to inform the following:

1. Documented fiscal policies and guidelines
2. Method of adopting fiscal policies and guidelines, future adherence and expectations for review
3. Recommended FY2020 budget adjustments for Fall STM and to establish the FY2020 tax rate
4. Short and long-term financial projections that incorporate updated financial policies and guidelines



Roadmap for Achieving Summit Outcomes

1. Fiscal Policy Summit Meeting - Kickoff
2. Staff to meet individually with boards and committees to receive feedback on fiscal policies and guidelines.
3. Policy and guideline documents drafted by staff with input from boards and committees.
4. Documents presented for discussion at Fall Summit meeting accompanied by supporting financial projections.
5. Staff, board and committees agree on policies and guidelines to be used over the next 5-10 years, with periodic check-ins as needed.



Financial Goals and Objectives

1. Develop a fiscally responsible, balanced budget each fiscal year
2. Avoid the need for an operating override
3. Establish and maintain adequate levels of fiscal reserves
4. Prioritize investments in the Town's physical assets in a way that minimizes operating expenses and maximizes the useful life of the assets
5. Stabilize the year-over-year fluctuation in residential tax bills
6. Maintain the Town's AAA bond rating



The FY2020 budget began a more aggressive reduction of use of Free Cash for the Operating Budget than in previous years, with an intent to eliminate its use within 5 years.

Area	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
Operating Budget	\$4,080,920	\$3,918,300	\$3,853,023	\$3,740,000	\$2,900,000	\$2,200,000	\$1,500,000	\$750,000	-
Cash Capital	\$2,419,000	\$2,500,000	\$3,350,000	\$4,050,245	\$4,400,000	TBD	TBD	TBD	TBD
OPEB Funding	\$3,247	\$312,318	\$1,079,721	\$1,079,721	\$1,129,721	\$1,179,721	\$1,229,721	\$1,279,721	\$1,329,721
Capital Stabilization Fund	\$6,405,035	\$3,100,000	\$5,000,000	\$502,085	\$1,536,759	TBD	TBD	TBD	TBD
Retire Note – Land Purch.	-	-	-	\$3,050,000	\$2,234,614	\$2,403,450	\$2,403,450	-	-
Getting to Net Zero		\$40,000	\$40,000	-	-	-	-	-	-
Unallocated*		\$924,961	\$565,125	\$480,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Set-Aside - Current Year*	\$200,000	\$200,000	\$200,000	\$160,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Total Free Cash	\$13,108,202	\$10,995,579	\$14,087,869	\$13,062,051	\$13,401,094	\$6,983,171	\$6,333,171	\$3,229,721	\$2,529,721

*If funds are not used for the budget, the balance falls to Free Cash again

As Free Cash becomes available, the intent is to apply it to the Capital budget to increase the annual capital program and/or reduce debt financing of capital projects.

Other potential uses of Free Cash:

- Additional funding of OPEB
- Pay-down of land purchases (20 Pelham and 171 Bedford)
- Transfer to Capital Stabilization Fund



Considerations for Setting the Tax Rate:

- TAX TO THE LEVY LIMIT – The annual tax rate is calculated to raise the maximum amount of revenue allowed by Proposition 2½, also known as the ‘Levy Limit’. In recent years, this has been Lexington’s practice. Rather than building up operating expenses, recent budgets have included significant set-asides into reserves, including the Capital Stabilization Fund. These reserves earn interest and may be used in future years as a way of offsetting or preventing an override vote.

OR

- EXCESS LEVY CAPACITY – If a municipality does not tax to the levy limit, it will leave excess capacity under the Levy Limit. The full amount of revenue allowed by Proposition 2½ is not raised, which will result in lower tax bills. Built-up excess levy capacity may be utilized for future annual budgets, meaning that within levy tax bills could grow by more than 2.5% in future years, but may avoid operating overrides.

