

# Structural Deficits, Budget Cuts, and Overrides

December 9, 2020

# Agenda

## Belmont's Budget Challenge

- Structural Deficit – What? Why?
  - Recurring Revenues
  - Recurring Expenses
- Options to Close a Budget Gap
  - A combination of:
    - Increase revenue
    - Reduce expenses
    - Increase use of reserves
    - Voter-approved operating override
- FY22 Budget Process: Next Steps

# Context

We are early in the budget process. Both town and school departments have put together a set of FY22 budget proposals that were first presented to the Select Board, School Committee, Warrant Committee, and Capital Budget Committee on November 23. These budgets will be vetted and adjusted over the next few months, and eventually voted by Town Meeting in June.

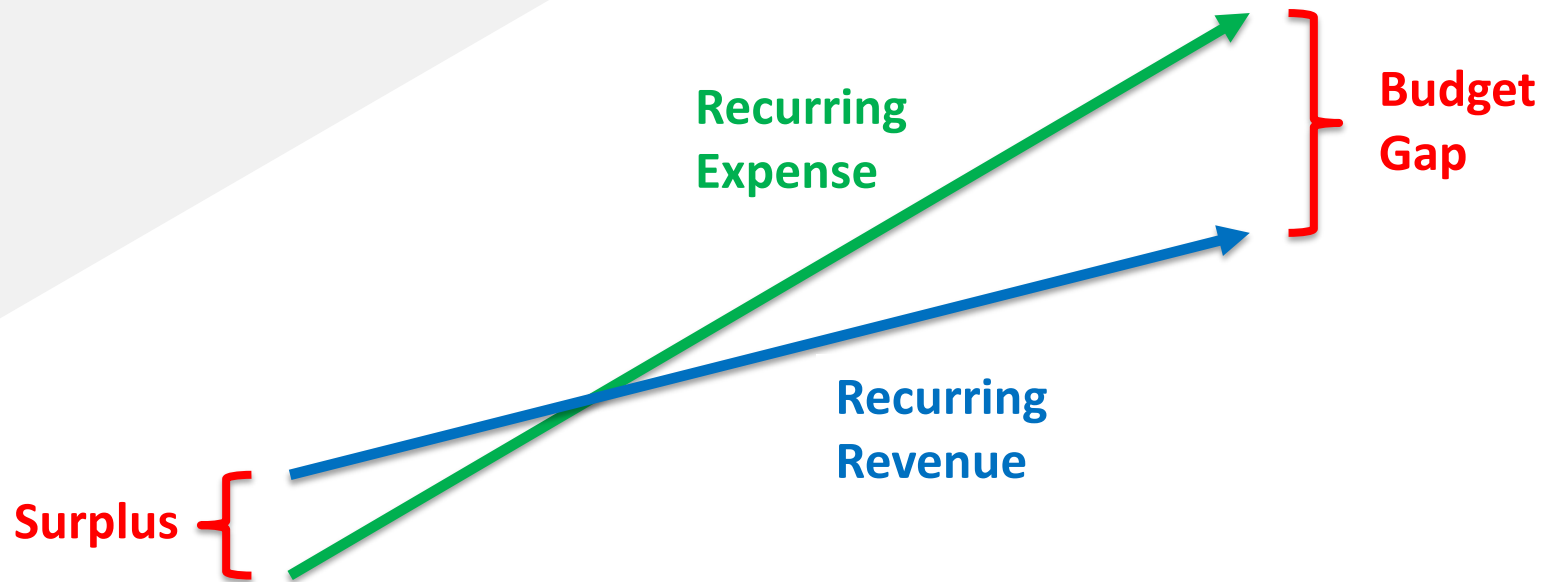
The same FY22 budget information is incorporated in the work of the Financial Task Force 2. The FTF created a financial model that makes it possible to test a wide variety of assumptions and examine many multi-year scenarios before budget decisions are made.

The information in this presentation is drawn from the FY22 budget proposals and financial model.

We are here tonight to begin a discussion about the budget assumptions and decisions that must be made over the next few months. Community input is a crucial part of the decision-making process. There will be multiple ways to participate, and tonight's meeting is just a beginning.

# What is a Structural Deficit?

A ***structural*** deficit happens when recurring expenses increase faster than recurring revenues.



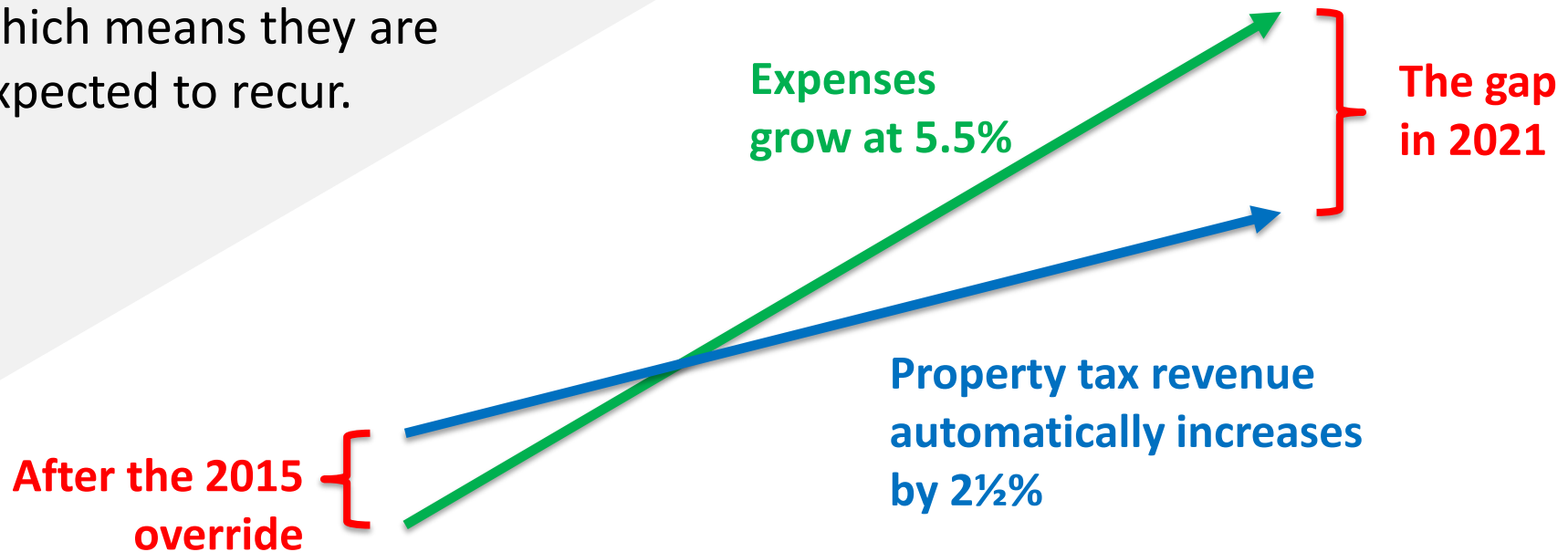
Conceptual Diagram of a Structural Deficit

# Why Is There a Structural Deficit?

Property tax growth is capped at 2½%.

