

**Town-Wide Financial Plan for 2008 Annual Town Meeting
Submitted by the Board of Selectmen**



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 (FY08), the proposed budget for FY09, and projected financial information for FY10. The Board of Selectmen expects to present a balanced budget for FY09 at the upcoming Town Meeting. Initial projections for the year indicated a deficit, but this was eliminated through a combination of departmental budget reductions, increased State aid and local revenue, and lower increases in health insurance costs than originally projected. This report also focuses on the Town's key financial planning issues and the adequacy of our plans for addressing these issues.

Key Planning Issues

In evolving the TWFP, the Selectmen have continued to focus on the following long-term financial challenges:

- Rising cost of health insurance;
- Structural deficit;
- Facilities maintenance; and
- Renovation/reconstruction of the High School.

A short discussion of each of these items follows.

Rising cost of health insurance: As previously discussed at Town Meeting, health insurance costs are absorbing an increasing portion of the Town's total tax levy. In 1984, such costs represented 2.9% of the tax levy, whereas in 2008 they represent 19%. This percentage will continue to increase as the growth of health insurance costs continues to outpace inflation, and the number of Town retirees continues to grow. Recent actions to address this major issue include:

- The Section 18 election approved at the 2006 Town Meeting, which requires eligible retirees to enroll in Medicare, thereby reducing the Town's share of retiree health insurance costs; and
- Funding of the Other Post-employment Benefits (OPEB) liability. Following voter approval of the OPEB funding exclusion at the May 2007 Special Election, the Town is funding \$3 million per year towards this cost. This funding is in addition to the increasing pay-as-you-go cost associated with these benefits, and in the long-term will constrain the growth of this cost.

In addition, the Selectmen have worked with the West Suburban Health Group (WSHG) to develop new health insurance plan offerings (the "Rate Saver" plans) that require additional, market-level co-payments. These changes are intended to bring co-payments into line with market norms, and thereby make Town employees more accountable for the impact of their

behavior on healthcare costs. The changes are also expected to yield recurring premium savings of approximately 10-15%. The Board of Selectmen and School Committee are currently bargaining with a number of the Town's unions regarding the proposed Town-wide adoption of the Rate Saver plans, effective January 1, 2009.

Structural deficit: The School Department budget represents approximately two-thirds of the Town's total budget exclusive of capital and debt service, and over the past ten years, the School budget has grown at an average rate of 6.75%. This growth reflects a number of factors including recurring enrollment increases and the increasing cost of special education and related transportation. The size and average annual growth of the School budget are sufficient to fully absorb the entire growth in the Town's total tax levy, as allowed under Proposition 2 ½. Factoring in the growth in health insurance costs and a 3% increase in the budgets for other Town departments results in a recurring annual (i.e., structural) deficit of approximately \$2 million.

Thus, absent other factors, the Town is confronted with a recurring annual override need of approximately \$2 million, which largely explains the need for general overrides in six of the last eight years. This issue was mitigated in the proposed FY09 budget largely by the exceptional increase in State aid, but is projected to recur in FY10 and subsequent years. Absent action to scale back specific departmental services, the Town is likely to experience the need for continued overrides in the near-term, or at least until such time as the recurring increases in health insurance costs, school enrollment and special education costs abate.

From a financial planning standpoint, the Selectmen have discussed alternative approaches for avoiding general overrides in successive years. For example, the more active use of reserves and other planning techniques could lead to general overrides in alternating years. While this approach might give the impression of better financial planning, it does not address the underlying financial issues.

Facilities maintenance: In 2006, the School Committee and Selectmen consolidated management responsibility for the operation and maintenance of all facilities under a new Town Facilities Director. The financial budget for facilities operation and maintenance remained distributed among the various departments. Based on our experience with the new management model and further planning for the long-term maintenance of the Town's buildings, the Selectmen believe a further consolidation of all facilities operation and maintenance costs into a new, standalone department would increase the level of transparency and accountability for facilities maintenance. This is the organizational model used by large corporations and a number of towns, and the Selectmen believe this model could be successfully implemented in the Town of Wellesley. Discussions regarding a potential consolidation are ongoing between the Selectmen and other Boards, and we expect to make a related proposal at Town Meeting (Article 32). Our proposal will also involve consolidation of the related budgets.