Informational videos on Proposition 2½, New Growth, Levy Limit and setting the annual tax rate can be found at the following link to the Massachusetts Department of Revenue, Division of Local Services: <https://www.mass.gov/service-details/proposition-2-12-and-tax-rate-process>



Policy Considerations	Tax to the Levy Limit	Create Excess Levy Capacity
Revenue	Maximize revenue, greater interest earnings	Less revenue, less interest earnings
Tax Bills	Higher tax bills - stable growth from year-to-year	Lower tax bills - may vary significantly from year-to-year
Equity	Current taxpayers contribute to current and future expenses	Current taxpayers contribute to current expenses only
Fiscal Reserves	Maximize reserves	Less reserves set aside
Flexibility	Maximum flexibility for Town Management and policy makers	Some flexibility for Town Management and policy makers



Potential available funds within FY2020 Levy Limit:

Revenues

Program	Element	Budgeted	Likely	Available	Notes
State Aid	Chapter 70	\$14,364,684	\$14,438,034	\$ 73,350	Expected increase in state aid based on House Final budget
New Growth	Property Tax - All	\$ 2,500,000	\$ 3,200,000	\$ 700,000	Estimate based on historical new growth trends; actual value unknown until Fall 2019
Subtotal - Revenues				\$ 773,350	

Available Funds

Description	Brown Book	Available	Notes
Unallocated - Tax Levy portion	\$ 182,705	\$ 182,705	Tax levy capacity not appropriated in FY2020 budget
Carryforward for Snow Removal Deficit	\$ 400,000	\$ 400,000	Budget set-aside for potential snow deficit- not needed due to mild winter.
Subtotal - Available Funds		\$ 582,705	

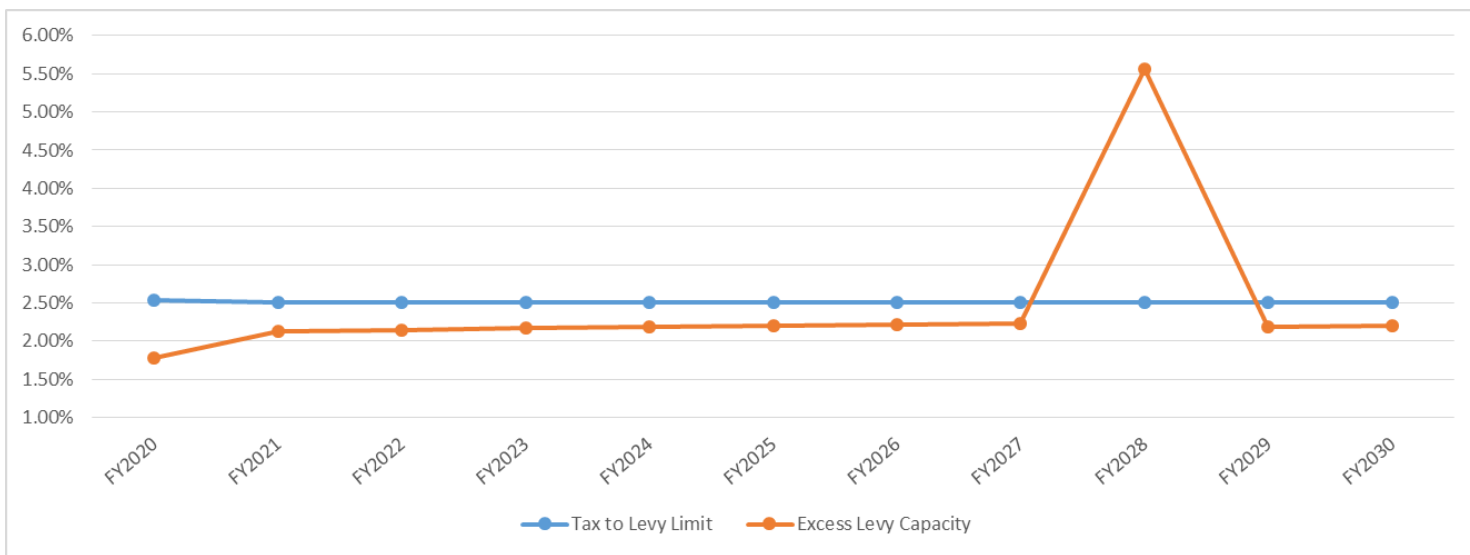
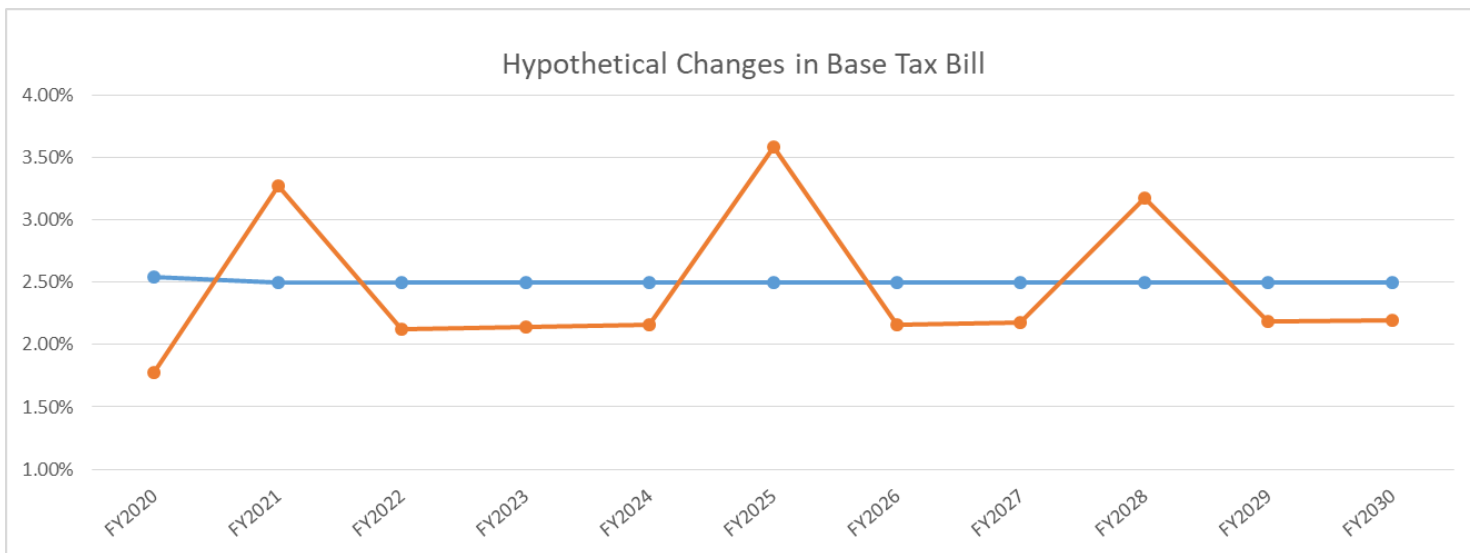
Total Potential Funds Available for Appropriation \$ 1,356,055