But some key expense categories, like health insurance, grow faster than 2½%.

These deficits are ***structural***, which means they are expected to recur.



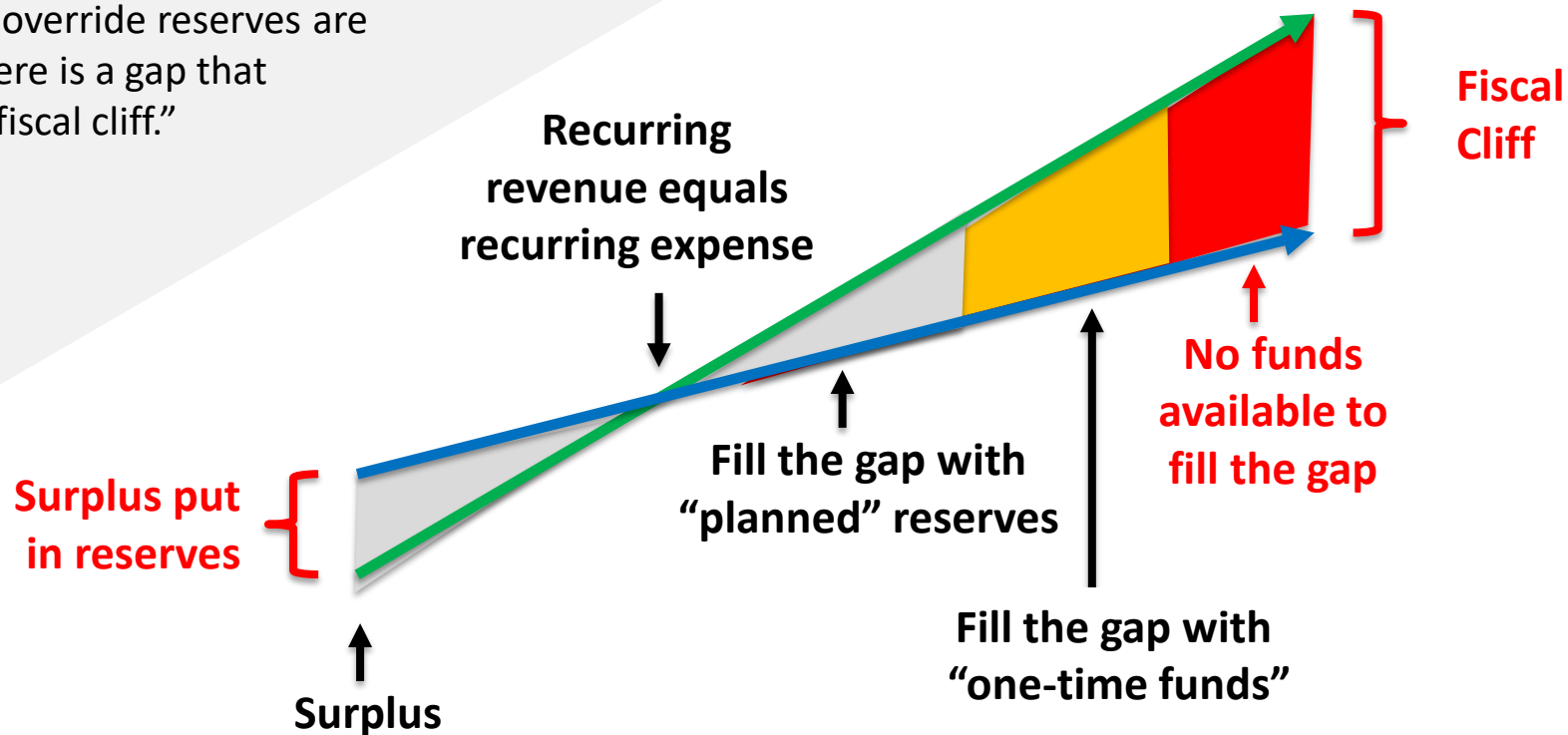
**Conceptual Diagram of a Structural Deficit**

# How Does a Structural Deficit Grow?

After the 2015 override, there was a surplus of property tax revenue, which was put in reserves.

But a **structural** deficit means that expenses will eventually exceed revenues. That is when the saved override funds are used to fill the gap.

When those override reserves are depleted, there is a gap that becomes a “fiscal cliff.”

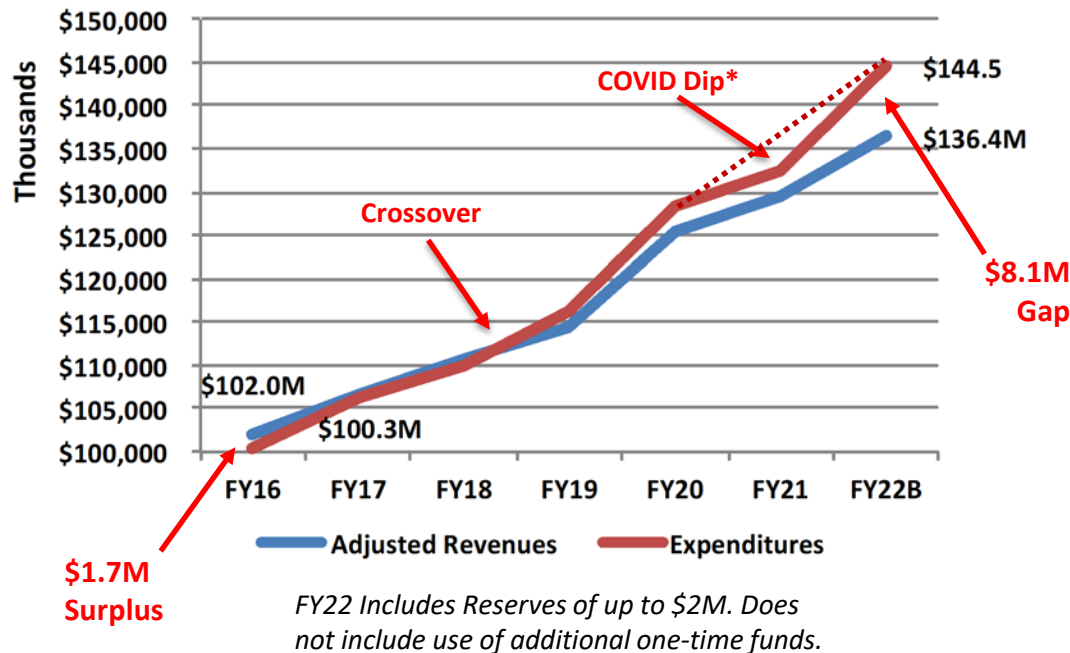


Conceptual Diagram of a Structural Deficit

# What is the Actual Structural Deficit?

In FY16, the \$4.5M override produced a surplus of \$1.7M, after funding the budget. The surplus was put in reserves for use in future years. The override was expected to sustain the budget for three years.

