FINANCE COMMITTEE REPORT

Dear Resident of Sudbury,

This report will assist you in understanding Sudbury's fiscal year 2014 ("FY14") budget – from July 1, 2013 through June 30, 2014 - and the related financial articles that will be presented to you at Town Meeting beginning on May 6th. We believe, above all, that the participation of an informed voter is essential for the success of Sudbury's democratic process and continued fiscal health.

The Finance Committee is responsible for reviewing budgets for the town and schools and making recommendations to the Board of Selectmen and to the taxpayers at Town Meeting. In this role, we have no authority to make spending decisions as that is the responsibility of our various elected bodies. Rather, our role is to examine those budgets on your behalf and make independent and informed recommendations regarding the budget and other financial issues. We do so by gathering data and asking numerous questions prior to forming a recommendation.

This diligence process happens throughout the year as we meet with the Sudbury Town Departments (the "Town"), the Sudbury Public School K-8 School System ("SPS"), and the Lincoln-Sudbury Regional High School ("LSRHS" or the "High School") and other entities in regularly scheduled Finance Committee meetings as well as in smaller liaison meetings between one or two FinCom members and the management teams for each cost center.

This report is the culmination of a six month budget process. In November 2012, the FinCom issued budget guidelines to the leaders of the three principal Sudbury cost centers - the Town, SPS and the High School. In preparation for the budget hearing process in February 2013, we asked each cost center to prepare two budget scenarios for FY14:

- a No Override Budget that allows for annual growth up to 2.7% for each cost center and was based upon expectations regarding State aid and local receipts; and

- a Level Services (or roll-up) budget that assumes each cost center maintains the same service levels in FY14 as funded through their FY13 budgets

While we recognized that each cost center has certain unique characteristics, FinCom believed it important that a level of consistency exist in all budget submissions. As a result, we asked each cost center to make the following assumptions when constructing their FY14 budget submissions:

- for SPS (and any other cost center that had completed contract negotiations), salary and other cash compensation was relatively straightforward as it was based on their new contract(s);
- for cost centers that had yet to enter into a new contract, we asked them to assume the following:
    - no cost of living increase (i.e. COLAs) when forecasting compensation costs for FY14;
    - normal salary steps given their current employee demographic and expiring contracts;
- best estimates of expected health and benefit costs increases; and
- best estimates of utilities and, where applicable, transportation and special education cost increases or decreases.

At the time this Warrant was prepared, several additional contract negotiations have been completed including, but not limited to, the LSRHS teachers. Fortunately, these contracts fit within the guidelines issued by FinCom last November and do not require tax overrides to accommodate current staff levels for FY14.

Recommended No Override Budget

For FY14, we are recommending only a No Override Budget of approximately $82.7 million. The No Override Budget represents a tax increase of approximately 3.15% ($353) on the average assessed home value of $622,862 and a total increase in taxes of approximately $2.2 million, including new growth and commercial property taxes, as compared to the FY13 budget.

	FY13 Appropriated	**FY14 Budget**	**Increase/ (Decrease)**	**%**
Tax Levy	$ 71,026,410	$ 73,265,001	$ 2,238,591	3.15%
SBAB School Debt Reimbursement	1,681,224	1,681,224	0	0.00%
State Aid [(a)]	5,616,657	5,752,053	135,396	2.41%
Local Receipts	3,657,000	3,859,034	202,034	5.52%
TOTAL REVENUE	$ 81,981,291	$ 84,557,312	$ 2,576,021	3.14%

[(a)] Reflects State Aid for Sudbury only; LSRHS State Aid included in “Offsets/Re-apportionments”.

The No Override Budget is in compliance with Proposition 2½ (“Prop 2 ½”), which was approved by Massachusetts voters in 1980 and first implemented in fiscal year 1982 (M.G.L. Ch. 59, sec. 21c). It limits the amount of revenue a city or town may raise, or levy, from local property taxes each year to fund municipal operations without the approval of taxpayers at the ballot box. Prop 2 ½ is not meant to be a “fiscally responsible spending benchmark”. Exceeding this level should not necessarily be construed with negative implications towards a town’s or a schools’ financial management. It is meant to reflect a “check and balance” point at the local level: town officials cannot raise taxes more than allowed under Prop 2 ½ without an affirmative vote of the taxpayers. To spend more money, town officials have to “make their case” to the taxpayers who can apply their own test of reasonableness by their votes at Town Meeting and the polls.

