

**Town of Littleton
Finance Committee Report**

Fiscal Year 2011



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To the residents of Littleton:

The Finance Committee is pleased to prepare this informational report containing our recommendations for the FY11 budget as well as recommended fiscal guidelines for the Town. It is our hope that this sharing of information prior to Town Meeting will enable voters to better understand the many issues facing the Town today and their impact on the budget recommendations made herein. The data presented here is based on information available as of mid-April 2010. Any significant changes to these figures will be presented at Town Meeting.

The Role of the Finance Committee

The Littleton Finance Committee consists of seven members, each appointed to a three-year term. Two members are appointed by the Selectmen, two by the School Committee, one by the Board of Assessors, one by the Moderator and one by the Light and Water Commissioners. This appointment procedure allows for a diverse group with overlapping terms and expertise.

The primary function of the Finance Committee (FinCom) is to review departmental budgets and submit a balanced budget (Article 4 of the Annual Town Warrant) to Town Meeting. In addition to this statutory budget responsibility, the FinCom has a set of specified financial management responsibilities including:

- Managing a small reserve fund account to meet unforeseen expenditures within the current budget year;
- Conducting public hearings on budgets and other financial matters that may come before the Town;
- Establishing fiscal guidelines for Town Officials for use in preparing their budget requests and capital planning needs;
- Participating in sub-committees requiring financial input or guidance, and;
- Providing financial feedback or input to Town boards or employees.

Committee members are assigned as liaisons to each department, board or committee to facilitate communication and understanding of the issues during the budget process as well as throughout the year. The FinCom's role, however, is limited to making recommendations to Town Meeting or the appropriate governing body. The decision-making responsibility rests with the elected officials and those who vote at Town Meeting and general elections.

Fiscal Year 2011 Budget Pressures

The Town continues to deal with the financial difficulties presented to us during the past several years. A weak state economy has placed increased burdens on local town governments to provide for the escalating costs associated with the delivery of services to the community. The dismal state of our nation's economy has made this situation even more acute. Through prudent financial planning and a conservative approach to spending, our community has been able to weather the cuts in local aid payments by the state, but we have serious concerns about our ability to do so in the long-term. Should state revenues continue to decline over the next several years, further reductions in such aid will seriously impact our town's services.

The Finance Committee and the Board of Selectmen approved an updated financial policy that strengthened many of the guidelines that have been incorporated in the Town budgets since FY05. Following these guidelines over the past several years has enabled the Town to be better prepared for these adverse changes in the economy. Our updated policy, presented at the end of this report, formalizes these guidelines to help us prepare for the uncertainty of the next few budget cycles as the economy and State finances rebound. Until that time, we will face some tough decisions regarding spending as we attempt to balance current and future needs against declining revenues. It is the Finance Committee's job to evaluate all options and provide Town Meeting with the best possible recommendation for the long-term financial health of the Town.

The Finance Committee's primary goal during each budget cycle is to maintain the financial stability of the Town. In addition to this goal we attempt to fund the desired levels of services to be provided to the citizens of the Town. The ability to fund all departments to the desired levels is difficult in the best of times, and in challenging years such as this, impossible. The best we can recommend is to essentially level-fund the budget for all departments, including the schools.

Littleton, like many of its neighbors, is facing many challenges that require Town officials and citizens to make difficult decisions. Growth in our population, quality of life, level of services and affordability to live in the Town can often be in conflict with each other. With each new residence come additional roads to maintain, children to educate, and neighborhoods to safeguard. Studies have shown that although this property is added to the tax roll, the cost of services provided exceeds the tax collected. If taxes are increased to cover the needs, Littleton may become unaffordable to some of its citizens, changing the character of the Town. If these needs are not covered, Littleton may become undesirable to some citizens.

The primary budget conflict stems from several factors. Proposition 2 ½ allows a Town to increase the levy capacity 2.5% from year to year plus any added new growth. This, along with State Aid and local receipts, forms the basis of available revenue to be allocated. Simply put, in order to manage the long-term balance of revenues and expenses without a Proposition 2 ½ override demands that growth in expenses cannot be allowed to outpace revenue growth.

While determining this year's recommended budget, the Finance Committee kept these priorities in mind. We would:

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- Not recommend or support an operational override for FY11;
 - Maintain level- funding for all town departments and the School Department;
 - Not recommend a Cost of Living Adjustment (COLA);
 - Provide for step increases and longevity payments for Town employees;
 - Provide funding for a Facilities Manager to oversee the maintenance for all Town and School buildings.
 - Provide funding for road repairs;
 - Provide funding for capital equipment.

Total revenues projected for FY11 have seen a modest increase. Net State aid, based on the initial Cherry Sheet from the Governor's budget, will decrease slightly on the Town-side and be level-funded for the School department. The Legislature has forecast that they may cut 4% from local aid and Chapter 70 (School funding) for FY11. Should this take place, it will put additional pressure on this budget, particularly in the School Department where they may have to dip further into their reserves or have to reduce staff. The final numbers from the Legislature may necessitate modifications to the budget presented in this report. New growth estimates are much less than last year and other non-tax receipts are showing no significant increases.

The change to quarterly tax billing continues to help the Town to better manage cash flow and not experience periods of cash short-falls which, in past years, forced the Town to borrow and incur unexpected interest costs.

The Finance Committee, in recommending a budget for FY11, has managed to fund nearly all the priority projects shown above. We were unable to fund a Facilities Manager at the present time due to these other priorities and lower overall growth in revenues. The committee realizes the importance of this position given the significant increases in new and rehabilitated Town properties. The Finance Committee and the Board of Selectmen will continue to plan for the filling of this position as soon as a stable funding source for the new hire and an adequate maintenance budget can be identified.

Changes in Revenues FY11 vs. FY10

(in dollars)

This chart details the revenue growth contained in the FY11 budget.

The net revenue growth % for FY11 is 2.35%. This % was also 2.35% last year.

<u>Item</u>	<u>Amount</u>
Total Revenue FY10	\$ 33,006,069
Add: additional revenue sources	
Allowed 2 ½ % Levy Increase	561,170
New Growth	175,000
Increase in Other Available Funds	39,927
Increase in Debt/Capital Exclusion	498,829
Less: Decrease in Local Receipts	(61,500)
Decrease in Free cash	(275,880)
Decrease in State Aid (Cherry Sheet)	(130,444)
Net Revenue Growth	<u>\$ 807,102</u>
Non-recurring revenue adjustments	
Add: Change in transfers of prior year funds	(31,725)
Net Change in Total Revenues	<u>\$ 775,377</u>
Total Revenue FY10	<u>\$ 33,781,446</u>
% Revenue Growth	2.35%

Changes in Expenditures FY11 vs. FY10

This chart details the growth in expenses contained in the FY11 budget.

A budget surplus of \$1,250 exists at this time.