## Recurring Revenues and Recurring Expenditures



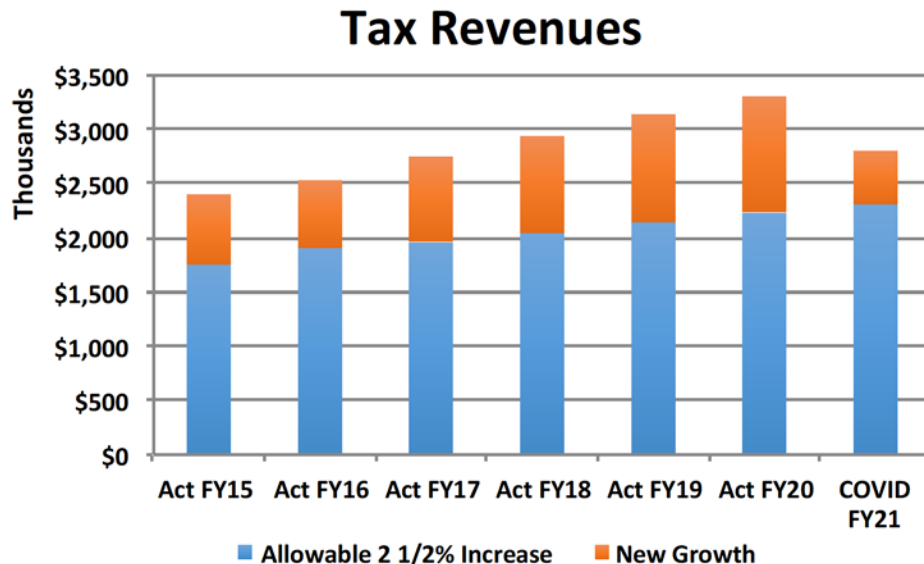
In FY19, recurring expenses crossed recurring revenues. The override reserves were used to sustain the budget. Additional one-time funds continued to balance the budget through FY21. The gap for FY22 is projected to be \$8.1M.

\* COVID Dip: Emergency, one-time actions (like deferring capital projects for one year) to address the COVID crisis, distorted the expense line.

# What Causes a Structural Deficit?

## *Revenue Side*

**Proposition 2½** is a Massachusetts law which requires voters to approve any property tax increases greater than 2½%.



Property tax revenue can automatically increase by 2 ½% annually. This is shown by the blue bars in the chart.

Prop 2½ is a significant constraint on revenue for a “town of homes” like Belmont, with little industrial or commercial activity.

An “override” vote resets the baseline property tax level.

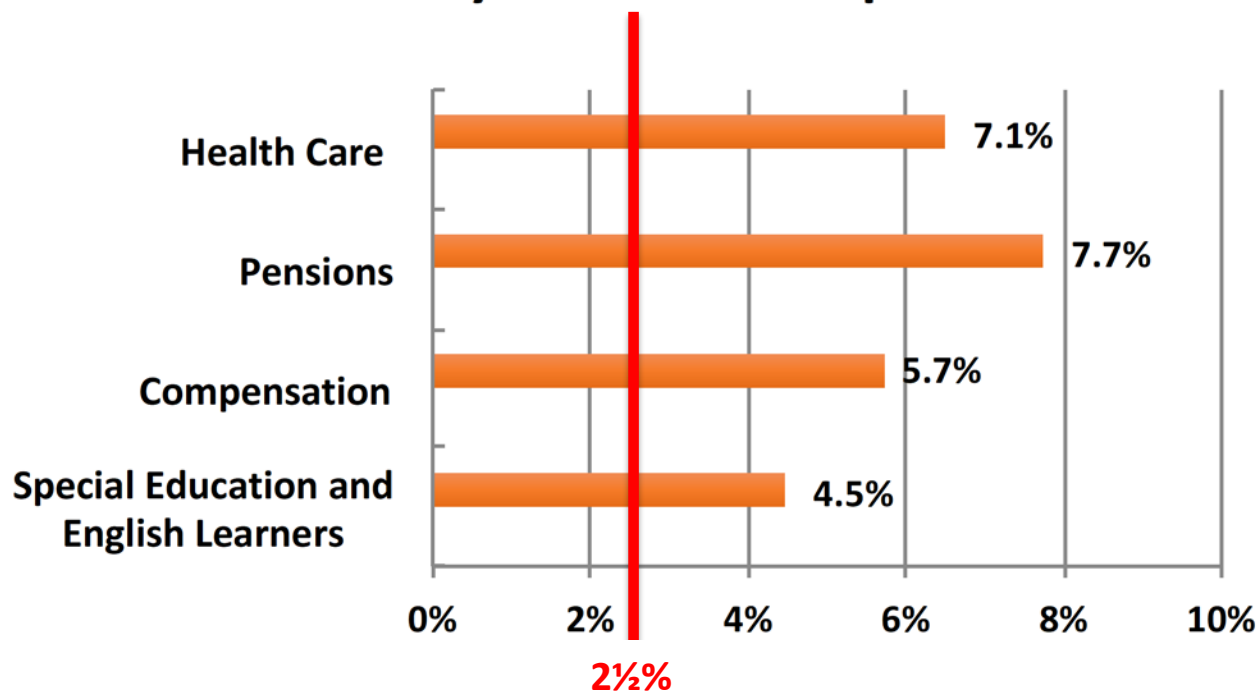
*In addition to the automatic 2 ½% increase, the tax base also increases to include New Growth, the value of new construction and renovations, but this varies from year to year. This is shown by the tan bars in the chart.*



# What Causes a Structural Deficit?

## *Expense Side*

### Key Sources of Expense Growth



*5-Year Compound Average Growth Rate FY17-22 for Town and Schools only, excludes Enterprise Funds.*

*Budgeted amounts for FY22:  
Health Care, \$14.0M, Pensions, \$10.1M  
Compensation, \$85.3M, SPED and EL, \$16.4M*