Leaving \$1.36M in excess levy capacity would reduce the Residential tax rate by approximately \$0.10 per \$1,000 of value. The result would be a reduction of **\$108** in annual property taxes (0.7% of the total \$15,237 bill), for the home of average value (\$1,050,000 in FY2019).



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Context for FY2020 Decision





**Should Lexington
Tax to the Levy Limit?**

Yes. Approximately
\$1.36M will be
available in FY2020.

No. \$1.36M will not be
taxed in FY2020,
reducing the average
annual tax bill by \$108.

**What should be done
with the additional
revenue collected?**

Options include –

1. Capital Stabilization Fund – use to mitigate ongoing excluded debt service payments.
2. Capital Stabilization Fund – build up balance to pay cash for a portion of the new high school.
3. Pay down Land Purchases (Bedford St./Pelham) more quickly.
4. Other ???

**What conditions are
acceptable to access the
additional levy capacity?**

Options include –

1. Never. Should hold the line indefinitely.
2. Fiscal downturn, and only if other funding streams are affected.
3. Dramatic surge in enrollment, documented by the school committee.
4. To help fund a capital investment.
5. Other ???



Why is there an issue with personal property and how does it differ from residential and commercial property?

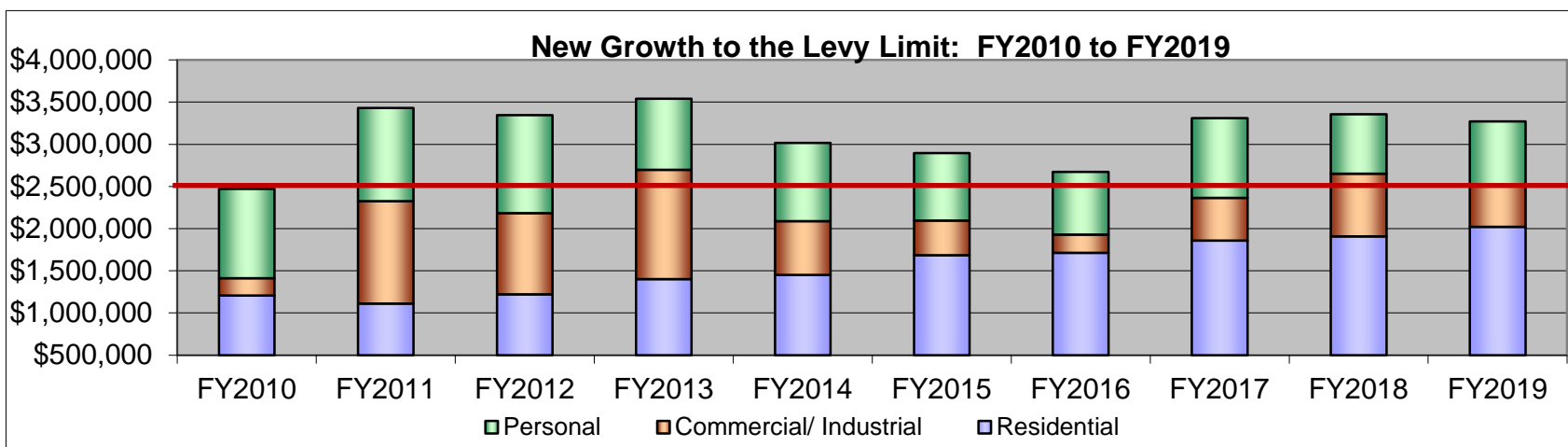
- The value for both Residential and Commercial tends to be fairly stable and is maintained from one year to the next, with adjustments due to market conditions.
- Personal Property is primarily made up of durable equipment used in commercial and industrial business, and is taxed at the same rate as Commercial/Industrial. However, a key distinction is that the value is set to depreciate over a period of years.
- Yet, because the value was initially set as new growth and added to the base, there is no mechanism in the Proposition 2½ formula for the value to be removed, so it is redistributed to the remaining tax base.
- As an example, if new growth of \$100,000 in Personal Property is recognized in one year, that is added to the tax levy, and grows by 2.5% each year. However, the actual tax bill for that particular property type may be reduced by 20% each year, until it is \$0 after 5 years but the \$100,000 added in the first year continues to be part of the permanent tax base.

This is a component of how the Proposition 2½ calculation works and while a number of communities have identified this as an issue, the MA Division of Local Services is not aware of any community that has addressed it.