<u>Item</u>	<u>Amount</u>
Total Expenditures FY10	\$ 33,001,388
Changes in expense items	
Decrease in Town Operating budget	(292)
Increase in debt service & exclusions	399,691
Decrease in Cherry Sheet charges	(552)
Increase in School Budget	6
Decrease in other expenditures	(146,114)
Increase in warrant articles	22,125
Increase in health ins & pension costs	409,222
Increase in Nashoba Tech assessment	94,722
Net Change in Total Expenditures	<u>\$ 778,808</u>
Total Expenditures FY10	<u>\$33,780,196</u>
% Expenditure Growth	2.36%

The above chart shows the realities of what the FinCom has been faced with in proposing the FY11 budget. The revenue increase comes from expected increases in the levy and new growth, which is slightly off-set by declines in State Aid and available cash.

The use of non-recurring revenues over the past years, coupled with prior decreases in State aid, has added to the budget pressures experienced by the Town. During the 3 year period between FY04 and FY06, for example, a total of \$953,431 in one-time revenues were used to cover operating budget shortfalls. Although these transfers were done to balance their respective budgets, their impacts continue to be felt year after year as we attempt to cover those additional expenses without the availability of those revenues. In FY11, no non-recurring revenue transfers were made. The Finance Committee has taken a strong stance against the use of non-recurring revenue streams. This opposition has been a major contributing factor in the financial health of the Town.

Moving forward, three items have been, and will continue to be, major contributors to the expenditure levels of the Town: debt service, the school budget and employee benefit costs.

Debt Service

The Town enters FY11 with total outstanding principal debt \$38,848,843 with associated future interest costs of \$12,267,600 for total debt service of \$51,116,443. These figures do not include projects that have yet to be permanently bonded or debt incurred by the Water Department. Bonds for the Police Station and other minor projects were issued during FY10 and are included in the above figures for the first time.

Reimbursements from the State for the High School and Shaker Lane construction projects offset \$13,944,551 of the above total debt service. Payments on debt issued for the Light Department, for which the Town will be reimbursed, total an additional \$1,454,215. Cell tower revenues, covering an additional \$998,528, support some recent debt incurred for the purchase of land. Funds from the Community Preservation Act offset \$463,000 of additional debt costs. This leaves a net of \$34,256,149 in total Town supported debt service. Of this total, \$23,528,558 in principal and interest payments has been issued as debt exclusion, where the year-to-year debt service payments are raised outside of the normal Proposition 2 ½ levy calculation. The FinCom has advocated limiting future debt within the operating budget of the Town. We have recommended, and feel that it is absolutely necessary, that any future construction projects, such as the proposed track be done as debt exclusions.

Adding debt to the Town, similar to households using credit cards, places the burden of payment onto future years and constrains operating budgets. The Town continues to feel that impact in FY11. The debt service within the operating budget of the Town (total debt service *less* reimbursements *less* debt exclusion items) represents 5.27% of the adjusted revenues of the Town. This percentage stood at 5.67 % in FY10 and is reflective of the FinCom's resistance to borrow within Prop 2½. The FinCom has been working to reduce this portion of the debt service payment below the stated guideline of 5%. Even as we achieve this level we feel that future debt issuance within Prop 2 ½ must be kept to a minimum.

In the current year's budget we have allowed for an increase of \$100,000 to the borrowing authorization for the replacement of the water main associated with the repaving of Goldsmith Street. The debt service

associated with this project is minimal for the Town as the Water Department will begin to make the payments from water revenues in FY12. The Finance Committee does not foresee the need to issue further debt in order to continue with the 10-year road reconstruction project. Projections currently show that the operating budget impact can be minimized through the use of State Chapter 90 highway funds and regular road repair dollars already allocated within the operating budget. In FY11, a total of \$490,700 is set aside within the operating budget for both the Goldsmith Street debt service and funding for the road project. The Finance Committee is committed to following the current road repair plan as a baseline. Any available funding during the project lifecycle should be used to decrease the need for future borrowings.

While decreased debt payments provide additional funds for spending in other areas, the Finance Committee feels that it is necessary to set aside these savings to fund capital purchases or other one-time expenditures. These funds should not be allowed to re-enter the operating budget where expenses normally compound at a rate greater than new available revenues. *The Town's new Financial Policy, approved by the Board of Selectmen and Finance Committee earlier this year will be discussed later in this report.*

This year, the Finance Committee has not recommended the use of capital exclusions to fund items that normally would have been borrowed in previous years. This decision has been taken in recognition of the current economic climate, but will continue to be option in future years. A capital exclusion is similar to a debt exclusion in that the payment is raised outside of the normal Proposition 2 ½ levy calculation. However, a capital exclusion raises the total amount of the funds needed all at once, essentially paying cash for our purchase instead of using our credit card. A capital exclusion does impact the tax rate of the Town since it raises funds outside of Proposition 2 ½ for a single year. *(Specific impacts to the tax rate will be discussed later in this report.)* This funding mechanism enables the Town to decrease the amount of debt service and free up dollars within the operating budget to maintain the level of services required.

During this budget cycle all Town departments were asked to update their projected capital needs for the next ten years. The information has been compiled in a fashion that enables the planning process for these major capital purchases to become much more efficient. The Finance Committee has also identified capital purchases and projects that are likely candidates for capital exclusions over the next few years. It is our hope that the Town and Town Meeting approve the use of capital exclusions as a strategy to help strengthen and ensure the financial well being of Littleton.

School Budget

The Littleton Public Schools are the major recipient of Town Meeting appropriation. There is no question as to the value of a quality school system within the Town and the need for the community to provide its children with a quality education and proper foundation for their future.

The responsibility of the School Committee is to provide quality education and to advocate for an ever-improving system based on the educational needs of the children, the desires of the community, and statutory requirements. It is the responsibility of the FinCom to recommend to Town Meeting an appropriation that it believes is sufficient to meet those educational needs represented by the School Department budget, as well as to provide for the safety, protection and other services to the community within the limited resources available to the Town.

In the FY11 budget process, the FinCom recommends a Town appropriated school budget of \$14,428,679, or level funding when compared to the FY10 appropriation. A level funded Town appropriation accompanied by level funded Chapter 70 dollars from the State may require the School Department to use their reserves to a greater extent than in previous years. As detailed in the paragraphs below, the Finance Committee has discussed this alternative with the School Department. Both Committees are aware of the potential impacts this may have on the School budget in future years and will work together to implement a plan to manage the impacts to the Schools and the Town in constructing future budgets.

The Finance Committee is also supporting \$47,000 in capital appropriations to fund the ongoing replacement of HVAC units at the Shaker Lane school and replacement of older existing computers at the high school.

The FinCom makes its recommendation by taking into account salary increases, special education spending, maintenance and utility costs and balancing those needs against the funds available to the Town.