The FY14 No Override Budget represents a 2.7% increase in the operating budget for each cost center compared to the FY13 budget. The difference in growth between the property tax increase of 3.15% and the allowable growth in the operating budgets of each cost center is due increased assessments from Minuteman Vocational Technical School District (“Minuteman”) and LSRHS as compared to FY13. For Minuteman, the increase in the assessment to Sudbury was due to changes in the enrollment mix of Sudbury students, increasing from 11 students to 16 students from FY13 to FY14, respectively. In the case of the High School, while the percentage of students did shift slightly towards Sudbury from FY13 to FY14, the principal reason for the increase in the assessment was a significant decline in Lincoln’s required statutory minimum contribution as calculated by the DOR. The determination of the overall assessment to each town has two major components in the calculation. The first component is a statutory minimum contribution as calculated by the DOR, which measures relative changes of member towns and incorporates those relative changes into a formula to calculate each member town’s contribution. The second component is based on average student enrollment and is governed by the specific regional agreement between the member towns. As shown in the table set forth below, Lincoln’s statutory minimum contribution declined by nearly 18% from FY13 to FY14 as compared to a more modest 2% decline for Sudbury. This resulted in a swing of approximately 160 basis points in the funding model from Lincoln to Sudbury.

$ in Thousands	FY13 Lincoln	FY13 Sudbury	FY13 Total	FY14 Lincoln	FY14 Sudbury	FY14 Total	Growth: FY13 vs. FY14 Lincoln	Growth: FY13 vs. FY14 Sudbury	Growth: FY13 vs. FY14 Total
Student Ratio Calculation	14.93%	85.07%	100.00%	14.33%	85.67%	100.00%			
LSRHS Operating Budget within Levy			$25,707			$26,642			3.64%
LSRHS Offsets [a]			(3,533)			(3,906)			10.56%
Sub-Total After Offsets			$22,173			$22,735			2.53%
Statutory Minimum Contribution [b]	$2,336	$12,187	$14,523	$ 1,925	$11,952	$13,878	-17.59%	-1.92%	-4.44%
Budget in Excess of Minimum [c]	1,142	6,508	7,651	1,269	7,588	8,858	11.13%	16.60%	15.78%
Operating Budget Assessment	$3,479	$18,695	$22,173	$ 3,195	$19,541	$22,735	-8.16%	4.52%	2.53%
Share of Total Operating Budget	15.7%	84.3%	100.0%	14.1%	85.9%	100.0%			

(a) Offsets include, but are not limited to, State Aid, receipt of fees, E&D usage and regional transportation reimbursement.
(b) The minimum contribution required from each town is calculated by the DOR (called the Statutory Method).
(c) Assessment of the Budget in Excess of Minimum is calculated as per the regional school agreement based on number of students from each respective town.

In round numbers, Sudbury funded roughly 84% of the LS operating budget in FY13 and now will fund roughly 86% of the LS budget in FY14, with the net result that the LSRHS operating budget assessment to Sudbury has increased by 4.52%. This increase should not be confused with the High School's overall budget, which in the context of an FY14 No Override Budget, has the same allowable growth of 2.7% as the other cost centers. In addition to this allowable growth rate, the High School is contributing an additional $240,954 from their excess & deficiency ("E&D") fund, an account similar to free cash for the Town, to supplement their FY14 budget. These additional funds for FY14 will increase their year-over-year growth rate to 3.64%. The additional funding was needed to hire additional teachers to accommodate the increase in students forecasted for next year, thereby maintaining class sizes comparable to FY13 levels. While generally we do not recommend using free cash to support operating budgets, the Finance Committee supports the decision of the LSRHS School Committee to use E&D funds to supplement the FY14 budget to help maintain service levels and class sizes.

Sources of revenue and changes from FY13 are set forth below.

- Under Proposition 2 ½, the tax increase is limited to 2 ½% of the overall tax levy; for FY14, this increase is approximately $2.2 million.
- New growth, the tax on new and upgraded properties, is estimated to generate $520,000 of new revenue in addition to the allowed increase in the levy (bringing the total levy increase to approximately $2.3 million or 3.15%), an increase from the estimated $400,000 assumed in the FY13 budget; this number assumes a continued recovery in new home construction and renovation activity from the recent economic downturn.
- The debt exclusion portion of the tax levy (for payment of principal and interest costs) is decreasing by approximately $844,000, or 20%, from FY13 due to maturing debt on prior borrowings and refinancing of existing debt.
- State aid revenue is estimated to increase by approximately 6% from FY13 levels, resulting in an increase of approximately $499,000 (comprised of an increase in State Aid to Sudbury and LSRHS of approximately $135,000 and $364,000, respectively). This projection is based on the Governor's proposed budget and represents our best estimate at the time of publication of the warrant. To date, discussions regarding state aid from the state legislature are still evolving. Should new information be provided we will update our assumption for state aid heading into Town Meeting as we've done in previous years.
- Local receipts, primarily motor vehicle excise taxes and fees charged for certain town services, are currently estimated at $3.9 million, an increase of 5.5% from the FY13 budget level of

approximately $3.7 million. While still well below pre-recession levels, local receipts have grown modestly over the past few years.