History of New Growth

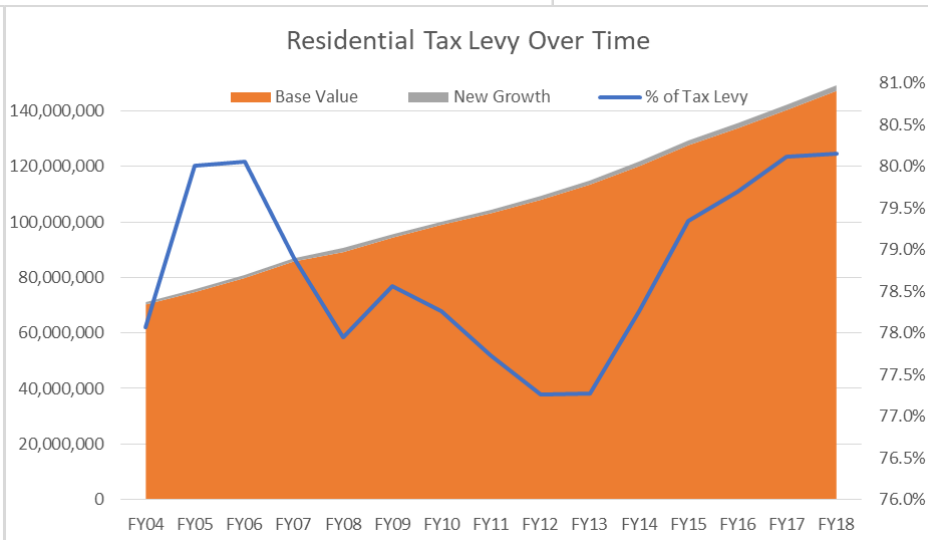
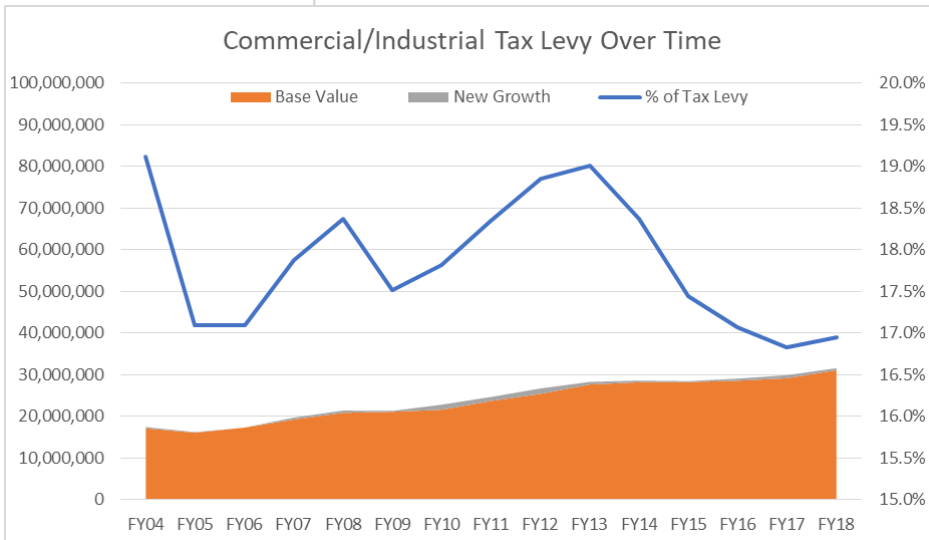
Fiscal Year	Residential	Commercial/ Industrial	Personal	Total
FY2010	\$1,206,197	\$206,414	\$1,058,669	\$2,471,280
FY2011	\$1,112,487	\$1,212,054	\$1,105,704	\$3,430,245
FY2012	\$1,222,142	\$960,174	\$1,164,220	\$3,346,536
FY2013	\$1,400,099	\$1,297,354	\$841,492	\$3,538,945
FY2014	\$1,451,904	\$635,052	\$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