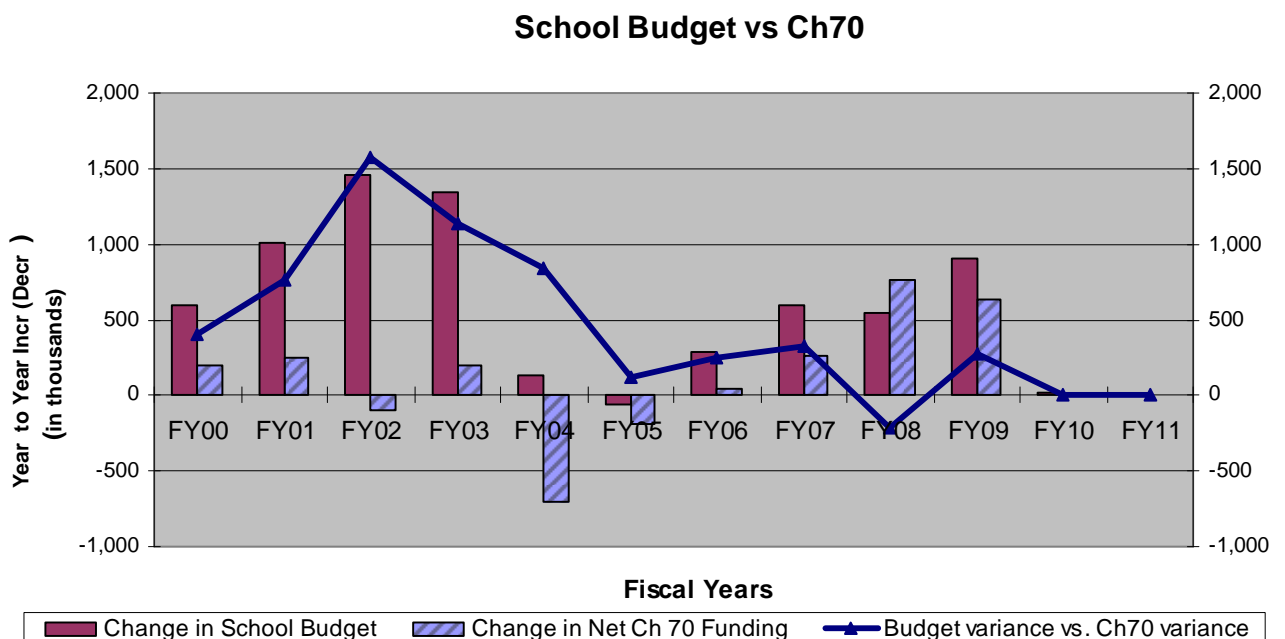
In addition to the Town's appropriation, the school system also funds its operations using available grants, donations and revolving funds. The use of these funds is incorporated into the current level of programs and staffing found in the schools with the unspent balance providing a cushion for the School Committee to access for unexpected costs such as special education without asking the Town to provide additional funding. The school department expects to end FY11 with a balance of \$400,000 in their revolving fund accounts.

The use of \$140,000 of these funds in FY11 will decrease the reserves within the revolving funds to their lowest levels in years. The Finance Committee has worked closely with the School Committee over the past three years in increasing these reserves and decreasing the school's dependence on using these funds within the operating budget. While the Finance Committee has agreed with the use of these funds in preparing the FY11 budget, we believe that spending these funds must be minimized in future budgets. Spending in excess of revenues cannot continue to occur since the fund balance could be exhausted within a year or two. Since the spending levels are incorporated into the current levels of programs provided by the school system, once these funds are exhausted, the school system will either be forced to cut programs or ask the Town to fund the shortfall in addition to its normal budget increase. The Finance Committee continues discussions regarding the use of revolving funds with the School Committee.

Chapter 70 is the funding that the Town receives from the state to supplement the school's operating budget. Starting in 2006, the state made changes to the distribution of Chapter 70 funding across the Towns of Massachusetts. Prior to 2006, it was clear that Littleton was not receiving its fair share of Chapter 70 funding. The correction implemented to bring Littleton up to par in Chapter 70 funding compared to similar Towns is now complete. Going forward, the increases that Littleton has enjoyed will not continue. We originally projected that the Town would need to fund a \$500,000 budget deficit in a projected level-services school budget at the point in time when Chapter 70 funding returned to normal levels. This shortfall has been offset through a combination of federal ARRA funds and revolving funds totaling \$439,086 to cover the deficit this year. If the school budget continues to grow and outpace projected future Town revenues, there will be a severe shortfall in the school operating budget. This is

due to the fact that approximately 70% of the school budget is linked to employee wages that have historically compounded at 5% - 6%. Additional staffing increases this number and will also increase a potential budget shortfall.

The chart below outlines the correlation between the year to year change in the school budget and Chapter 70 funding. The Town has increased the school operating budget at levels greater than the increases in Chapter 70 funding in 9 of the past 12 years. The projected funding shortfall occurred when Chapter 70 was level funded by the legislature, as opposed to the increases shown from FY07 to FY09. Note that at this writing the legislature is expected to cut Chapter 70 funding by approximately 4.0% for FY11.



With the spending of the revolving funds and federal stimulus funds in addition to the Town’s appropriation total spending for the school system in FY11 is projected to be \$14,866,330, a 3.0% increase over FY10. This amount does not include Town provided employee benefit costs as well as costs for other Town services provided to the school system. Currently this figure is \$2,689,350. Debt service payments will account for an additional \$3,246,912. In total, estimated school related spending in FY11 will be approximately \$21.9 million (64.9% of the total Town budget).

Russell Street School Renovation Project – The Town will receive a 47.84% reimbursement of qualified expenses for this project from the state. The good news is that the project was originally approved at \$13,400,000, but is coming in at about \$10,500,000. *This project and its impact to the tax rate will be discussed later in this report.*

Looking to the future, these issues cause increasing concern for the Finance Committee. Without significant new recurring revenue growth, the total spending of the Town on the school system will continue to increase as a percentage of overall spending, and adversely affect other vital Town services.

The Outlook for the Future

The FinCom continues to try to achieve a balance between revenues and expenses in order to provide the citizens of the Town the services they require and expect. The lack of any significant new revenue sources becoming available in the near term and the continuing State Aid cuts from Beacon Hill have made achieving this balance very difficult. This year we have attempted to budget our available funds in such a way as to maintain Town services at current levels. In general, we have been able to provide, at minimum, near level-services funding to all departments while continuing to work to meet the challenge of rising employee costs for both salaries and benefits. The only FY11 budgeted salary increases are step and lane increases dictated by current contracts.

Stabilization – The Stabilization fund is estimated to end FY10 at approximately \$1,500,000. For the fourth consecutive year, no stabilization funds will be expended in the operating budget due to the use of available free cash and the savings currently incorporated within the revenue stream of the Town. Beginning in the FY06 budget, the FinCom incorporated a savings component to the revenue stream of the Town. *See the Financial Policy later in this report.* This savings component is based on the premise that any new revenue stream should not be fully added to the operating budgets of the Town. Free cash and/or stabilization must be allowed to grow in order to begin to cover our capital costs both now and in the future. A minimum of 10% of recurring revenue growth and 100% of the year-to-year reduction in debt service within the levy must be set aside each year. In addition we cannot allow non-recurring revenues to be added to the operating budget of the Town. Our ability to allow our stabilization fund to grow has been a major contributing factor in the Town's bond rating increase to AA. This rating increase will decrease borrowing costs and interest rate levels for future bond issues potentially saving the Town more in long term costs than any short term benefit that may have been derived from a withdrawal from these funds.