The Town does not currently have a comprehensive operational and financial plan for the long-term maintenance of all of the Town's buildings. While the \$11.2 million of school infrastructure capital approved at the 2007 Annual Town Meeting was a constructive step toward addressing certain maintenance needs, this required an exceptional planning effort, and the

scope, cost and timing of follow-on work has yet to be determined. Renovation of the Town's elementary schools will be a significant element of this follow-on work, and the School Committee has committed to study this need.

Given the high cost of infrastructure maintenance and the State's new approach to school building assistance, the Town must improve its long-term planning for these costs. Under any future circumstances, some combination of increased capital spending or further debt exclusions will be required to adequately address the Town's long-term facility maintenance needs. Increased transparency to the full cost of building maintenance, and greater accountability for the development and execution of comprehensive maintenance plans are important next steps.

Renovation/reconstruction of the High School: Considerable work is ongoing to determine the scope, timing and cost of renovations needed at the High School. Consistent with the new Massachusetts School Building Authority (MSBA) regulations, a School Building Committee (SBC) including representatives from the Board of Selectmen, School Committee and Permanent Building Committee; Town residents with germane expertise; and other individuals, was formed to monitor and advise the Town on the project. The SBC, School Committee, and Permanent Building Committee have been actively engaged in the ongoing planning for this project.

The cost of this project will necessitate a Proposition 2½ debt exclusion, and will significantly impact property taxes in future years. Major unknowns at this time include the timing of the project and the level of State reimbursement that will be available to defray a portion of the project costs. On February 28th, representatives of the SBC met with representatives from the MSBA to discuss the status of the Town's planning for this project and solicit the Authority's guidance on next steps. Following this meeting, it appears likely that Town officials will be in a position to present a proposed High School project at a Special Town Meeting this fall with a town-wide debt exclusion vote for its funding by year-end.

A comprehensive update regarding the planning for the High School project will be presented at Town Meeting (Article 17), along with a request for additional planning funds. While the scope and cost of the project is not yet known, a table illustrating the potential long-term impact of this project on taxpayers is presented later in this report. We also intend to propose the establishment of a School Facilities Maintenance Trust in order to benefit from potential matching State funds (Article 18). Appropriations to this Trust may be sought as part of the funding for the High School project.

FY09 Budget

Early last fall, we discussed preliminary revenue projections with the Advisory Committee which included new tax revenues of \$1.2 million from "new growth" and minimal growth in State aid. The Advisory Committee issued budget guidelines designed to minimize, or possibly avoid, an operating override, by capping increases in personal services for the School department at 5% and all other Town departments at 3%.

Capital requests were submitted in October and departmental operating budgets were submitted in early January. Finance was able to provide a first look at the total operating budget during the second week of January. The initial deficit was approximately \$6.4 million. This deficit was eliminated through a combination of factors, including increased state aid and local revenue, departmental budget reductions, and lower health insurance cost increases than originally projected.

The FY09 budget request is summarized in the following table:

	FY08 Budget	FY09 Request	FY08-FY09 \$ Δ	FY08-FY09 % Δ
Sources of Funds				
Taxes	\$ 78,689,438	\$ 81,856,674	\$ 3,167,236	4.0%
State Receipts	6,642,683	8,551,294	1,908,611	28.7%
Local Fees	10,614,714	11,266,315	651,601	6.1%
Other Sources (Incl. Non Tax Impact)	2,491,773	4,183,799	1,692,026	67.9%
Exclusions and Exemptions	6,164,839	6,855,863	691,024	11.2%
Total Sources	\$ 104,603,447	\$ 112,713,945	\$ 8,110,498	7.8%
Uses of Funds				
School	\$ 49,619,071	\$ 53,842,308	\$ 4,223,237	8.5%
Other Town Departments	23,757,912	24,361,388	603,476	2.5%
Employee Benefits	15,134,241	15,752,815	618,574	4.1%
Cash Capital	2,942,719	2,851,283	(91,436)	-3.1%
Debt (inside Levy)	4,010,180	4,119,819	109,639	2.7%
Other Uses (Incl. Non Tax Impact)	2,974,485	4,930,469	1,955,984	65.8%
Exclusions and Exemptions	6,164,839	6,855,863	691,024	11.2%
Total Uses	\$ 104,603,447	\$ 112,713,945	\$ 8,110,498	7.8%
Surplus/(Deficit-Override)	\$ -	\$ -		

The 28.7% increase in State receipts is attributable to a \$ 1.9 million increase in Chapter 70 State aid for education. This increase reflects continued progress toward bringing Wellesley to parity with other towns in terms of the level of such aid. This revenue is subject to the State's budget process and will not be finalized until June. The School budget increase of 8.5% is higher than the average rate of increase for the past 10 years (6.75%), primarily due to a \$1.76 million increase in the cost of out-of-district special education placements, which cost is largely controlled by the State. The large increases in Other Sources and Other Uses both reflect a \$1.47 million increase in the proposed use of Community Preservation Act funds, as well as other offsetting items. The 4.1% increase in Employee Benefits reflects an 8% increase in health insurance premium rates, partially offset by recent favorable enrollment experience. The health insurance budget increase does not take into consideration the potential savings related to the implementation of the new Rate Saver plans. Any collective bargaining agreements that include provisions for implementation of these new plans will be subject to Town Meeting ratification.

Contracts with six of the Town's unions expired in June 2007, and the remaining seven contracts expire in June 2008. The results of these bargaining efforts will impact the FY09 and future years' budgets. Partly due to the proposed health insurance changes, the majority of the

union negotiations remain ongoing. Given the sensitivity and fluid state of these negotiations, we are deferring any further update until Town Meeting.

Except for the School department, the FY09 budget request 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 the contract is presented to Town Meeting for ratification.

The Town is also planning to fund two FY08 supplemental appropriations for the School Department (special education costs) and the Department of Public Works (snow and ice removal costs) through the use of free cash. These appropriations are currently projected to be \$800,000 and \$400,000 respectively and will be considered under Article 7.

The FY09 budget request includes “Cash Capital,” which are those items to be funded by cash and not by borrowing. The FY09 cash capital budget reflects a slight decline from the prior year, which included a one-time site remediation cost of \$200,000 for the new MLP/DPW facilities. While the Selectmen and Advisory Committee believe an increase in facilities maintenance capital is warranted, this need has been addressed in the near-term by the prior year appropriation of \$11.2m for School facilities maintenance.

Debt Capital

The Town’s Five-Year Capital Budget Program is presented elsewhere in this book. The FY09 budget request includes new debt service amounts related to the following “inside the levy” debt capital projects:

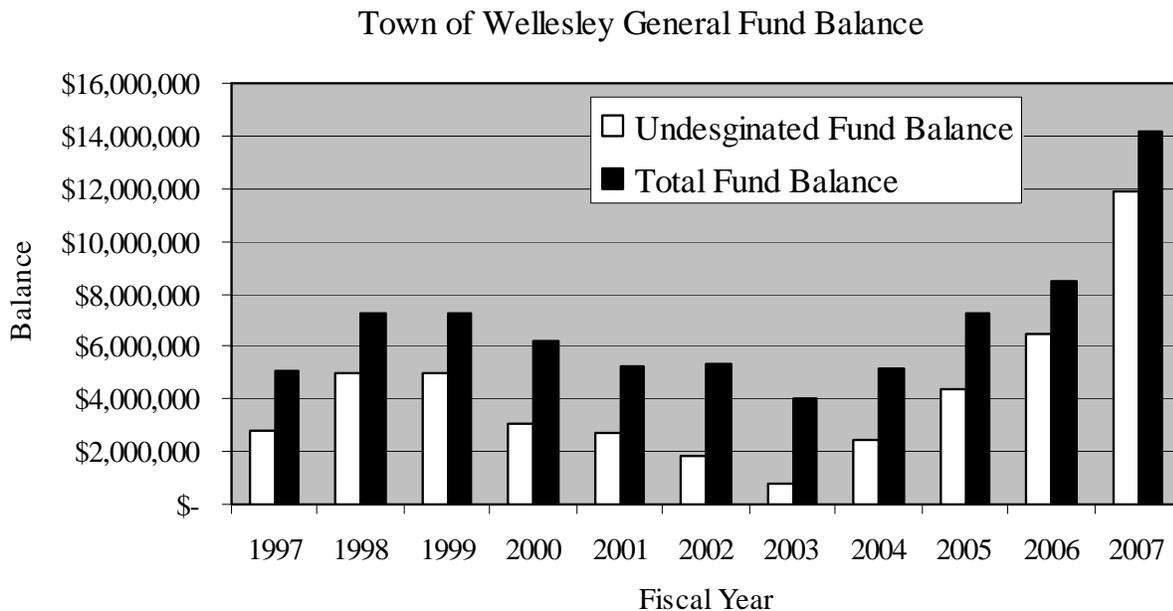
- \$600,000 for the Town’s portion of the proposed Sprague Field remediation work (2008 Annual Town Meeting Warrant Article 20);
- \$797,000 for planning work related to the renovation/reconstruction of Wellesley High School (appropriated at the 2007 Annual Town Meeting);
- Additional funds for further planning work related to High School (Article 17).
- \$3,609,500 for the acquisition of three properties on Seaver Street (appropriated at the Fall 2007 Special Town Meeting);
- \$475,000 for a new Fire Engine (Article 8);
- \$500,000 for engineering planning and other work related to the reconstruction of Weston Road from Linden Street to Route 9 (appropriated at the 2002 Annual Town Meeting); and
- \$428,000 for the reconstruction of Woodside Avenue (appropriated at the 2007 Annual Town Meeting).

The future debt service impact of the High School project is discussed later in this report. Otherwise, the remaining 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.

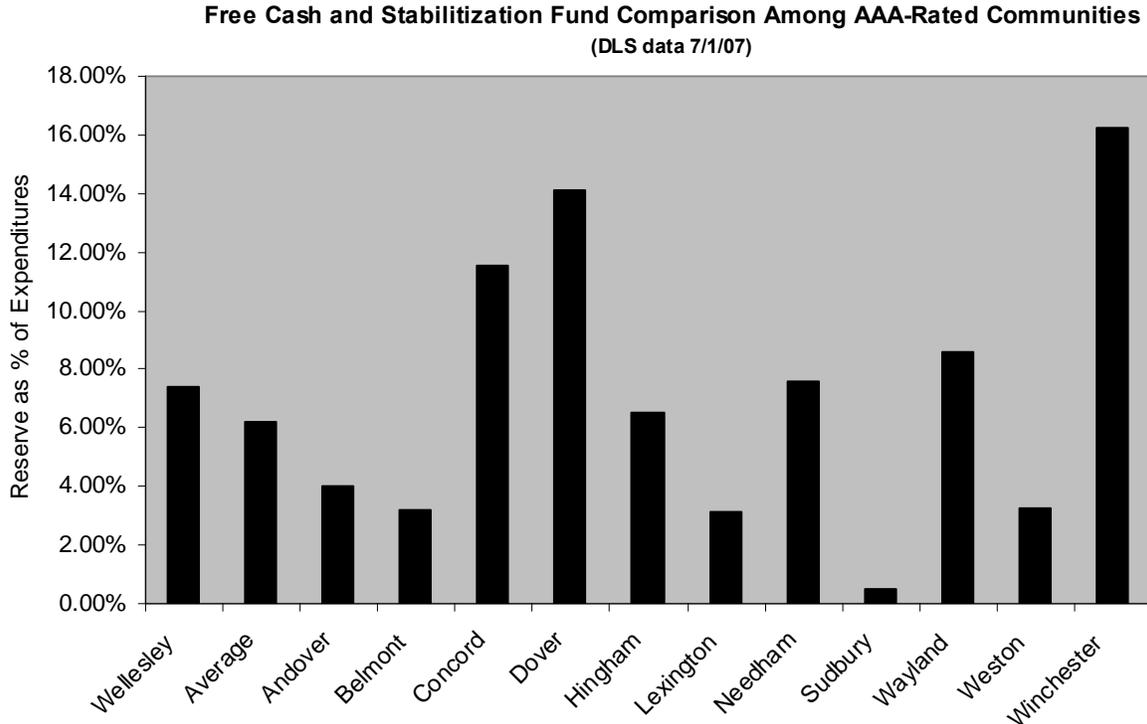
The following graph shows the continuing improvement in reserve levels, as expressed in terms of undesignated fund balance and total fund balance:



Undesignated fund balance and total fund balance are technical terms used in municipal accounting, analogous to the term "stockholders' equity" as used in private sector financial statements. Credit rating agencies focus on these balances when evaluating the credit worthiness of a town and we expect these balances to continue to grow in FY08.

Of more practical concern, are the balance in the Town's Stabilization Fund and the balance of Free Cash, which is a more restrictive subset of the Undesignated Fund Balance. Under Department of Revenue (DOR) rules, these are the amounts specifically available for appropriation by Town Meeting to pay extraordinary or unforeseen expenditures, or cover revenue shortfalls. Appropriations from Free Cash require a majority vote by Town Meeting whereas appropriations from the Stabilization Fund require a two-thirds vote by Town Meeting. The FY09 budget includes a \$1,000,000 transfer from Free Cash to the Stabilization fund, which is intended to further emphasize the reserve nature of these funds.

The following chart compares Wellesley's total level of Stabilization Fund and Free Cash reserves at July 1, 2007 to other Aaa rated communities:



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 2009 appropriation will increase the Stabilization Fund to approximately 3% of expenditures, and we are projecting to maintain Free Cash at a slightly higher level, despite our plan to use this reserve to cover the FY08 supplemental appropriations and collective bargaining settlements.

The proactive funding of the Town's pension and OPEB liabilities further evidence the Town's commitment to prudent fiscal management. The Town's pension fund remains fully funded. The Town began funding this liability in 1978, with annual payments projected to fully fund the liability in 30 years. Excellent investment results helped to fund the full amount of the Town's obligation in 19 years. Thus, no pension contributions by the Town have been required since 1997.

Earlier in this fiscal year, the Retirement Board transferred investment management responsibility for the Town of Wellesley Contributory Retirement System assets to the Massachusetts Pension Reserves Investment Management Board (PRIM), with the objective of sustaining the Retirement System's superior investment returns. By virtue of this transfer, the Town will benefit from the State's greater level of professional resources and greater flexibility with regard to the use of alternative investment vehicles.

In FY07 the Town made its first \$600,000 appropriation to the Group Insurance Liability Trust, the segregated fund set aside to fund the Town's liability for retiree health insurance costs.

Following voter approval of the OPEB funding exclusion at the May 2007 Special Election, the FY09 budget request includes \$3 million of funding towards this liability (\$1.2m inside the levy, plus \$1.8m exclusion).

