



Town-Wide Financial Plan for 2009 Annual Town Meeting Submitted by the Board of Selectmen

February 26, 2009

Dear Town Residents:

We are pleased to submit this report on the Town-Wide Financial Plan (TWFP). This report provides summary financial information for the current fiscal year (FY09), the proposed budget for FY10, and projected financial information for FY11. The Board of Selectmen will present a balanced budget for FY10 at the upcoming Annual Town Meeting. Last spring we projected a deficit for FY10, before the outlook worsened as a result of the downturn in the overall economy. This decline required us to reduce the Town's projections for State aid and local revenues. In addition, the decreased value of the Town's pension assets has necessitated a resumption of pension funding. Despite this worsened outlook, we have been able to balance the proposed FY10 budget through a combination of departmental budget reductions, lower health insurance costs, and a modest reserve drawdown. Our FY11 budget projection also shows a balanced budget as our initial planning target. The Selectmen have convened a budget workgroup with representation from the major Town boards, to consider strategies to achieve the required restraint in FY11 departmental spending.

Key Issues

The key issues impacting the Town's financial planning include:

- Reduction in State aid
- Decline in local revenues
- Growth in departmental budgets
- Facilities maintenance needs
- Funding of new High School
- Health insurance changes
- Resumption of pension funding

A short discussion of each of these items follows.

Reduction in State aid

State aid (\$8.1 million) comprises approximately 7% of the Town's total sources of funds. The largest components are Chapter 70 Aid for Education and Lottery Aid. While the proposed FY10 State budget recently submitted by Governor Patrick level-funds Aid for Education, a reduction in Lottery Aid is anticipated. Thus, a reduction in total State aid is projected for FY10, and we are not projecting any increase in FY11 or beyond. Governor Patrick is also proposing to partially offset the reduction in Lottery Aid with an increase in the state meals tax, and he is also proposing to give communities the option to levy a local meals tax. We are continuing to monitor the status of these proposals. The proposed FY10 budget does not include any new meals tax revenues, whereas the projected sources and uses for FY11 includes a preliminary estimate (\$500,000), based on historical Department of Revenue data.

State aid comprises a smaller percentage of the Town of Wellesley's budget than for most other communities in the Commonwealth. Thus, we are relatively more dependent on property taxes but less impacted by the State's financial difficulties. A number of communities that are more dependent on State aid are currently considering layoffs and wage freezes in order to balance their FY09 and proposed FY10 budgets.

Decline in local revenues

Local revenues (\$10.1 million) comprise approximately 9% of the Town's sources of funds. The principal components are motor vehicle excise taxes, interest earnings, and permits and fees. Given the current low interest rates, reduced sales of new vehicles, and slowdown in construction activity, we are projecting a 7% decline in local revenues for FY10. We are not projecting any increase in such revenue in FY11 or beyond.

Growth in departmental budgets

The School budget is the largest single component of the Town budget. The rate of growth of this budget is a key factor each year in determining whether a Proposition 2½ override is required. Whereas the annual growth in the School budget over the past 10 years has averaged approximately 7%, the proposed FY10 budget reflects a 3.1% year-to-year increase, largely due to lower growth in Special Tuition and Transportation costs. For financial planning purposes, our projections for FY11 reflect a lower rate of growth (2%), as necessary to achieve a balanced budget.

Excluding the facilities maintenance department and electrical costs related to the streetlights, the proposed FY10 budget for other Town departments reflects a 1% growth. Our projections for FY11 reflect level funding (i.e., no increase) for these departments.

While the projected rates of growth in all of the departmental budgets in FY11 is less than historical averages, the Selectmen believe this level of constraint is mandated by the current economic conditions.

Facilities maintenance needs

The Town's long-term facilities maintenance needs have not been adequately funded in the Town's operating budget. We have partially addressed this issue through the appropriation of \$11.2 million of school infrastructure capital at the 2007 Annual Town Meeting. The maintenance work funded by this appropriation will be completed during the summers of 2009 and 2010. Effective July 1, 2008, the custodial and maintenance costs for all Town buildings (excluding the DPW and MLP facilities) are budgeted in a standalone department under the joint control of the Board of Selectmen and School Committee. During the past year, a new Facilities Maintenance Director was hired and the proposed FY10 budget includes provisions for 2.5 additional maintenance personnel (2.5 FTE). At the upcoming Annual Town Meeting, we expect to present more information regarding the Town's historic level of facilities maintenance spending versus external benchmark data. As with other non-School Departments, our projections for FY11 reflect no increase. Beyond FY11, we are projecting to increase facilities maintenance spending to a more adequate long-term level. Further work on the Town's elementary school master plan is an integral part of this initiative.