Debt Management – Additional borrowings must be held to a minimum. While we continue to support our practice of paying for big-ticket capital purchases by the use of capital exclusions rather than borrowing, the amount of exclusion dollars has been decreasing over the past few years. The Town is able to fund only limited capital purchases inside the levy during this FY11. Debt service within the levy decreases substantially over the next few years. This reduction in debt levels cannot be allowed to be added dollar for dollar to the operating budgets. The Financial Policy requires that 100% of these dollars be set-aside in free cash for future capital plan use or to the stabilization account. The Finance Committee, as we did for the Middle School and new Police Station, will recommend debt exclusions for major capital programs in the future. State reimbursement for the Russell Street School project will be 47.84% or approximately \$5.48 million towards the total project cost of \$10.5 million. This total cost is down from the budgeted \$13.9 million. The town is expecting to bond this project during Quarter 2 of calendar 2011.

Capital Outlays – The Finance Committee recommends that the Town engage in and execute capital planning that fully meets the Town's needs. Beyond major capital projects (the Russell St. School renovation, etc.) current capital equipment needs remain ever present. For the past number of years the

Town has addressed these capital needs through a combination of funding both inside the tax levy and through one time capital exclusions. This approach has helped the Town keep pace while having the benefit of not increasing Town borrowing. For FY11 the Selectmen have decided on minimal capital spending within Prop 2 ½ only. As the list of unfilled capital requirements grows and is put off into the future, the dollar amounts and service needs rapidly become unmanageable. All town departments (including the Schools) have put together their prioritized capital needs. Going forward the Town NEEDS to agree upon, COMMIT to, and IMPLEMENT a capital spending plan which funds what we can inside Prop 2 ½ and utilizes capital exclusions as a fiscally responsible tool to fund ongoing capital needs .

Operating Budgets – Spending by all departments must be controlled. This is extremely important especially when faced with consecutive years of decreasing or slight increases to the Town’s revenues. Additional personnel will be added only in situations where a direct benefit in cost efficiencies can be realized or where the safety of the community would be compromised. Further, as personnel costs consume more than 70% of the operating budget, the Board of Selectmen and the School Committee are urged to take a very conservative fiscal approach to wage negotiations with our unions. **Considering the severe economic pressures on our operating budget, the Finance Committee is again recommending a 0% increase for all contracts to be negotiated in the coming year.** Without new tax revenue, the Town’s revenues will not keep pace with increases in expenses. Each year revenue growth without new taxes is limited by Proposition 2 ½ to 2 1/2 % of the prior year’s budget plus the amount of new growth. However, beyond contractual pay increases there are step increases, lane changes, and benefits built into the Town’s labor contracts that alone can account for 3% to 4% increases year to year.

Interest rates – The Town has benefited over the past several years from declining interest rates. The Town has implemented strong fiscal policies (attached at the end of this report). Managing to these policies has aided the Town in receiving an upgraded Bond rating (AA). This has resulted in lower interest debt payments for the Town.

The Town continues to experience favorable cash flow since it moved from a semi-annual to a quarterly real estate tax payment. On top of the beneficial cash flow that the Town experienced from the change in billing, the Town has also seen sizable growth in investable cash, as much of the positive cash flow from the quarterly bill payments has earned additional interest income for the Town. With the decline in interest rates, the Town can no longer rely on the same amount of interest income that has been generated in the past. Clearly, there is an offset, as future borrowings will be made in this same lower interest rate environment, but the ability to generate and rely upon additional revenue through interest income is an example of a revenue source that is diminishing, at least in the short-term for the Town.

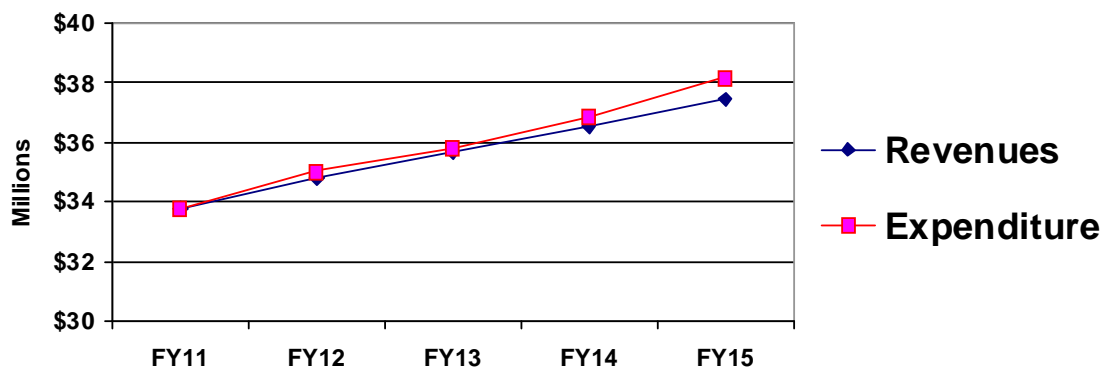
Revenues – As with most communities the Town needs to find new sources of revenue where possible. Increasing fees for services has brought in some additional revenue, but not at the recurring and increasing levels that are needed to sustain increasing expenses. Unfortunately, such fees can be burdensome on certain segments of a community and may be viewed as an additional tax, which is not shared by all.

New growth for FY11 is budgeted to be \$175,000. This is DOWN from the \$450,000 level the Town enjoyed a few short years ago.

By having entered into the Economic Target Area (ETA) in 2006, the Town is attempting to reach economic development goals that consist of utilizing and redeveloping the existing commercial space within the Town and attracting technology companies which can create jobs and add to the tax base without drawing on or dramatically impacting Town resources. The Tax Increment Financing (TIF) sub-committee developed the strategy for the Town and successfully negotiated the TIF with the owners of the several properties. This has led to the re-development of 550 King Street now being occupied by IBM and Curtis Wright at 151 Taylor Street.

While these ETA actions could result in significant future new growth increases, the Finance Committee continues to take a more conservative approach in forecasting the finances of the Town. We cannot take some of these future projects or revenue streams into account too early and bank future projects or expenses on them. If a current project, capital purchase, or contractual obligation cannot stand on its own using known revenues streams or normal projected increases to these revenue streams, we cannot and will not recommend the expenditure to the Town.