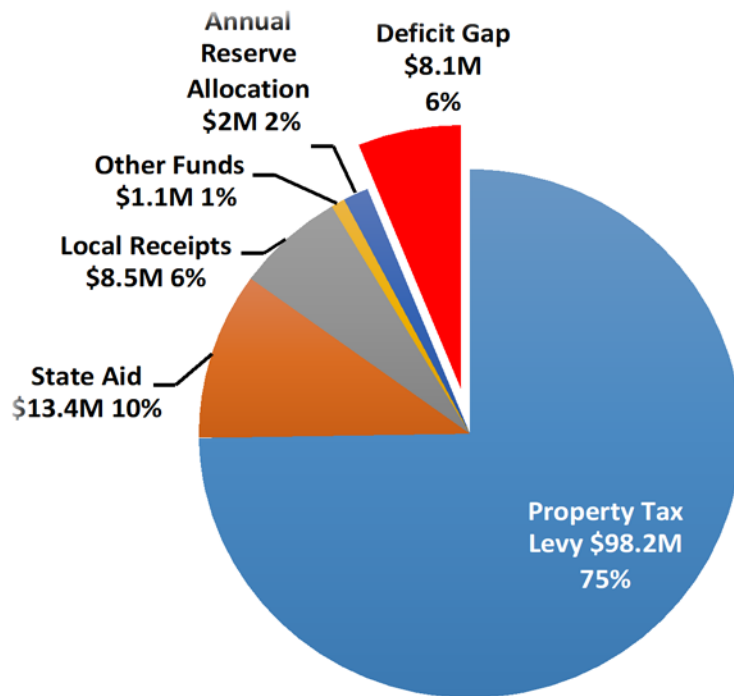
These cost drivers grow faster than the automatic 2½% increase from Prop 2 ½.

*SPED and EL represents Special Education and English language learner expenditures, which are mandated by the State.*

# What Does the FY22 Budget Look Like?

## *Revenue Side*

For a “town of homes” like Belmont, 75% of revenue comes from property tax, and 95% of that is residential.



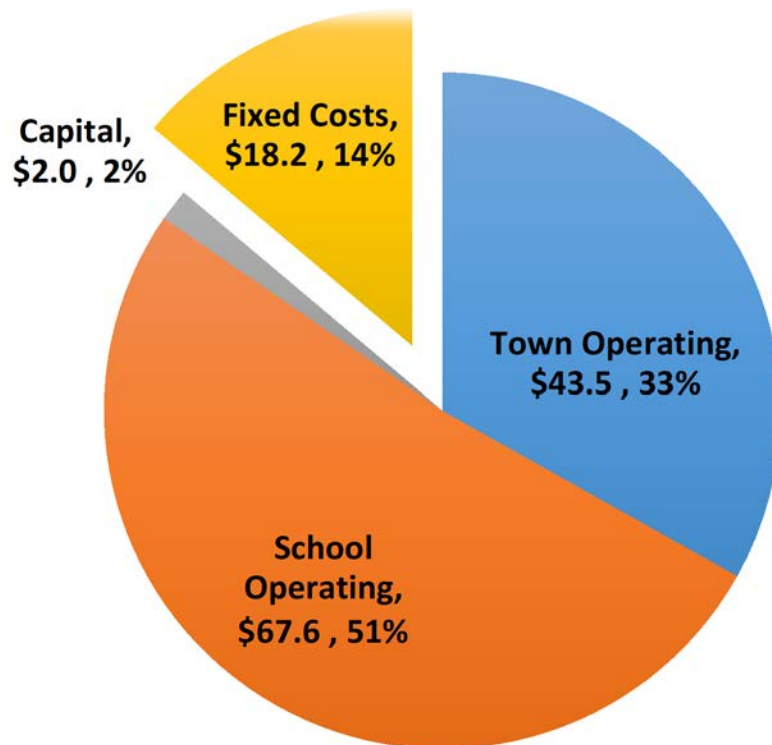
**FY22 Operating  
Revenue = \$123.2M**  
*(excluding Enterprise Funds and Debt Exclusions)*

*Local Receipts includes meals and motor vehicle excise taxes, ambulance revenues, penalties and interest, PILOTs, licenses and permits, earned interest and town fees and fines. Other Funds includes enterprise fund indirect costs, parking meter receipts assessor's overlay, bond premium amortization, return of unspent capital, and capital endowment periodic contributions.*

# What Does the FY22 Budget Look Like?

## *Expense Side*

The FY22 budget presented by the Town and School Departments reflects the Financial Task Force's "Minimal Level Services" budget which maintains town and school services at their current level.



## **FY22 Operating Budget = \$131.3M**

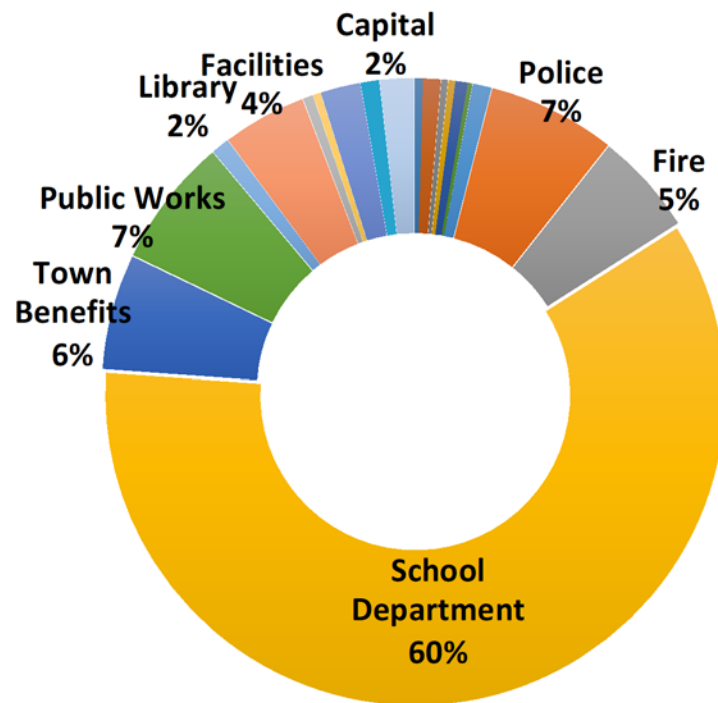
*(excluding Enterprise Funds and Debt Exclusions)*

*Fixed Costs include state assessments, non-exempt debt service, school and town pension obligations, roads and sidewalks, voc-tech tuitions and assessor's overlay. School expenditures carried by town include facilities and maintenance, crossing guards, SROs, and other allocated departmental expenditures.*

# What Does the FY22 Budget Look Like?

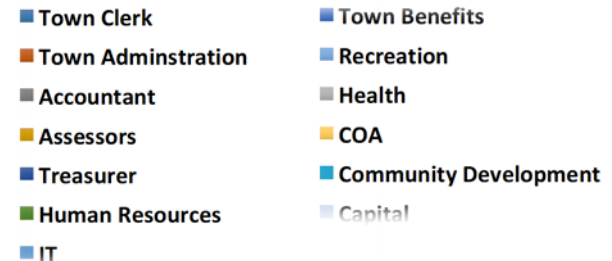
## *By Department*

Reducing the budget beyond “Minimal Level Services” would reduce or eliminate services provided by the town and school departments.