Funding of new High School

Following Town Meeting's approval of the High School project last October and the favorable debt exclusion vote in December, the Permanent Building Committee and School Building Committee are actively working on the detailed design and permitting of the new

school. Limited site work is expected to begin in 2009 and full-scale work is scheduled to commence in 2010. The funds for the project will be borrowed in phases, according to the projected cash flow for the project. Thus, the projected debt service cost of the project will increase gradually over the next few years. At its peak, the projected annual debt service will approximate \$6 million, and represent approximately 5% of the Town's total budget. The proposed FY10 and projected FY11 debt service cost related to the High School project are \$1.0 million and \$2.8 million, respectively.

Health insurance changes

Health insurance costs represent 18% of the Town's Proposition 2½ tax levy and have been growing at a faster rate than other items in the Town's budget. Effective January 1, 2009, 767 employees (83% of the active employees who participate in the Town's health insurance plans) transitioned to the new "Rate Saver" plans offered by the West Suburban Health Group. These new plans require additional and higher dollar value co-payments, resulting in 15% lower premiums. This transition to the Rate Saver plans is a key milestone in the Town's multiyear initiative to control the growth in health insurance costs, and reflects the successful outcome of collective bargaining with 8 of the Town's 13 unions. Negotiations with the remaining 5 unions are ongoing, and in the meantime, we have been able to avoid any increase in total health insurance cost for FY10 versus the prior fiscal year. This represents a savings of approximately \$1.2 million. Looking forward, we are projecting total health insurance costs to increase at a rate of 8% for FY11. This compares to an average annual growth rate of 13.7% over the past 7 years.

Resumption of pension funding

As a result of the Town's early funding of the pension plan liability, favorable investment performance and significant ongoing employee contributions, the Town has not been required to make any pension contribution since 1997. A 33% decline in the value of the pension assets during calendar 2008 (\$143.7 million at 12/31/07 vs. \$96.3 million at 12/31/08) prompted a decision to phase-in a resumption of funding, beginning with \$1 million in FY10, and increasing by \$1 million in each of the three following years. This funding plan is dependent on future investment performance, and further adjustments in the funding level may be required. Employee contributions to the pension plan approximated \$2.7 million in calendar 2008 and continue to grow commensurate with the growth in wages. (*Note: this amount excludes contributions by Teachers and School Administrators who belong to a separate retirement system.*)

FY10 Budget

Early last fall, we reviewed preliminary revenue projections with the Advisory Committee and discussed the impact of general economic conditions and the pending High School project. This led to the Advisory Committee's issuance of tighter budget guidelines designed to avoid the need for a Proposition 2½ override for FY10. These guidelines capped the total budget increase for the School Department at 3% and all other Town departments at 1%.

Capital requests were submitted in October and departmental operating budgets were submitted in early January. Following various adjustments to the original submissions, the proposed FY10 budget has been balanced with a modest drawdown of reserves and without the need for an override. The FY10 budget request is summarized in the following table:

	FY09	FY10	\$	%
	<u>Budget</u>	<u>Request</u>	<u>Inc/(Dec)</u>	<u>Inc/(Dec)</u>
Sources of Funds				
Taxes	\$ 82,382,731	\$ 85,742,299	\$ 3,359,568	4.1%
State Aid	8,556,840	8,061,281	(495,559)	-5.8%
Local Revenue	10,880,506	10,085,241	(795,265)	-7.3%
Other Sources	5,820,030	2,733,382	(3,086,648)	-53.0%
Exclusions and Exemptions	7,455,144	8,820,749	1,365,605	18.3%
Total Sources	\$ 115,095,251	\$ 115,442,952	\$ 347,701	0.3%
Uses of Funds				
School	\$ 51,683,013	\$ 53,283,503	\$ 1,600,490	3.1%
Other Town Departments	26,858,145	27,491,119	632,974	2.4%
Employee Benefits	15,738,082	16,059,178	321,096	2.0%
Cash Capital	2,826,283	2,787,410	(38,873)	-1.4%
Debt (inside Levy)	4,119,821	3,719,821	(400,000)	-9.7%
Other Uses	6,430,985	3,281,172	(3,149,813)	-49.0%
Exclusions and Exemptions	7,438,922	8,820,749	1,381,827	18.6%
Total Uses	\$ 115,095,251	\$ 115,442,952	\$ 347,701	0.3%