Looking Ahead

The assumptions on which the longer-term plan is based results in ongoing shortfalls to be funded either through operating overrides or through cuts in programs and services. The critical assumptions include \$1.2 million new growth annually; minimal increases (2%) in State and Local receipts; School department budget – 6.79%; Other Town departments - 3%; Group Insurance increases held to 8%; and no SBA reimbursement for the Middle School. The projected sources and uses of funds through FY10 are summarized in the following table:

	<u>FY08</u> <u>Budget</u>	<u>FY09</u> <u>Request</u>	<u>FY10</u> <u>Projection</u>	<u>FY09/FY10</u> <u>\$ Δ</u>
Sources of Funds				
Taxes	\$ 78,689,438	\$ 81,856,674	\$ 85,103,091	\$ 3,246,417
State Receipts	6,642,683	8,551,294	8,722,320	171,026
Local Fees	10,614,714	11,266,315	11,491,641	225,326
Other Sources	2,491,773	4,183,799	1,100,000	(3,083,799)
Exclusions and Exemptions	6,164,839	6,855,863	6,623,713	(232,150)
Total Sources	\$ 104,603,447	\$ 112,713,945	\$ 113,040,765	\$ 326,820
Uses of Funds				
School	\$ 49,619,071	\$ 53,842,308	\$ 57,498,201	\$ 3,655,893
Other Town Departments	23,757,912	24,361,388	25,092,230	730,842
Employee Benefits	15,134,241	15,752,815	16,917,040	1,164,225
Cash Capital	2,942,719	2,851,283	2,850,000	(1,283)
Debt (inside Levy)	4,010,180	4,119,819	4,419,819	300,000
Other Uses	2,974,485	4,930,469	2,462,277	(2,468,192)
Exclusions and Exemptions	6,164,839	6,855,863	6,623,713	(232,150)
Total Uses	\$ 104,603,447	\$ 112,713,945	\$ 115,863,280	\$ 3,149,335
Surplus/(Deficit-Override)	\$ -	\$ -	\$ (2,822,515)	

The above projections do not reflect any assumption regarding future funding for the High School project, apart from a provision for additional planning funds to be requested under Article 17. As discussed earlier in this report, the projected shortfall in FY10 is largely due to the structural deficit inherent in the projected growth of the Town's revenues and expenses.

High School Project

As noted previously, the projected Sources and Uses presented earlier does not reflect any assumption regarding future funding for the High School project, which is projected to be the biggest financial commitment in the Town's history.

While the scope and cost of the project are not yet known, the following table illustrates the **potential** long-term impact of this project on taxpayers:

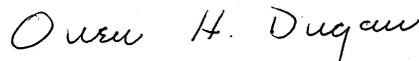
Assumptions:			
<i>Project cost</i>		\$155,000,000	
<i>Interest rate</i>		4.5%	
<i>Amortization period (yrs.)</i>		25	
<i>Annual debt service without reimbursement</i>		\$10,453,049	
<i>Median home value</i>		\$832,000	
<i>Total assessed value</i>		\$9,175,647,000	
		Median Annual Tax Bill Impact	
Assessed Value		Without Reimbursement	With 25% Reimbursement
		With 40% Reimbursement	
\$600,000		\$684	\$513
\$832,000		\$948	\$711
\$1,500,000		\$1,709	\$1,025

The Town has begun discussions with the Massachusetts School Building Authority (MSBA) regarding its potential support for the High School project. While the level of MSBA reimbursement available to defray some portion of the project cost is not yet certain or quantifiable, we are currently estimating that reimbursement could range from 25-40% of total project cost. Accordingly, the “With Reimbursement” estimates presented in the above table are presented solely for discussion purposes.

We are looking forward to providing Town Meeting with additional information regarding the Town-Wide Financial Plan at this year’s Town Meeting and having an opportunity to respond to any questions you might have.

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,



Owen H. Dugan, Chair
 Gregory B. Mills, Vice-Chair
 Katherine L. Babson, Jr., Secretary
 David J. Himmelberger
 Harriet S. Warshaw