## FY22 Department Budgets = \$113.1M

*(excluding Enterprise Funds, Debt Exclusions, and Fixed Costs)*



# How Do You Manage a Budget Gap?



A combination of:

- Increase revenues
- Reduce expenses
- Increase use of reserves
- Reset the property tax baseline with a voter-approved override

# What Has Been Done About the Structural Deficit?

## *Revenue Side*

In recent years, much work has been done to increase recurring revenue.

### New Growth from Property Development Tax Revenues

- Expanded revenue sources from developments in Cushing Square, McLean, Royal Belmont, and Waverley (Trapelo corridor)

### Grants

- Aggressively pursued grant funding from Green Communities, Complete Streets, Safe Routes to Schools, Community Compact, MASS DOT, MAPC planning, etc.
- FEMA, CARES and other COVID grants, State earmarks

### Local Receipts

- Host Community Agreements for marijuana businesses on Pleasant St
- Promoting business in our commercial districts – outdoor dining, Belmont Center redesign, rezoning South Pleasant St
- Increased facility rentals for schools, Beech St Center, recreation assets, etc.

### Recreation Enterprise Fund

- New recreation programming and pool revenue will allow department to become self-sustaining

# What Has Been Done About the Structural Deficit?

## *Expense Side*

In recent years, much work has been done to reduce recurring expenses.

### Health care plan redesign

- Adjusted health benefits to (again) match the state GIC plans and contain premiums

### Pension fund payment schedule

- Extended payment schedule makes annual payments lower

### Full Day Kindergarten

- Increases State aid to replace School costs and eliminate Kindergarten fees for all students

### Energy savings

- Zero Net Energy decision will contain costs for new middle/high school

### Restructuring positions

- Combined Assistant Town Administrator and Recreation Director
- Consolidated Town and School Facilities departments for efficiencies

### Enterprise Funds

- Transitioning recreation to a self-funded enterprise fund
- Reallocated water/sewer costs to appropriate enterprise funds

### Partnerships

- Using consortiums and multi-town partnerships to reduce costs, e.g. heating oil, procurement contracts (e.g. sand), SPED, nurse, inspector, etc.

# What Is Being Done NOW About the Structural Deficit?

New initiatives are currently underway to implement changes to increase revenue and reduce expenses.

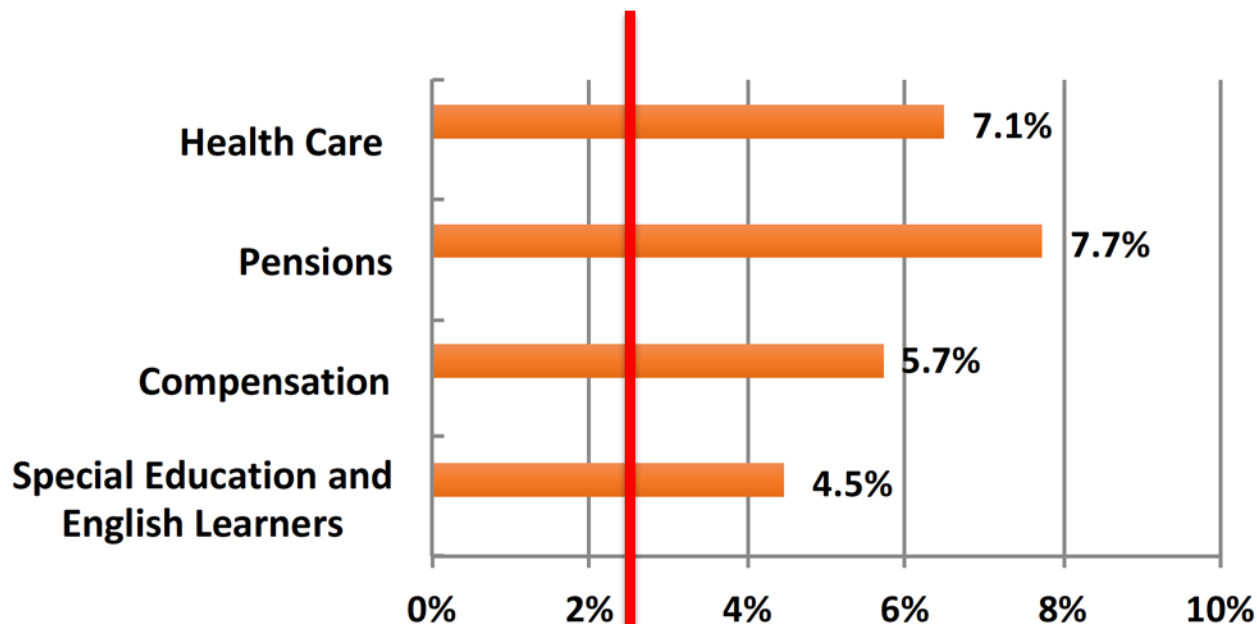
- Structural Change initiatives
- Economic Development initiatives
- Aggressively pursuing grants
- Long-term capital planning
- Maximizing FEMA and CARES Act for COVID expenses
- Plans to create a new solar/battery farm at the incinerator site
- Website redesign initiative



# What Drives Growth of Expenses?

Let's examine the key cost drivers that increase faster than 2½%.