- The annual school debt reimbursement represents aid from the State and is the same as FY13 as this amount will not change for the remainder of the payments scheduled through FY21 (unless the outstanding debt is refinanced); this aid must be used to reduce the amount of school debt issued and is excluded from the normal Proposition 2 ½ tax levy limit.

Ongoing Savings from Healthcare Changes

The significant rate of growth in health insurance costs for current and retired employees over the past decade has placed significant pressure on municipal operating budgets. Historically, making changes to these plans has been constrained by the requirements of collective bargaining. Fortunately, changes negotiated in our labor contracts four years ago helped to decrease that rate of growth in healthcare from prior levels. This resulted in significant savings from prior budget levels for the Town and SPS as well as for the High School.

Two years ago, the Legislature provided municipalities with an important tool to continue to reign in the significant growth of healthcare costs and provide significant and immediate savings to local governments. On July 12, 2011, Governor Duval Patrick signed An Act Relative to Municipal Health Insurance which amends Massachusetts General Laws Chapter 32B. This legislation provided a mechanism for municipalities to move to the Group Insurance Commission (the "GIC") outside the collective bargaining process. Prior to this recent change in legislation, entry into the GIC was subject to approval by all labor unions.

The Board of Selectmen voted to accept the provisions of sections 21-23 of Chapter 32B of the General Laws in November 2011. After following the prescribed process, the outcome for the Town and SPS was a decision to join the GIC. On July 1, 2012, all active employees and retirees for the Town and SPS migrated to the Commonwealth's GIC health benefits system. Collectively, the move to the GIC generated savings of more than $2 million in FY13. Similarly, as we head into FY14, the GIC announced on March 6th that health insurance premium rate increases would be held to an average increase of 3.5% across its offering of health plans, below both the state and national averages.

Similarly, the LSRHS School Committee embarked on a process in FY12 to determine what changes to make to their health insurance coverage. The outcome of this process was for the School Committee to drive savings by making GIC-like changes to the local plans offered by their current purchasing coalition, Minuteman Nashoba Health Group ("MNHG"). By making these changes year-over-year savings for FY13 were approximately $339,000, or a reduction of approximately 11%, as compared to FY12 budget levels. Heading into FY14, MNHG announced on January 31st that health insurance premium rates would actually be held flat vs. FY13. In addition, the High School made other changes in cooperation with the LSRHS teachers by decreasing the contribution rate on the high cost indemnity plans and implementing an opt-out incentive to drive further savings. Collectively, these changes along with the MNHG announcement have resulted in savings of approximately $255,000 in their FY14 budget as compared to previous assumptions.

The Finance Committee commends the actions taken by the Town, SPS and the High School to implement these healthcare changes over the past several years. These savings have been a critical piece of lessening any potential adverse impacts that might result from the constraints of operating within a No Override budget.

OPEB Liabilities

The Commonwealth's Department of Revenue defines OPEB as post-employment benefits other than pensions which generally take the form of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including in some cases their beneficiaries. They may also include some type of life insurance. For decades, state and local governments have promised defined benefit pensions together with retiree healthcare benefits as part of the compensation package provided to government employees. While funds were often set aside to cover the cost of the pension payments when they came due, generally no funds were set aside to cover the cost of the promised healthcare premiums. As a result, most towns today (including Sudbury) have an operating budget that includes salaries and healthcare benefits for active employees, plus healthcare benefits for retired employees who are no longer actively employed. Operating budgets are paying for the cost of operating government today plus part of the cost of operating government in the past - that unfunded liability to pay for healthcare in retirement. It has only been in the last five years that the Government Accounting Standards Board ("GASB"), which governs municipal accounting, required municipalities to calculate the amount of this liability and include it in the footnotes to their financial statements.

