## FINANCE COMMITTEE REPORT

Dear Resident of Sudbury,

This report will assist you in understanding Sudbury's fiscal year 2013 ("FY13") budget – from July 1, 2012 through June 30, 2013 - and the related financial articles that will be presented to you at Town Meeting beginning on May 7th. 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 October 2011, 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 2012, we asked each cost center to prepare two budget scenarios for FY13:

- A No Override Budget that allows for annual growth up to 2.5% for each cost center and was based upon expectations regarding State aid and local receipts as of the date this warrant went to publication; and
- A Level Staff (or roll-up) budget that assumes each cost center maintains the same service levels in FY13 as funded through their FY12 budgets.

For FY13, the majority of the labor contracts for our three principal cost centers are set to expire at the end of FY12 and are currently in negotiation. Given this fact, and while still recognizing that each cost center has certain unique characteristics, FinCom believed it important that a level of consistency exist in which all budget submissions were prepared. As a result, we asked each cost center to make the following assumptions when constructing their budget submissions:

- No cost of living increase ("COLA"s) when forecasting compensation costs for FY13;
- Normal salary steps given their current employee demographic;
- Estimates of expected health and benefit costs increases or decreases; and
- Estimates of utilities and, where applicable, transportation and special education cost increases or decreases.

In addition, from a longer term planning perspective, the conditions surrounding our collective revenue forecast are not expected to show much improvement given continued economic uncertainty. As a result, consistent with revenue forecast assumptions, FinCom recommend that each cost center assume 2.5% annual budget growth over the next three fiscal years (FY13-FY15) for planning purposes.

<u>Recommended No Override Budget</u>

For FY13, we are recommending only a No Override Budget of approximately $82.8 million at the time this warrant was prepared. The No Override Budget represents a tax increase of approximately 3% ($327) on the average assessed home value of $621,410 and a total increase in taxes of $2,084,493 including new growth and commercial property taxes.

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 FY13 No Override Budget represents a 2.5% increase in the operating budget for each cost center compared to the FY12 budget. The difference in growth between the property tax increase of 3% and the allowable growth in the operating budgets of each cost center is due to continued projected declines in State Aid as well as stagnation in local non-property tax revenues. Sources of revenue and changes from FY12 are set forth below.

- Under Proposition 2 ½, the tax increase is limited to 2 ½% of the overall tax levy; for FY13, this increase is approximately $1.6 million.
- New growth, the tax on new and upgraded properties, is estimated to generate $400,000 of new revenue in addition to the allowed increase in the levy (bringing the total levy increase to approximately $2 million or 3%), up slightly from an estimated $350,000 estimated in FY12 budget; this number assumes a continued slow recovery in new home construction and renovation activity from the recent economic downturn.
- State aid revenue is estimated to decrease by approximately 3% from FY12 levels, resulting in a decrease of approximately $239,000 (comprised of a reduction in State Aid to Sudbury and LSRHS of approximately $159,000 and $80,000, respectively). This projection is based on our best estimates leading 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 expected to remain flat vs. forecast FY12 levels of approximately $3.7 million.
- The annual school debt reimbursement represents aid from the State and is the same as FY12 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.

| | BUDGET FY12 | BUDGET FY13 | Increase/ (Decrease) | % |
|---|---|---|---|---|
| Tax Levy | 69,007,532 | 71,092,025 | 2,084,493 | 3.02% |
| SBAB School Debt Reimbursement | 1,681,224 | 1,681,224 | 0 | 0.00% |
| State Aid [(a)] | 5,409,800 | 5,251,297 | (158,503) | -2.93% |
| Local Receipts | 3,657,000 | 3,657,000 | 0 | 0.00% |
| Sub-Total | 79,755,556 | 81,681,546 | 1,925,990 | 2.41% |
| Prior Year Articles/Recoveries | 300 | 0 | (300) | -100.00% |
| Enterprise Funds | 1,117,233 | 1,090,601 | (26,632) | -2.38% |
| **TOTAL REVENUE** | 80,873,089 | 82,772,147 | 1,899,058 | 2.35% |

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

*FY13 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 three 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.

Heading into FY13, however, 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. While there are many details to this new legislation, the highlights of the new law are as follows:

- Provides greater flexibility to local governments over their health insurance decisions;
- Preserves a role for labor in the process;
- Provides a process outside of collective bargaining for changes in co-pays, deductibles and other cost-sharing features only; changes in contribution rates are still subject to collective bargaining; and
- Savings are shared with subscribers who are most affected by changes.

The law requires that all Massachusetts municipalities do an assessment of their healthcare costs and compare it to benchmark plans provided by the GIC. The purpose of this exercise is to discover the maximum possible savings if a municipality offered insurance coverage under the GIC benchmark plan. Once done, the local process that municipalities follow to implement healthcare design changes is to choose one of two options, either (a) join the GIC, or (b) change local plans (adjust local plan co-pays, deductibles and/or other cost-sharing features) to bring them within 5% of the prescribed GIC benchmark.