The following chart shows the estimated revenues and expenditures for the Town over the next five years. These assumptions, as are all the numbers included in this document, are based on levels of revenues and expenses which the FinCom feels are most likely to occur given the Town’s most recent financial history, the current economy and levels of services and projects currently in progress or likely to occur within the next few years. Even with controlled expenditures that track in step with a slightly increasing recurring revenue base and minimal additional debt the expected revenues generated by the Town over this time period will not keep up with estimated expenditures. Additional revenue sources must be found; preferably those that when added to the tax base, do not create a demand for additional services.



FY11 Operating Budget

We began the planning for the FY11 budget with our annual budget message to Town departments asking them to prepare a level-funded budget and a budget reflecting a 5% reduction. Departments were told not to expect increases in personnel or new programs that were not supported by a new and sustainable revenue stream. In developing our forecast for FY11, it was anticipated that any additional revenues available to the Town would be used primarily to fund capital items that were pushed off in last year’s capital expenditures, step and lane increases in salaries (dictated by union contracts) and funding for the

road repair plan.

Despite cuts in state aid and local receipts we have been able to put together a budget which will have a minimal impact to current services, does not result in personnel layoffs, and allows us to allocate some money to capital purchases while still providing funding for our road repair plan. The state budget is still far from settled. Current estimates from the State Legislature are to expect cuts of 4% to both local aid and Chapter 70 funds to our schools. Should the state come out with further cuts to local aid in their final budget, or as the year goes on, we will have to revisit our priorities.

Our general position on operational overrides has not changed. In order to avoid funding consecutive years of overrides, Town spending must be controlled. In the short-term, if new programs are needed, it will be necessary to eliminate existing programs of lower priority and re-direct the resources. The FinCom will only recommend future operational overrides when all other financing mechanisms have been exhausted and the long-term impact of this permanent increase can be sustained and integrated within an overall financial plan. We do not, and will not recommend building operating budgets that hinge on the passage of an operational override every year.

Warrant Articles

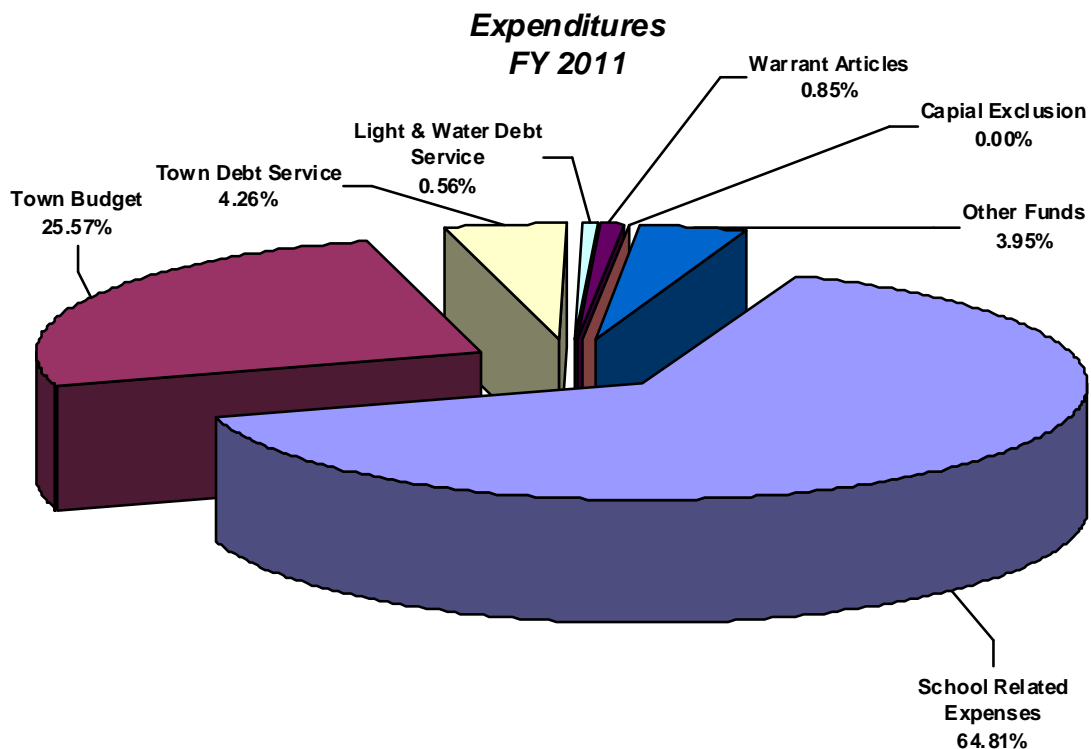
The Finance Committee has taken a position on all finance related Warrant Articles. Unlike last year, we do not support all of the articles. Those articles that we are in favor of represent expenses that the Finance Committee believes cannot be deferred. Capital purchases for various department equipment requests total \$289,120 - *Article (8)*. This includes needed equipment for the Police, Fire and Highway departments. One article of note that FinCom voted not to support is the funds for Track Design and Development – *Article (9)*. This article was rejected on a split vote. The Fincom believes that this project, including design should be funded as a debt exclusion, and not as part of the towns operating budget.

Debt Exclusions

There are no debt exclusion articles appearing on this year's warrant. Renovations continue at the Russell Street School, a debt exclusion article that was approved at last year's Town Meeting in the amount of \$13,400,000. On the horizon, if the new track that is being discussed moves forward into the construction phase, the Finance Committee will recommend that this project be funded as a debt exclusion. We feel that that the Town Meeting voters should be aware of this as they vote to approve \$35,000 for the next phase of the project this year.

Expenditures - Where the Town spends the money it raises

<u>Expenditure</u>	<u>FY11 Amount</u>	<u>Comments</u>
School Budget	\$14,428,679	Level funding from FY10
Debt Service - Schools	\$3,246,912	Shaker Lane, HS, MS & Russell St projects
School Capital Exclusions	0	
Charter/School Choice	\$966,821	Students attending other schools
Nashoba Tech Assessment	\$590,670	Students attending Nashoba Tech HS
School Related Expenditures in Town Budget	<u>\$2,689,350</u>	
Total School Related Exp.	\$21,922,432	64,90% of Total Town Expenditures
Town Budget	\$8,650,540	Town Departments Only including \$555,043 for road repairs
Town Debt Service	\$1,440,178	
Light Dept Debt Service	\$189,705	Expense is reimbursed by L&W
Warrant Articles	\$289,120	Capital
Capital Exclusions -Town	\$0	
Other Funds	\$1,335,221	Includes \$325,000 snow & ice deficit
Total Town Expenditures	\$33,780,196	



Proposition 2 ½

Proposition 2 ½ (Prop 2 ½) is the basis of municipal finance in Massachusetts. It was established as a way to stabilize property taxes imposed by cities and Towns by limiting the amount of tax increases to 2 ½ percent of the prior year's levy limit. To better understand Prop 2 ½ we will define some terms that will be referred to and then illustrate how Prop 2 ½ affects the Town of Littleton with some examples for the current fiscal year.

Levy – The revenue that the Town can raise through real and personal property taxes.