The Town and SPS ("Town/SPS") and LSRHS obtained actuarial valuation reports from KMS Actuaries (copies of which are available on the Town's website) to determine the estimated value of their respective OPEB liabilities. These reports also determined the Town/SPS's and LSRHS' annual required contribution ("ARC") for OPEB purposes. The ARC represents a level of funding that, if paid on an ongoing basis, is projected (i) to cover the normal cost per year (the cost that year of the promises of retiree healthcare benefits made to active employees) and (ii) amortize the actuarial accrued liability (the unfunded cost of the promises of retiree healthcare benefits made in prior years to employees now retired) over a period of thirty years. As of the last actuarial report as of July 1, 2011, the ARC for the Town/SPS and LSRHS was $3,663,686 and $4,457,705, respectively.

The estimated OPEB liability for the Town/SPS employees is $34.3 million, or roughly $37,400 per active employee and $64,400 per retired employee (the amount of the obligation attributable to active employees divided by the number of active employees and the amount of the obligation attributable to retiree employees divided by the number of retired employees). Due to the move to the GIC, the OPEB liability actually decreased by nearly $16 million as compared to the prior actuarial assumptions. The estimated OPEB liability for LSRHS is $46.1 million, or roughly $181,700 per active employee and $161,400 per retired employee. These amounts assume that the Town/SPS and LS continue the current practice with regard to retiree healthcare liabilities of "Pay-As-You-Go" (i.e. - pay the bills for retirees' health costs as they are presented without setting aside funds for future costs). In addition to the specific plans available to each cost center's employees, differences in per employee liabilities for a cost center are also impacted by employee contribution levels towards their insurance costs.

The Town/SPS and LSRHS are in the very early stages of looking at funding mechanisms to address this potential future burden. While the Commonwealth has not mandated that communities with OPEB trusts make their ARC each year, the Finance Committee believes it is prudent to determine a mechanism to begin to fund the OPEB trust on a sustainable basis.

Conclusions

Within the context of what is still an uncertain economic environment, and like many other communities across the Commonwealth, achieving a balanced budget in Sudbury is not without its challenges. Over the past several years, the Town's fiscal situation has been constrained by increases in the cost of wages and benefits which have risen faster than the rate of inflation. Moreover, with one of the highest levels of households with school age children in the State, we have a much higher demand for education services relative to other communities. On a comparative basis, Sudbury has amongst the highest per capita spending on education in the entire State. That said, our spending on schools and services as measured on a per student basis is in line with, or lower than, many of our peers. In fact, per pupil expenditures in the Sudbury Public Schools are well under the State average.

However, our cost structure is constrained by the fact that our revenue structure is heavily dependent on property taxes with only 7% of Sudbury's total revenues coming from commercial property taxes and 70% coming from residential taxes. As a result, residents bear the brunt of any tax increases.

Fortunately, changes negotiated in our labor contracts four years ago helped to decrease that rate of growth of growth in wages and benefits, particularly healthcare, significantly. These changes helped to lessen the collective impact of lower State Aid and non-property tax related revenues during the economic downturn. To be clear, layoffs and the elimination of services were still required in many areas to collectively allow us to balance our budget during the downturn. However, on a relative basis, Sudbury still fared better than many other communities in the Commonwealth during this time. More recently, the move to the GIC by the Town and SPS as well as healthcare changes made at the High School have yielded significant cost savings.

We encourage the Selectmen and School Committees to continue their efforts to reduce our structural costs. They have already begun the process of implementing several initiatives including reductions in the rate of growth in wages, reductions in the cost of employee health insurance, enhancing cooperation among school administrations, achieving clean energy benefits through the Green Ribbon Energy and Sustainability Committee, and sharing staff with neighboring communities. Moreover, we continue to support the Selectmen's on-going efforts to sustain and grow our commercial sector so that we might diversify our tax base and secure revenue opportunities beyond the traditional residential property tax, which we believe is critical.

We strongly urge you to be informed on the budgets being presented for your consideration. You have several avenues to increase your understanding of how each budget will affect the level of services, schooling and quality of life in Sudbury. Please review the Finance Committee Report section of the Town Warrant; attend budget forums; watch the Finance Committee budget hearings, which will be rebroadcast on Channels 8 (Comcast) and 31 (Verizon) during March and April; and review the vast array of budget materials available on the town and school websites. Also, do not hesitate to ask questions of your elected officials and committee members.

Whether or not you agree with our findings and recommendations, please make sure that when you cast your vote, it is an informed one.

Lastly, the Finance Committee would like to recognize and extend thanks to the employees of the Town, SPS and LSRHS, and the various committees for their support and contributions during the preparation of the FY14 budget.

Respectfully yours,
Sudbury Finance Committee

Jim Rao, Chair
Joan Carlton
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Robert Jacobson
William Kneeland, Jr.
Doug Kohen, Vice Chair
Mark Minassian
Robert Stein
Chuck Woodard