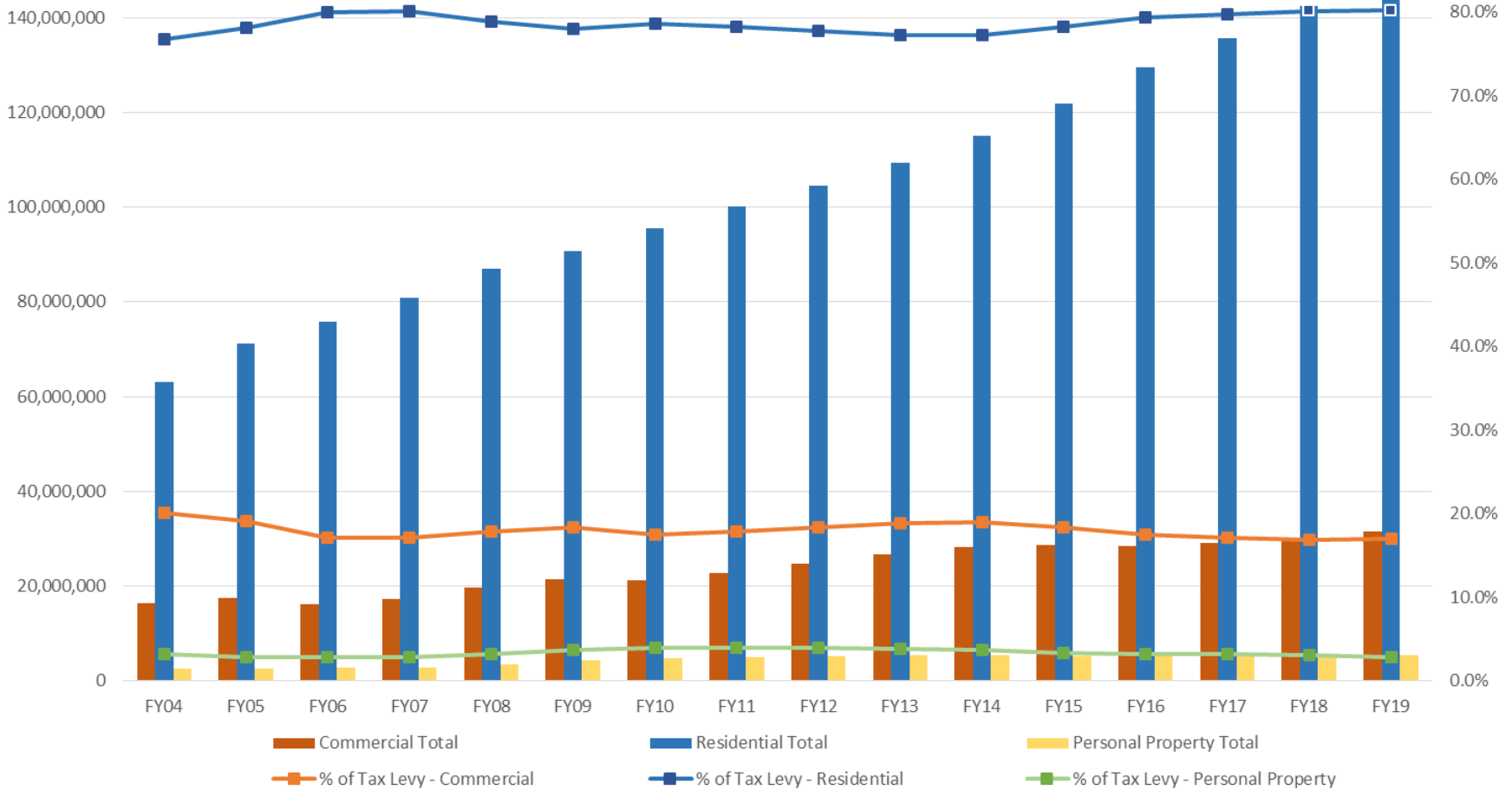
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Personal Property Tax Levy Over Time





Tax Levy Distribution Over Time





Potential Actions to address Personal Property new Growth:

1. Continue Status Quo – Utilize for annual operating budget as has been the Town's past practice
2. Continue the Status Quo, but Ensure that Amounts Generated from Personal Property are Set-Aside for One-Time Needs – Be more rigorous in identifying and ensuring that revenue from Personal Property is used for one-time costs such as Cash Capital or set-aside to Stabilization Funds
3. Determine the Amount of the Shift in a Given Year, and Leave Excess Levy Capacity – Excess Levy Capacity attributable would build over the years, and would be available for future policy makers if so desired. This could reduce or eliminate the need for future operating override votes or debt exclusions.



Capital Stabilization Fund

- The Capital Stabilization Fund (CSF) was established and funded to mitigate the impact of several large capital projects that were funded within a short time period.
- Funding peaked in FY2018 at over \$28 million
- Recent use of the CSF has been to mitigate the impact of exempt debt service on the tax rate and to stabilize the impact of within levy debt on the operating budget.
- Staff projects transfers out of the CSF will exceed transfers into the CSF for the next 5 years, at which point the balance will be significantly lower than it is today.

Next Steps:

- Review policy on future use and funding of the CSF, with focus on funding a potential High School reconstruction project.