The 4.1% increase in taxes reflects the allowed growth in the levy limit and \$1.3 million of new levy growth. The 5.8% decrease in State Aid is attributable to a projected decrease in Lottery Aid, and assumes level funding of Chapter 70 Aid for Education. The 7.3% reduction in Local Revenues reflects the decline in interest rates, motor vehicle excise taxes, and permits and fees. The 18.3% increase in Exclusions and Exemptions primarily reflects the increased debt service associated with the permanent financing for the recently completed Middle School project and the initial financing for the High School project.

The 3.1% increase in the School budget is largely consistent with the Advisory guideline. The 2.4% budget increase for the other Town departments is over the 1% guideline due to increases in facilities maintenance and streetlight operation costs. The 2.0% increase in Employee Benefits reflects the resumption of pension funding, level year-over-year health insurance costs as a result of the migration of employees to the new Rate Saver plans, and a reduction in Workers Compensation reserve provisions. Cash capital is down slightly and debt service inside the levy is down as a result of the continuing pay-down of related debt, which is amortized on a level principal basis. The reductions in Other Sources and Other Uses for FY10 reflect significant year-over-year fluctuation in the utilization of Community Preservation Act (CPA) funds and other anomalous items. These two items largely offset each other.

Contracts with five of the Town's thirteen unions remain open at the time of this writing. With the exception of the School-related contracts, the proposed FY10 budget does not include any provision for contractual wage increases that are still subject to negotiation. The Town plans to fund the cost of such increases through an appropriation from Free Cash at the time these contracts are presented to Town Meeting for ratification.

The Town is also proposing to fund the following appropriations from Free Cash:

- \$985,000 for the creation of additional High School classrooms, as approved at the October 2008 Special Town Meeting.
- \$600,000 supplemental appropriation to the Department of Public Works for FY09 snow and ice removal costs (Article 7).

- \$200,000 to the Facilities Maintenance Reserve Account (Article 16).
- Yet to be determined amount to the Permanent Building Committee to fund the cost of designing a new Senior Center (Article 20).
- \$52,241 for the FY09-related cost of union contract settlements (Article 5)
- \$18,200 to the Library Trustees for branch library capital maintenance (Article 15).

Debt Capital

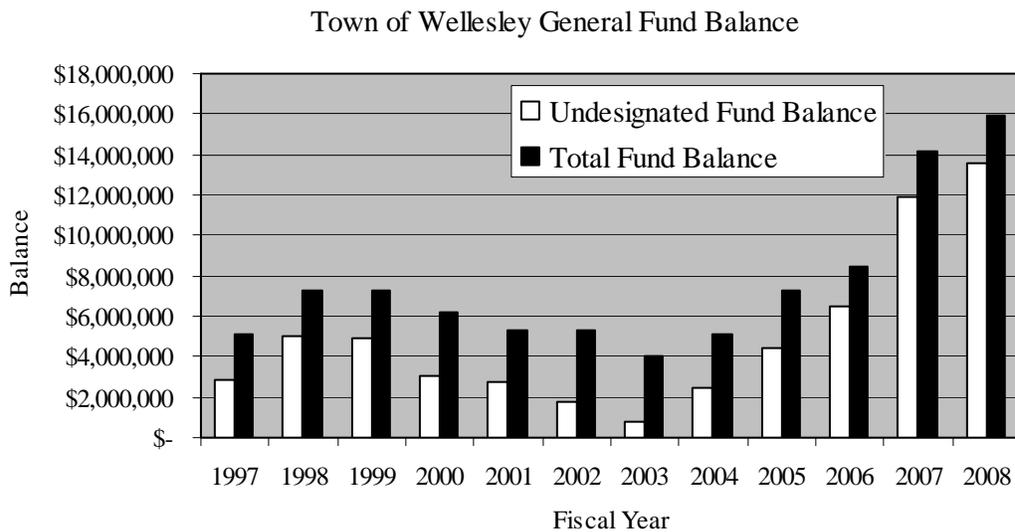
The Town’s Five-Year Capital Budget Program is presented elsewhere in this book. The FY10 budget request does not include any provision for new debt capital projects. Under Article 20, Town Meeting will consider an appropriation to fund the cost of designing a new Senior Center. An estimate of the potential debt service cost of the new Senior Center will be presented at Town Meeting.