## Key Sources of Expense Growth



*5-Year Compound Average Growth Rate FY17-22 for Town and Schools only, excludes Enterprise Funds.*

**2½%**

*Budgeted amounts for FY22:  
Health Care, \$14.0M, Pensions, \$10.1M  
Compensation, \$85.3M, SPED and EL, \$16.4M*

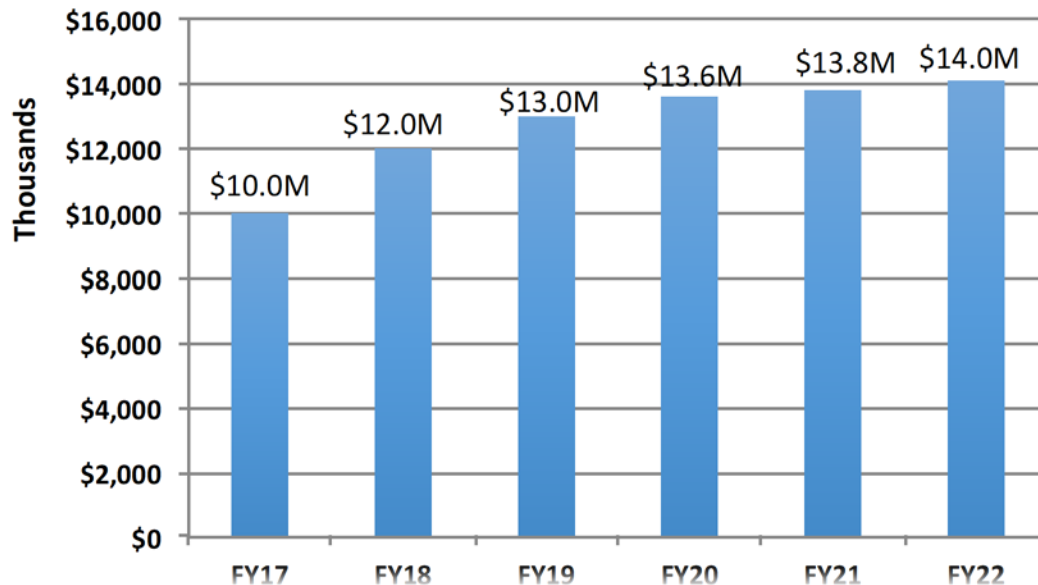
These cost drivers grow faster than the automatic 2½% increase from Prop 2½.

*SPED and EL represents Special Education and English language learner expenditures, which are mandated by the State.*

# How Does Health Care Impact the Gap?

## Town and School Health Costs

*Health Care grows by 7.1% on average, compared to 2.5%*



Health Care represents 12.4% of the FY22 School and Town Department Budgets.

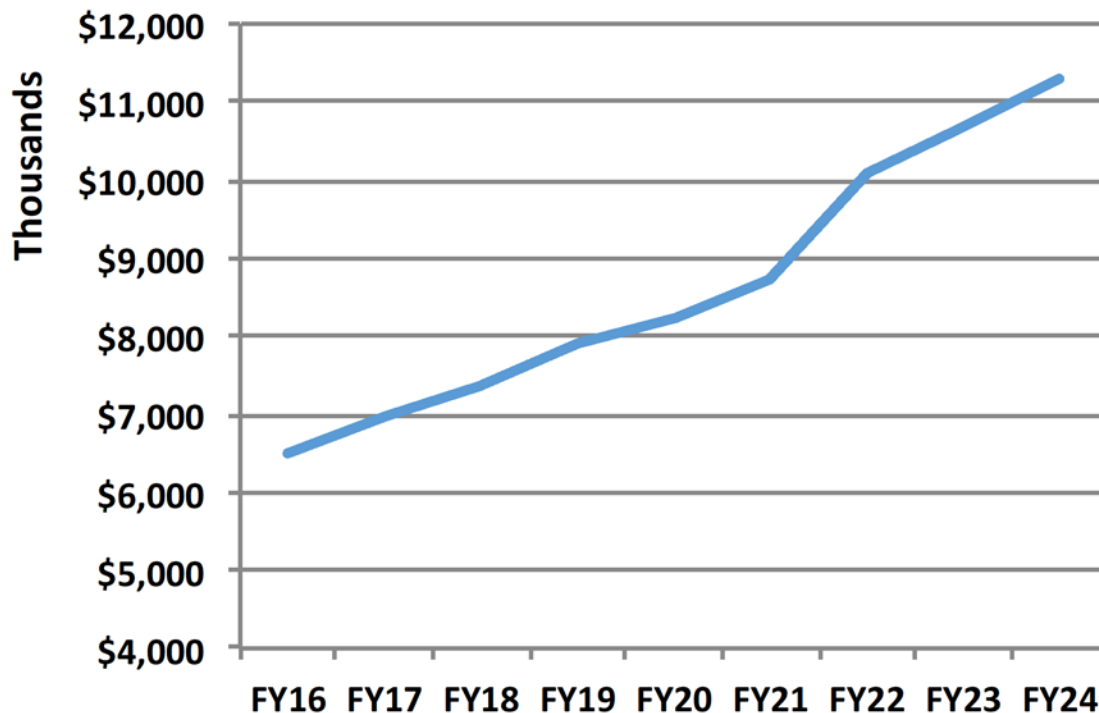
The cost of health care is market driven and consistently increases more than 2.5%

- Belmont self-insures. Some years are good. Some aren't.
- We changed the plan design last year to again be in line with the state GIC plan and reduce premiums.  
*(The GIC is the state employee insurance program that covers 460,000 members across the state – 918 state, regional, municipal, and quasi-public agencies)*
- We are currently exploring the possibility of joining the GIC plan.

# How Do Pensions Impact the Gap?

## Retirement and Pension Costs

*Pensions grow by 7.7% on average, compared to 2.5%*



Towns are legally required to fund their pension liability by 2040

- Previously, pensions were “pay as you go.”
- Now, cities and towns must pre-pay a pension fund.
- The funding timetable and outstanding balance determine how the liability impacts the operating budget.
  - The remaining pension fund liability is \$82 million.
  - The timetable is set by an independent retirement board.

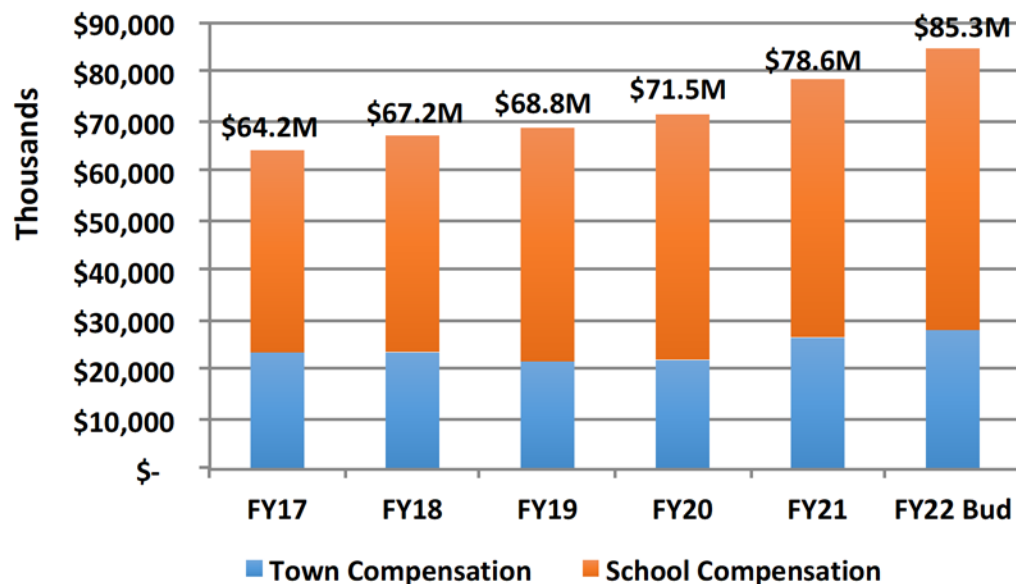
**Current Retirement and Pension Costs increase around \$600,000 every year.**

*Town and Schools only, excludes Enterprise and Housing Authority. Total pension liability includes all entities.*

# How Does Compensation Impact the Gap?

## Total School and Town Compensation

*Compensation grows by 5.7% on average, compared to 2.5%*



Most compensation is governed by collective bargaining agreements with 12 unions.