History of Capital Stabilization Fund				
	Appropriations and Interest into the Capital Stabilization Fund	Anticipated Use of Capital Stabilization Fund for Within Levy Debt	Anticipated Use of Capital Stabilization Fund for Excluded Debt	Ending Balance
FY2013	\$1,601,835	\$0	\$0	\$1,601,835
FY2014	\$3,988,868	\$0	(\$1,600,000)	\$3,990,703
FY2015	\$5,926,762	(\$919,000)	(\$950,000)	\$8,048,465
FY2016	\$9,513,048	(\$215,000)	(\$620,567)	\$16,725,946
FY2017	\$7,187,263	\$0	(\$710,000)	\$23,203,209
FY2018	\$8,119,224	(\$324,500)	(\$2,400,000)	\$28,597,933
FY2019	\$3,560,335	(\$573,500)	(\$4,500,000)	\$27,084,768
FY2020⁽¹⁾	\$1,536,759	\$0	(\$5,200,000)	\$23,421,527
FY2021 (est.)	\$0	(\$1,910,000)	(\$6,200,000)	\$15,311,527
FY2022 (est.)	\$0	(\$1,474,000)	(\$4,000,000)	\$9,837,527
FY2023 (est.)	\$0	(\$1,329,000)	(\$2,200,000)	\$6,308,527
FY2024 (est.)	\$0	(\$1,025,000)	\$0	\$5,283,527
FY2025 (est.)	\$0	(\$198,000)	\$0	\$5,085,527
FY2026 (est.)	\$0	\$0	\$0	\$5,085,527
FY2027 (est.)	\$0	\$0	\$0	\$5,085,527
FY2028 (est.)	\$0	\$0	\$0	\$5,085,527

⁽¹⁾ As appropriated at 2019 Annual Town Meeting



Hypothetical High School Funding Analysis

Borrowing Term 30 Years
Interest Rate 4%

Model #1	
Total Project Cost	\$ 350,000,000
Less: MSBA State Contribution	\$ 105,000,000
Less: Cash from Cap. Stab. Fund	\$ 25,000,000
Total Project Financing	\$ 220,000,000

Model #2	
Total Project Cost	\$350,000,000
Less: MSBA State Contribution	\$105,000,000
Less: Cash from Cap. Stab. Fund	\$ -
Total Project Financing	\$245,000,000

Total Interest Expense- Level Principal \$ 142,266,667
Total Interest Expense- Level Payment \$ 167,545,321

Total Interest Expense- Level Principal \$158,433,333
Total Interest Expense- Level Payment \$186,584,562

Result of \$25M cash payment from CSF:

Interest Savings- Level Principal \$ 16,166,667
Interest Savings- Level Payment \$ 19,039,241

First 5 years of debt service payments are reduced by approx \$1.5M- \$1.8M/year (principal & interest)



Additional Financial Policies and Guidelines Under Review:

- Other Post-Employment Benefits – continuation of current approach for consistent funding from one year to the next from Free Cash and the Health Care Trust Fund. Consider implementing a more robust approach for 2024 and beyond.
- Capital Planning & Debt Management – Establish a prioritized system for funding capital projects (currently under review). Review of continuing capital programs and one-time requests compared to available funds. Review 5% increase thresholds for annual General Fund Capital and within-levy debt service.
- Police Station Construction Future Debt Exclusions – Timing of Debt Exclusion Referendum for Police Station construction project. Review of other large capital projects that may qualify for a debt exclusion referendum and discuss future guidelines.



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Strategy and Commitment for Funding OPEB

Per GASB, the Town is required to report its OPEB liability on its balance sheet. Ratings agencies look to see that consistent effort is being made to fund that liability, as a measure of good fiscal management. The Town's AAA bond rating provides a significant savings on debt interest payments.