In November 2011, the Board of Selectmen voted to accept the provisions of sections 21-23 of Chapter 32B of the General Laws. After following the prescribed process, the outcome for the Town and SPS was a decision to join the GIC. At the time this warrant was prepared, the year-over-year savings generated by joining the GIC are estimated at approximately $1.1 million as compared to FY12 budget levels with approximately $0.7 million and $0.4 million attributed to SPS and the Town, respectively. This projection will continue to be refined as new information and estimates regarding rates and employee enrollment are acquired. A new savings estimate for the Town and SPS may be provided heading into Town Meeting.

Similarly, the LSRHS School Committee embarked on a process to determine what changes to make to their health insurance coverage. The outcome of this process was for the School Committee to choose the second option: to drive savings by making change to the local plans offered by their current purchasing coalition, Minuteman Nashoba Health Group. By making these changes, year-over-year savings are estimated at approximately $339,000, or a reduction of approximately 11%, as compared to the FY12 budget levels.

The Finance Committee commends the actions taken by the Town, SPS and the High School to implement these healthcare changes. While there is still much uncertainty heading into FY13, these savings go a long way to lessening any potential adverse impacts that might result from the constraints of operating within a No Override budget next year.

*FY13 Impact of Out-of-District Special Education Costs*

A key growth driver for the SPS and LSRHS budgets are special education costs. The provision of a free and appropriate education in the least restrictive environment for all students is a federal and state mandate; our two school districts continue to seek the most efficient means to effectively meet these requirements. Despite developing programs within our schools, a rising portion of these costs are not within the direct control of our two districts as a growing proportion of spending represents tuition and transportation for students who are required to attend schools outside of SPS and LSRHS, so called out-of-district placements. As compared to the FY12 budget, net special education expenses (excluding instruction) for LSRHS and SPS are forecasted to increase in FY13 by 33% ($1.3 million) and 12% ($0.4 million), respectively. The biggest driver of these increases are required costs for out-of-district placements. The Finance Committee remains concerned that the significant rise in these costs continues to put downward pressure on the remaining operating budgets of our two school systems.

In particular, the increase in Special Education costs at the High School is so large that it qualifies for an "Extraordinary Relief" provision that the state provides for school districts incurring over a 25% increase in Special Education costs within a single fiscal year. LSRHS is applying for Extraordinary Relief and could realize up to $621,366 in incremental funding from the state. However, the amount for which the High School will be reimbursed by the state is dependent on a number of factors including, but not limited to, the total number of Massachusetts school districts that qualify for Extraordinary Relief and how far this special funding from the state can stretch to meet the districts' needs. Funding decisions regarding Extraordinary Relief are not expected to be communicated by the state to school districts until sometime in April.

<u>Override Budget</u>

The FinCom is not recommending an Override budget at this point in time given the uncertain status of labor contract negotiations as well as the level of Extraordinary Relief funding that the High School receives from the state. Favorable contract settlements for FY13 and beyond will be the single most important factor in eliminating and/or reducing any FY13 projected deficit and potential future deficits in FY14 and FY15. While it is not possible to publicly comment on the status of negotiations given the constraints of collective bargaining, all Boards, Committees and Town officials understand the need to settle these contracts as economically as possible.

Closer to Town Meeting, the FinCom may consider proposed override scenarios based on particular needs and as additional information becomes available.

Conclusions

Within the context of what is still a difficult 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 severely constrained by increases in the cost of wages and benefits which have risen much 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 three 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.

In the short-term, it is unlikely that our non-residential tax revenues will see any meaningful increases given the current economic climate and the potential continued decreases in state aid and stagnation of local receipts. For the past three years, these non-residential tax revenues have decreased substantially. As a result, the Finance Committee believes the Town will increasingly be confronted with three alternatives:

- Additional overrides needed to fund our ongoing level of services given current organizations and cost structures;
- Reductions to staff, and therefore services, within our current organizations and cost structures in order to fit within the constraints of Proposition 2 ½ and avoid overrides; or
- Changes to our current organizations and cost structures that enable our Town to deliver substantially (but perhaps not completely) the same level of services at a lower overall cost.

The Finance Committee believes that achieving the latter of these three alternatives is imperative if we are to avoid or limit either of the former alternatives. To that end, we encourage the Selectmen and the School Committees to continue their efforts to reduce our structural costs. Several initiatives have already been implemented - including reductions in the rate of growth of employee health insurance, enhanced cooperation among school administrations, and sharing of staff with neighboring communities to reduce overall costs. In addition to these cost initiatives, we support the Selectmen's on-going efforts to sustain and grow our commercial sector. Over the long-term, diversifying our tax base and securing revenue opportunities beyond the traditional residential property tax 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 FY13 budget.

Respectfully yours,
Sudbury Finance Committee

Jim Rao, Chair
Joan Carlton
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