Capital projects included in the five-year capital plan, but not proposed for funding this year, require further planning and deliberation, and the exact timing of these projects is not yet certain.

Reserves

In recent years, Town Meeting has been cognizant of the need to increase the level of the Town’s financial reserves, in order to maintain the Town’s favorable Aaa bond rating. This has required us to carefully monitor the level of revenues and expenses versus budget, and the resulting impact on reserve levels. It has also required us to be judicious in our utilization of reserves.

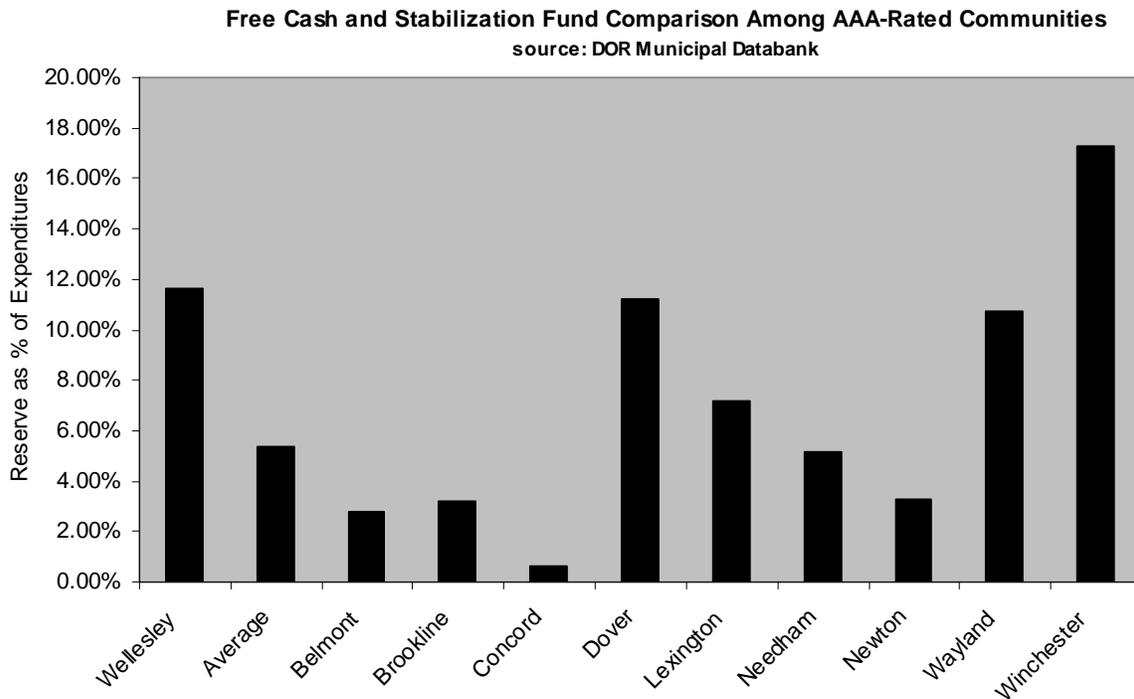
As of June 30, 2008 the Town’s Undesignated Fund Balance was \$13.6 million. This reflected a significant improvement in the Town’s financial reserves since a low point in 2003. The following graph shows the recent improvement in reserve levels, as expressed in terms of undesignated fund balance and total fund balance:



Undesignated fund balance and total fund balance are technical terms used in municipal accounting. Total fund balance is analogous to the terms “stockholders’ equity” as used in private sector financial statements. Undesignated fund balance is the portion of the total fund balance that has not been designated for any purpose. Thus, undesignated fund balance is a key component of a town’s financial reserves. Credit rating agencies focus on these balances when evaluating the creditworthiness of a town.

Of more practical concern are the balances in the Town’s Stabilization Fund (a separate reserve fund) and the balance of Free Cash, which is a restrictive subset of the undesignated fund balance. Under Massachusetts Department of Revenue (DOR) rules, these are the reserve balances specifically available for appropriation by Town Meeting to pay extraordinary or unforeseen expenditures, or cover revenue shortfalls. Appropriations from the Stabilization Fund require a two-thirds vote by Town Meeting, whereas appropriations from Free Cash require a majority vote. The Stabilization Fund balance as of June 30, 2008 was \$2.2 million. The level of Free Cash, as certified by the DOR, was \$10.7 million as of June 30, 2008. This was the highest level ever recorded by the Town.