Levy Ceiling – The total levy allowed to be raised cannot exceed 2.5% of the full and fair cash value of all taxable real and personal property in the Town.

Levy Limit – The maximum amount the Town can levy in any given year. The levy limit cannot exceed the levy ceiling. Prop 2½ does allow a Town to levy above the limit on a temporary basis as well as a permanent increase to the levy limit. These options will be explained later.

New Growth – Annual allowed increase to the Town's levy limit based on the value of new development or other growth in the tax base that is not the result of property revaluation. This amount is multiplied by the prior year's tax rate to determine the amount to be added to the current years levy limit.

Override – An override allows the Town to assess taxes in excess of the normal 2½ % increase allowed by Prop 2½. An override cannot raise the levy limit above the levy ceiling. The levy limit for the year is calculated including the override amount and becomes part of the levy limit base. This base would be increased the following year by 2½ %.

Debt Exclusion – debt exclusion allows the Town to raise funds above its levy limit or ceiling for certain purposes. The Town, in this example, would be allowed to raise funds for a specific debt service costs. The amount added to the levy limit due to debt exclusion is not added to the levy base and would not be included in the levy calculation for the following year. Debt exclusion would only last for the life of the specific debt.

Capital Exclusion – A capital exclusion allows the Town to raise funds above its levy limit or ceiling for capital projects. The Town, in this example, would be allowed to raise funds for a specific single year capital project. The amount added to the levy limit due to capital exclusion is not added to the levy base and would not be included in the levy calculation for the following year. Capital exclusion is limited to a one year increase in the levy limit.

Special Exclusion – An exclusion that allows the Town to raise taxes above its levy limit in order to fund a program to assist homeowners to repair or replace faulty septic systems. A special exclusion does not require voter approval.

Levy Ceiling Calculation

FY10 total real and personal property value *	\$1,451,398,874
Add: FY11 estimated new development	<u>9,694,950.39</u>
Total property value	\$1,461,093,824
	<u>x 2 ½ %</u>
Levy Ceiling	\$36,527,346

* Does not include current year revaluation

Levy Limit Calculation

FY 10 Levy Limit	\$22,446,795
x 2 ½ %	561,170
Add: New Growth	<u>175,000</u>
FY 11 Levy Limit	\$22,182,965
Add: Debt Exclusion	1,802,467
Capital Exclusion	<u>0</u>
Total Levy Limit with Debt Exclusion	\$24,985,432

In the above calculations the Town is allowed to assess taxes to the levy limit of \$24,985,432 since it remains below the \$36,527,346 levy ceiling.

The Town currently has debt exclusions for the following projects:

<u>Project</u>	<u>Original Balance</u>	<u>FY11 Payments</u>
WasteWater treatment system		\$142,626
Middle School project	\$7,554,000	\$843,174
Frost/Whitcomb Land	\$700,000	\$45,845
Morrison Land	\$1,768,000	\$153,900
Police Station	\$6,285,308	\$554,644
Less: SBA Settlement		\$(17,274)
Less: Self Help Grant		\$(18,000)
Less: Bond premiums		<u>\$(18,128)</u>
Total Current Debt Exclusion		\$1,686,787
Proposed New Debt Exclusions:		
Russell St Renovation	\$5,700,000	<u>115,680</u>
Total Debt Exclusions		\$1,802,467

Property Taxes¹

¹ Tax data is estimated based on current information and past practices. It is provided as a reference in this report to enable the taxpayer to make informed decisions.

Current property tax rates in Littleton for FY10 average \$16.36 per \$1,000 of assessed property value. The Town uses a split tax rate that assigns a different rate depending on property classification.

Residential property is taxed at \$14.63 / \$1,000 while commercial and personal property is taxed at a higher rate of \$23.11 / \$1,000.

While the ultimate decision of setting the tax rate rests with the Board of Selectmen, the FinCom estimates the impact to property tax bills when compiling the budget by using the same set of options used by the Selectmen when setting the current year's tax rate. Any changes to these options will affect the estimated residential rate. The overall tax rate is not affected.

Our estimates include new growth and current property valuations. Revaluations, which are done every three years by the Town Assessor's Office, or interim valuation adjustment assumptions, are not included in the estimates described. The revaluation process does not affect the total amount of taxes that the Town can raise, since that is capped by the levy limit. It will affect the tax rate paid by the property owner. As property valuations rise, the tax rate should fall. As property values fall, the tax rate should rise. For this reason, while we will show an estimate for a tax rate, it is important to look at the tax bill amount for the property value shown.

Using the budget submitted by the FinCom we estimate the average tax rate for the Town for FY11 to be approximately \$17.10 with an estimated residential rate of \$15.30. The chart on the following page factors in the property values reflected in the first column and includes the impacts of all debt exclusion items recommended by the FinCom and reflective of an approximate 4.50% tax increase in the average tax rate and a 4.59% increase in the residential tax rate.

Estimated Residential Tax Bills FY11

Residential Property Valuation	Annual Tax Bill FY10	Estimated Annual Tax Bill FY11	Increase FY11 Tax Bill
\$350,000	\$ 5,120	\$ 5,355	\$ 235
\$368,309 (Median)	\$ 5,388	\$ 5,635	\$ 247
\$400,000	\$ 5,852	\$ 6,120	\$ 268
\$500,000	\$ 7,315	\$ 7,650	\$ 335

Capital Exclusion Impacts

As previously mentioned capital exclusions raise funds outside of Proposition 2½ similar to debt exclusions, which have been utilized by the Town previously. Capital exclusions, however, raise the entire project costs in a single year in order to avoid the ongoing debt service costs associated with borrowings. There are no capital exclusions for discussion for FY11. Even though this in essence provides a "break" to the tax payers for FY11, which is a "good thing", it is the Finance Committee's opinion that this is not fiscally prudent for the Town. The majority of the \$289,000 in capital spending planned for the Town in the FY11 budget is related to necessary routine maintenance and existing leases. Since most of the capital spending is tied to existing commitments, the funding for new capital

equipment is not sufficient, therefore the list of capital needs for the Town continues to grow and get pushed off into future years.

Debt Exclusion Impacts

The Town bonded the Police station in February 2010. FY11 will be the first year that that full impact of the payment for the Police station bond will be realized. In FY11 the total debt service for the Police station will be \$539,856, net of the associated bond premium. This represents \$0.37 of the \$17.10 estimated average tax rate for FY11 and will account for \$121.54 (or \$0.33 of the \$15.30 estimated residential rate) of the annual tax bill on the median value \$368,309 property.

The interest costs for the Police station bond are significantly less than previously projected due to the favorable interest rate environment and the upgrade of the Town's bond rating by S&P to AA. The rating increase makes the bonds issued by the Town more appealing to investors, lowering the interest rate. In addition, the Town no longer needs to have bond insurance, cutting our costs to issue new bonds. This rating increase is a direct result of the FinCom and Board of Selectmen's development and commitment to follow the financial policy put in place back in FY05. That policy was revised and strengthened in January 2010 by a vote of both boards.