### Town Departments

- Salaries increase by COLA and experience.
- Headcount has been relatively flat, with a small increase budgeted in FY22.

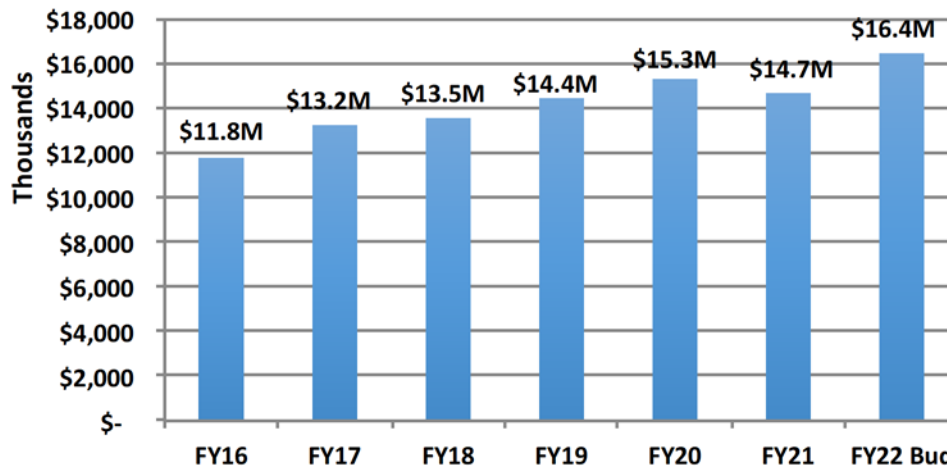
### School Department

- Teacher salaries increase by COLA and “steps and lanes,” a nation-wide compensation structure that incentivizes teaching experience and education.
- Headcount has grown to address the rapidly rising enrollment growth.<sup>20</sup>

# How Do Mandated Services Impact the Gap?

## SPED and EL Expenditures

*SPED & EL grows by 4.5% on average compared to 2.5%*



*School Department reserves of \$1.7M were used to fund a higher share of costs in FY21.*

Many functions of town government are mandated by state or federal law.

Special Education (SPED) are mandated services that are partially funded by the state.

English Language Learning (EL) are mandated services that do not have an external funding source.

There are many other mandated services that are embedded in department budgets. New unfunded mandates also have a financial impact. Examples in the last several years are early voting and public records requests.

# How Do You Manage a Budget Gap?

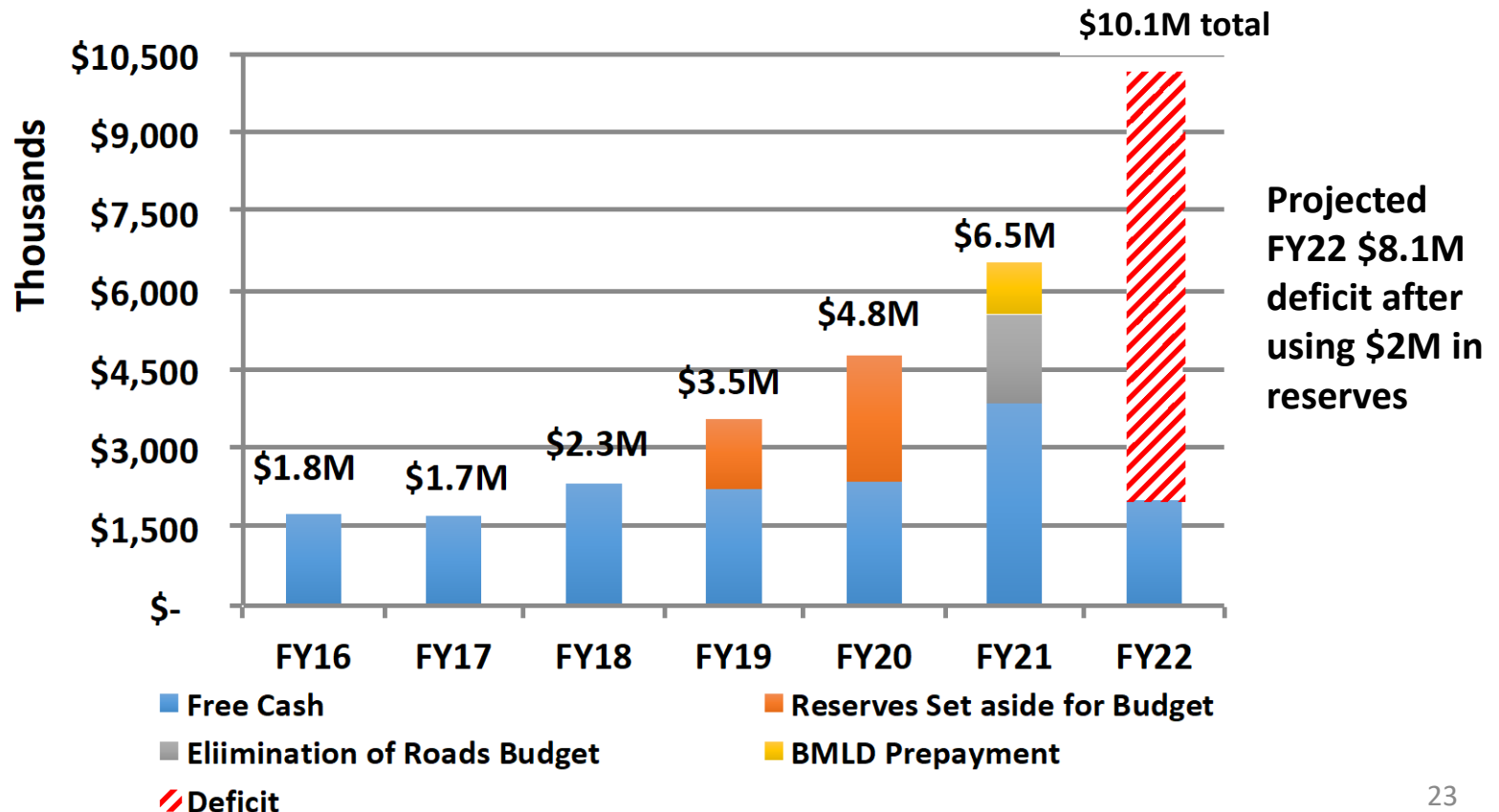


A combination of:

- Reduce expenses
- Increase revenues
- Increase use of reserves
- Reset the property tax baseline with a voter-approved override

# How Have We Filled the Gap in Recent Years?

We have used ***one-time funds*** to extend the 2015 override.