The following chart compares Wellesley’s total level of Stabilization Fund and Free Cash reserves at June 30, 2008 to other Aaa rated communities, expressed as a percent of annual expenditures:



DOR recommends that communities maintain reserves (free cash and stabilization fund) of at least 3-5% of annual expenditures. The credit rating agencies recommend higher levels.

The proactive funding of the Town’s pension and Other Postemployment Benefits (OPEB) liabilities further evidence the Town’s commitment to prudent fiscal management. Following the recent decline in the value of the Town’s pension assets, the proposed FY10 budget includes \$1 million of funding toward the pension liability. Consistent with the prior year, the budget also includes \$3 million of funding toward the Town’s OPEB liability (\$1.2

million inside the levy, plus \$1.8 million exclusion as authorized by the May 2007 Special Election).

Looking Ahead

The key assumptions on which the projections for FY11 are based include:

- Growth in property tax revenues through \$1.3 million in new levy growth plus the allowed 2.5% increase under Proposition 2½
- Growth in State aid limited to new meals tax revenue of \$500,000 (contingent on enactment of proposed State legislation and future Town Meeting action)
- No growth in local revenues
- Departmental budget growth
 - School Department - 2%
 - Other Town Departments – 0%
- Growth in health insurance costs – 8%
- Pension funding – increased to \$2 million
- Cash capital – no increase
- New debt service capacity (inside the levy) - \$500,000
- No material use of Free Cash to supplement revenues.

The School and non-School departmental budget growth assumptions (2% and 0%, respectively) are each one percentage point lower than the revised FY10 budget guidelines, in order to achieve a balanced budget. Based on these assumptions, the projected FY11 Sources and Uses outlook is summarized in the following table:

	FY10	FY11	\$	%
	<u>Request</u>	<u>Projection</u>	<u>Variance</u>	<u>Variance</u>
Sources of Funds				
Taxes	\$ 85,742,299	\$ 89,185,856	\$ 3,443,557	4.0%
State Aid	8,061,281	8,561,281	500,000	6.2%
Local Revenue	10,085,241	10,085,241	-	0.0%
Other Sources	2,733,382	1,636,268	(1,097,114)	-40.1%
Exclusions and Exemptions	8,820,749	11,030,714	2,209,965	25.1%
Total Sources	\$ 115,442,952	\$ 120,499,360	\$ 5,056,408	4.4%
Uses of Funds				
School	\$ 53,283,503	\$ 54,349,173	\$ 1,065,670	2.0%
Other Town Departments	27,491,119	27,491,119	-	0.0%
Employee Benefits	16,059,178	18,275,482	2,216,304	13.8%
Cash Capital	2,787,410	2,787,410	-	0.0%
Debt (inside Levy)	3,719,821	4,066,325	346,504	9.3%
Other Uses	3,281,172	2,499,137	(782,035)	-23.8%
Exclusions and Exemptions	8,820,749	11,030,714	2,209,965	25.1%
Total Uses	\$ 115,442,952	\$ 120,499,360	\$ 5,056,408	4.4%

At this time, the Selectmen do not support a Proposition 2½ override for FY11. Therefore, absent additional State aid or local revenue, living within the tighter budget guidelines will require some combination of cost efficiencies, service reductions, wage freezes, furloughs or layoffs, increased class sizes, or other difficult tradeoffs. These actions will be complicated by the Town's collective bargaining agreements. Recognizing the depth of this challenge, the Selectmen have implemented a number of near-term cost saving initiatives and have initiated discussions with a budget workgroup comprised of representatives from the Town's other major Boards (Schools, Public Works, and Library) along with the Human Resources Board and the Advisory Committee, regarding a larger scale response plan. The Selectmen will provide an update on these initiatives at the Annual Town Meeting.

We would like to express our sincere appreciation to all of the Town boards and their respective staffs for their cooperation in working with us to create a plan that will ensure the continued financial health of our community.

Sincerely yours,

Gregory B. Mills, Chair
Barbara D. Searle, Vice Chair
Owen H. Dugan, Secretary
Katherine L. Babson, Jr.
Harriet S. Warshaw