The Russell Street School project cost has been reduced to \$10.5 million from its original \$13.9 million. This project, for the repair and renovation of the school, was approved at last year's Special Town Meeting. The Massachusetts School Building Authority (MSBA) will cover 47.84% of this cost. The fully realized debt service for the borrowing of these funds would not occur most likely until FY12. Based upon current market conditions it is difficult to predict the interest rate that this borrowing will be bonded at, however, if the Police station is used as a proxy, once bonded, the debt service for the Russell Street School should be roughly \$500k in FY12.

Conclusion

Despite a downward trending economy and continuing cuts in Local Aid money from the State, the overall financial stability of the Town has been improving over the past several fiscal years. During the downturn in the State's economy in FY02 through FY06 the Town struggled as did most Towns throughout the Commonwealth. State aid declined and Town services were cut. The Finance Committee had forecast the potential impacts to the Town, however spending was allowed to continue and non-recurring revenues were used to cover budget increases. The Finance Committee established stronger financial policies and practices after the override of FY06 to protect the Town from future potential operational overrides. In this, the fifth year of these policies, the Town is much stronger financially and the current fiscal crisis on Beacon Hill has not forced the Town to propose operational overrides or the drastic service cuts that many other communities are facing today.

The Town must not spend every tax dollar collected and increase budgets at will. Spending must be controlled and revenue cannot be assumed to increase each and every year. Reserves must be allowed to increase. Portions of new revenues should be held outside the operating budget and used for capital purchases or other one-time only expenses. If we unconditionally increase budgets that compound at 6% per year using tax dollars that compound at only 2 ½% per year, then the Town will face the cuts in services that we experienced in the economic crisis of FY02-FY06.

The Selectmen and School Committee must negotiate union contracts that put the financial well being of the Town first and foremost. For instance, a negotiated 3% salary increase becomes a 5% - 6% increase after all steps, longevity and lane changes are taken into account. We simply cannot afford to compound our Town-wide payroll at 5% - 6% per year.

Moving forward, each department must be able to stand-alone and justify the services it provides to the Town with the Town ultimately deciding the levels of services it requires. To that end, we urge all citizens to become involved in the budget process and voice their opinions to not only the FinCom, but also the Board of Selectmen and other Town Boards and Committees as appropriate.

Supporting Information

Financial Policy

Well conceived and practiced financial planning can assist Town officials in achieving the best possible use of funds while providing both short and long term stability. Financial policies can improve a Town's credit rating and reduce the cost of interest paid on the Town's long-term debt issues. In addition, established policies can provide a base line for reference and consistency independent of political climates and personal agendas.

The Finance Committee and the Board of Selectmen recognize the need to establish financial guidelines to provide the Town the ability to withstand periods of decreased revenues while minimizing the need for operational overrides as well as controlling spending during periods of increased revenues. The established guidelines must address the ongoing use and minimum balances of the stabilization fund, the Undesignated Fund Balance (UFB) or "Free Cash", debt management and provisions for future additions to these funds.

The Finance Committee and the Board of Selectmen should review these financial guidelines annually.

- Funds needed to provide the necessary balances must be appropriated prior to any appropriations for operations.
- If recommended balance levels cannot be attained in any given year, a plan to meet the balance guidelines must be established and affirmed by both committees.
- The Finance Committee will provide annual projections and suggested levels for additions to the stabilization fund, debt service and capital needs and use of current year certified free cash.

The Financial Guidelines approved by the Finance Committee and Board of Selectmen are as follows:

Financial Guidelines

These recommended guidelines for the management of Free Cash, the Stabilization Fund and Debt Management should serve as a platform for the annual budget message. The principles contained in these guidelines must be incorporated in the recommendations by the FinCom in each year's budget and used as the basis for any projections of the Town's future financial condition.

The following sections outline the longer-term financial goals of the Town. In some cases, the attainment of certain levels of funds or percentages may not be attainable in the short-term. Specific short-term goals are outlined in the *Planning* section of this document.

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Undesignated Fund Balance – "Free Cash"

The accumulation and use of "Free Cash" now referred to in Massachusetts Accounting Statutes as the Undesignated Fund Balance (UFB) of the General Fund, is an important component of the Town's

overall financial management policies. The available amount is calculated and certified each year by the Massachusetts Department of Revenue using data submitted by the Town.

The UFB is comprised of year-end revenues in excess of projections and year-end expenditures less than appropriations. The UFB is also impacted by the resolution of contingencies or deficits since the UFB is reduced in order to cover any deficits at year-end. Therefore, it is imperative that the Town maintain a minimum balance of 2.5% of the operating budget in order to provide a reserve for unexpected financial crisis during the year. Further, the undesignated fund balance should not be relied upon as a mechanism for funding the Town's operating budget.

Therefore the following policy must be applied in each budget cycle:

1. Maintain a minimum UFB balance of 2.5% of the Total Operating Budget.
2. Appropriate amounts above the 2.5% minimum threshold in the following order:

<u>Use</u>	<u>Description</u>
a. Stabilization	appropriate amounts from the UFB to maintain the minimum balance of the Stabilization fund as detailed in the section below;
b. Capital Projects	appropriate amounts up to 2% of the operating budget for capital items for which long-term borrowing is authorized or for other expenditures of a non-recurring nature;
c. Other reserves	use UFB to augment other reserves/trust funds such as post-retirement benefit reserves or stabilization;
d. Rollover balance	the remaining balance of the UFB must meet this 2 nd threshold of 5% of the operating budget before any additional funds may be appropriated;
e. Extraordinary Deficits	use the UFB to fund extraordinary deficits that cannot be funded either by budgetary transfers or by the reserve fund, and would otherwise be carried to the following year;
f. Additional Capital Projects	use UFB to fund additional capital projects (b);
g. Budgetary Uses	Exception only – with approval of Board of Selectmen and Finance Committee.

Stabilization

The Stabilization Fund is a special reserve account allowed by Massachusetts General Laws to allow savings to be set aside in order to be available for emergency expenditures. In the case of an emergency

expenditure a community with a Stabilization Fund balance may use the available fund balance rather than spiking its property tax rate. The tax rate may be therefore “stabilized”. Bond rating agencies rate municipalities more highly if they maintain a healthy reserve balance in this and other reserve accounts. The funds appropriated to a Stabilization account can also be earmarked for specific capital needs. The Town should endeavor to avoid the use of stabilization fund balances, or any reserve balance for a recurring expense. A two-thirds vote at town meeting is required to appropriate funds from this account. The Fund balance may not exceed ten percent of the equalized valuation of the Town and all interest shall be added to and become part of the fund. The Treasurer may invest the proceeds in keeping with the regulations as set in M.G.L. Ch. 40 s 5B.