Historical Levels of OPEB Funding

5/1/2019

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
Opening Balance	\$ 4,482,338	\$ 5,798,656	\$ 7,997,042	\$ 10,532,069	\$ 13,137,657	\$ 15,845,902	\$ 17,731,388	\$ 19,667,162	\$ 21,653,239	\$ 23,689,634
Additional Contributions										
Tax Levy*	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 325,000
Health Claims Trust Fund*	\$ 1,000,000	\$ 1,858,947	\$ 1,200,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 425,000
Free Cash**	\$ 119,000	\$ 3,247	\$ 312,318	\$ 1,079,721	\$ 1,079,721	\$ 1,129,721	\$ 1,179,721	\$ 1,229,721	\$ 1,279,721	\$ 1,329,721
Water/Sewer	\$ -	\$ -	\$ -	\$ 13,174	\$ 13,174	\$ 5,765	\$ 6,053	\$ 6,356	\$ 6,674	\$ 7,007
Total OPEB Contribution	\$ 1,119,000	\$ 1,862,194	\$ 1,512,318	\$ 1,842,895	\$ 1,842,895	\$ 1,885,486	\$ 1,935,774	\$ 1,986,077	\$ 2,036,395	\$ 2,086,728
Fund Gains/(Losses)	\$ 197,318	\$ 336,192	\$ 1,022,708	\$ 762,693	\$ 865,350	\$ -	\$ -	\$ -	\$ -	\$ -
Ending Balance	\$ 5,798,656	\$ 7,997,042	\$ 10,532,069	\$ 13,137,657	\$ 15,845,902	\$ 17,731,388	\$ 19,667,162	\$ 21,653,239	\$ 23,689,634	\$ 25,776,362

*Because the Health Claims Trust Fund can only be used for health insurance costs, the transfer from that fund to the General Fund frees up tax levy funds that are then used for OPEB. For presentation purposes, that two-step transfer is shown as one for FY2015-19.

**Free Cash must be appropriated by Town Meeting. If certified Free Cash is not fully appropriated by June 30th, the balance will go to fund balance, and will be included in the amount of Free Cash certified for the following year.

Health Claims Trust Fund	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
Opening Balance	\$ 8,567,189	\$ 7,559,595	\$ 5,693,188	\$ 4,540,875	\$ 3,851,400	\$ 3,178,612	\$ 2,500,824	\$ 1,818,035	\$ 1,130,247	\$ 437,459
Transfers to General Fund	\$ (1,000,000)	\$ (1,858,947)	\$ (1,200,000)	\$ (750,000)	\$ (750,000)	\$ (750,000)	\$ (750,000)	\$ (750,000)	\$ (750,000)	\$ (425,000)
Transfers to Special Revenue Fund	\$ (178,405)									
Expenses	\$ (5,196)	\$ (75,641)								
Revenue	\$ 160,951	\$ 43,851	\$ 6,486	\$ 328						
Interest Earnings	\$ 15,054	\$ 24,330	\$ 41,202	\$ 60,197	\$ 77,212	\$ 72,212	\$ 67,212	\$ 62,212	\$ 57,212	\$ -
Ending Balance	\$ 7,559,595	\$ 5,693,188	\$ 4,540,875	\$ 3,851,400	\$ 3,178,612	\$ 2,500,824	\$ 1,818,035	\$ 1,130,247	\$ 437,459	\$ 12,459

Because a significant portion of OPEB Funding is taken from the HCTF, this chart is provided to show actual activity in the HCTF from FY2015 when it was first tapped for OPEB, and projecting forward until the fund is fully depleted in FY2024.

DOR has asked the Town to transfer the balance of the HCTF more quickly. Staff have deferred action, preferring to show a consistent transfer from the operating budget to OPEB to demonstrate a commitment to fund OPEB for the ratings agencies.



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Next Steps, Proposed Timeline

	May	June	July	August	September	October	November	December	January
Budget Process				Initiate FY2021 Capital Budget	Initiate FY2021 Operating Budget	Staff & Town Manager to Review FY2021 Budget	BOS FY2021 Budget Hearings		Publish White Book
Summit/ Policy Meetings	Spring Fiscal Policy Summit	<u>Staff to Prepare Fiscal Policies and Guidelines</u>			Fiscal Policy Summit: Review of Fiscal Policies and Financial Projections	Budget Summit I: Indicators, 5-Year Rev & Exp Projections	Budget Summit II: FY2021 Revenue Allocation		Budget Summit III: Review White Book
Tax Rate					New Growth Finalized	Property Values Reviewed and Submitted to DOR	DOR to Approve Property Values/ Tax Rate Hearings	Tax Rate Classification Finalized, Approved by DOR	Mail FY2020 Actual Tax Bills
Town Meeting						Special Town Meeting		Potential Debt Exclusion Referendum	