Therefore the following policy is recommended:

1. A minimum balance of 5% of the current operating budget must be maintained in the Stabilization Fund.
2. Withdrawals from Stabilization should only be used to mitigate a catastrophic or emergency event(s) (such as substantial damage to a municipal facility due to fire, or infrastructure compromised by a major storm event) that cannot be supported by current general fund appropriations.
 - a. Withdrawals of funds should be limited when possible to the amount available above the 5% minimum reserve previously referenced
 - b. Withdrawals from stabilization that drive the balance below the minimum level should be avoided. If, however this was deemed necessary, the withdrawal should be limited to 1/3 of the Stabilization Fund balance, and the Finance Committee must develop a detailed plan that will replenish the fund to the minimum levels within the next 2 fiscal years.

Debt Management

Debt management is essential to the overall financial planning of any municipality, but especially critical in times of expansion such as we are in. Borrowing funds and repaying over a number of years allows the Town to finance projects we could not afford to pay from our operating budget. The objective of debt management is to borrow at the least cost over the term of the repayment debt. It requires careful planning and strategies to minimize the negative effect to the taxpayer and should be used only when the cost allocation is deemed equitable and the interest costs do not outweigh the advantages. It is critical to develop a policy or guidelines, determining the issuance, timing and tax impact of current and future debt.

Dedicated revenue supported debt are those borrowings which the Town has identified a reimbursement from a specific revenue source that has the ability to repay 100% of the annual debt service for the life of the borrowing. Examples of current revenue supported debt are borrowings associated with the Light & Water departments, land purchases with dedicated reimbursements made from cell tower revenues or CPA funds and any debt exclusion items such as the Middle School borrowing.

Recommended Guidelines for Non-Dedicated Revenue Supported Debt

1. Every effort should be made to minimize the amount of non-dedicated revenue supported debt
-

within the operating budget of the Town.

2. Repayment of principal and interest together with issuance cost and short term financing costs should be targeted at approximately 5% of the total budget to maintain and improve credit rating.
3. At no time should non-dedicated revenue supported debt service exceed 10% of the total budget.
4. Repayment schedules should be in accordance with published requirements and be set as aggressive as possible.

These guidelines achieve the following:

- Capital needs are not displaced by the fiscal demands of current operations.
- Borrowing is controlled.
- The cost of interest is minimized.
- The capability to borrow is quickly restored.

Financial Planning

Proper financial planning is essential for the Town in order to continue to provide the services necessary for its citizens in the least costly manner possible. Decisions made to alleviate issues in one budget cycle may carry impacts several years down the road. The Town will maintain a budget forecast at a minimum of 3 years to assist in the planning of future projects, and quantify the impacts of today's decisions on future years.

Increases to the budget on the expenditure side cannot be allowed to increase greater than the recurring revenues available. That is a very easy statement to make, but is essential in proper municipal fiscal management. Inflating revenue projections and under budgeting expenses to balance an operating budget cannot be allowed to occur. Using other non-recurring revenue items and moving dollars from older warrant articles should only be used for like non-recurring expenses. In addition, a savings plan that will allow the Town to set aside dollars in an effort to minimize the impacts of future economic downturns in the economy on Town operations will be incorporated into each budget cycle. We cannot move forward and continue to spend every available dollar within the operating budget.

The Town must take care to fund its obligations relating to health insurance, retirement benefits and snow and ice expenditures at the appropriate amount.

- Early retirement incentives offered must only be adopted when a proven financial benefit will be recognized by the Town.
- At a minimum, the Snow and Ice budgets should be crafted using a five year rolling average expenditure total.

Underfunding these obligations will mandate the use of the following year's revenue stream to meet the expense, thus perpetuating the shortfall.

Planning for capital purchases as well as the ongoing maintenance of facilities and equipment is an essential part of the financial plan for the Town. The following guidelines must be adhered to;

- A five-year capital plan will be maintained in detail by department and projected funding source;
-

- Capital purchases will be accomplished either as a capital exclusion item or as a raise and appropriate article when funds within the levy are available or an appropriation from the UFB is made.
- Major capital projects such as new construction or major renovations to existing facilities will be accomplished through debt exclusions.
- Infrastructure maintenance budgets (such as Roadway Improvement) or facility maintenance budgets built into the general operating budget will not be reduced to fund other departmental budgets.

It is the intention of the Town to minimize the amount of debt and capital exclusions since this amount has a direct impact on the taxpayer. As a general guideline, the tax impact of excluded items should be held to less than 10% of the single tax rate. For example, if the single tax rate is \$16.50, the amount of tax from exclusion items should not contribute more than \$1.65 to this rate. In some instances, such as periods where multiple projects may be in process or recently bonded, this guideline may be exceeded. In those instances, the Finance Committee should develop a plan to reduce this ratio by either reducing or eliminating capital exclusions or delaying future projects, if circumstances allow.

In addition, the following savings plan will be incorporated into each budget cycle:

<u>Item</u>	<u>Description</u>
a. New revenues	At a minimum, 10% of the new recurring revenue stream should be left unappropriated and allowed to roll into the UFB. Recurring revenues are defined as total revenue less capital and debt exclusions and any other specific non-recurring revenue items.
b. One Time Revenues	One time sources of revenue should be appropriated to the Stabilization Fund or other such reserve fund, and not be used in funding the Town Operating budget.
c. Debt service	100% of the year-to-year decrease in non revenue supported debt service from inside the levy limit be rolled into the UFB and not used in funding the Town Operating budget.

Enterprise Funds

Light Department

The Light Department is a self-funding entity owned by the Town of Littleton. Their salaries, expenses, and debt payments are paid out of receipts from the sale of electricity to the rate-payers of Littleton and Boxboro. Their budget has no impact on the tax rate. The Town of Littleton receives interest on the Light Departments funds and receives an annual payment in-lieu of taxes. Debt service payments made by the Town on behalf of the Light Department are fully reimbursed by the department.

Water Department

The Water Department is a self-funding entity. Their salaries, expenses and debt payments are paid out of receipts. The Water Departments budget, although voted by Town meeting, has no impact on the tax

rate. Debt service payments made by the Town on behalf of the Water Department are fully reimbursed by the department.

EMS Fund

The EMS Enterprise Fund was recently established by Town Meeting. Ambulance receipts are used to cover the salary, benefits and expenses of any ambulance related expense incurred by the Town. Excess funds remain in the enterprise fund and can be used to cover capital purchases such as equipment and vehicles used in ambulance and emergency management related activities.

Finance Committee Members

<u>Member</u>	<u>Appointed By</u>	<u>Term Expires</u>	<u>Years on FinCom</u>
Allen McRae –Chair	Board of Assessors	2011	8
Ken Adam – Vice Chair	Board of Selectmen	2012	23
Eliot Putnam – Clerk	School Committee	2011	2
Fred Faulkner	Light & Water Dept	2010	25
Richard Montminy	Moderator	2010	11
Tyler Gray	Board of Selectmen	2012	2
Alvin Rasmus	School Committee	2012	1