# Where Do One-Time Funds Come From?

One-time funds are ***not recurring*** – they can only be used for the budget once, leaving a gap the following year. Most often, using one-time funds means using reserves.

Reserves come from three sources:

- Revenue surpluses
  - Meals and vehicle taxes
  - Building permits, etc.
- Turnbacks from unspent budget lines
  - Employee turnover
  - Cost savings for new supply contracts
  - Not much snow, etc.
- Exceptional events
  - FEMA reimbursements
  - Sale of property
  - CARES act reimbursements for COVID -19 expenditures
  - Insurance settlements
  - Unexpected additions to state aid



# Why Are Reserves So High Right Now?

COVID-19 had a significant impact on reserves and on the FY21 and FY22 budgets.

## Immediate concerns last spring:

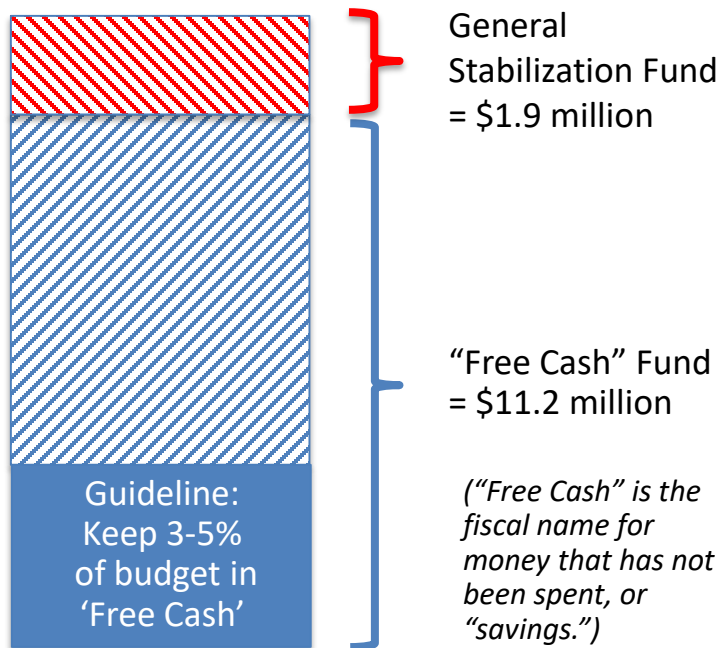
- Protect the health of our residents and employees
- Protect the financial health of the town
- Potential for a world-wide recession
- Impact on state aid and local taxes/fees
- COVID-related costs (PPE, staff, facilities)

## Immediate actions last spring:

- Closed offices, spending freeze, postponed vacations
- Revised FY21 budget amid tremendous uncertainty
  - Assumed 75% state aid
  - Reduced the total budget by \$4.3M
- Aggressively tracked COVID expenses and pursued state & federal grants for reimbursements

# How Much Do We Have in Reserves?

## Current Reserves



1. Our careful management of the COVID shockwave since March resulted in significant turnbacks in FY20.

2. We also had several unanticipated, one-time events that increased reserves. (Investment income & accounting reclassifications)

So there is a total of \$13.1 million in reserves, but ...

This is our "savings account" – we cannot spend it all. Our guideline specifies we need to keep 3-5% of budget in 'Free Cash'.

# What is the Gap?

The estimate of the gap depends on how much is used from reserves.

The estimates below *(based on the Nov 23 draft budget proposal and Financial Task Force model)* include the usual \$2M of reserves we have used in recent years. No decisions have been made regarding the use of additional reserves.

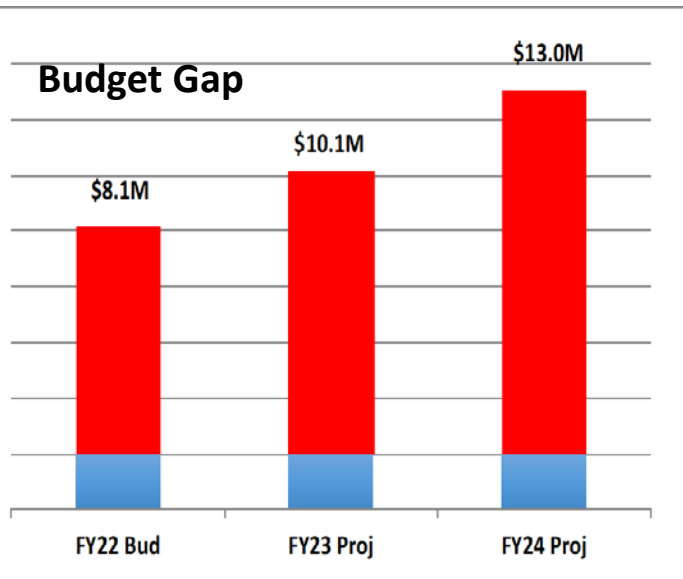
SUMMARY	FY22	FY23	FY24
Receipts*	\$121,200,602	\$125,425,020	\$128,684,492
Expenditures*	(\$131,332,956)	(\$137,553,396)	(\$143,721,269)
Reserves	<u>\$2,000,000</u>	<u>\$2,000,000</u>	<u>\$ 2,000,000</u>
Gap (using \$2M reserves)	(\$8,132,354)	(\$10,128,376)	(\$13,036,777)

*\*excluding Enterprise Funds and Debt Exclusions*

# How Much of Reserves Should We Use to Fill the Gap?



Many scenarios must be considered to determine the best way to use our reserves.



- How much do we need to keep in 'free cash' to mitigate risk in these uncertain times? Guideline is 3-5%.
- Do we need to set aside reserves for known one-time expenses like the Chenery roof? What about potential COVID expenses? Other unanticipated needs?
- Do we use reserves to level out the gaps over the next three years (and therefore reduce the size of a potential override)?
- Do we use as much as possible in FY22 to delay an override for one year (but also significantly increase the size of the needed override the next year)?
- What is our tolerance for risk?

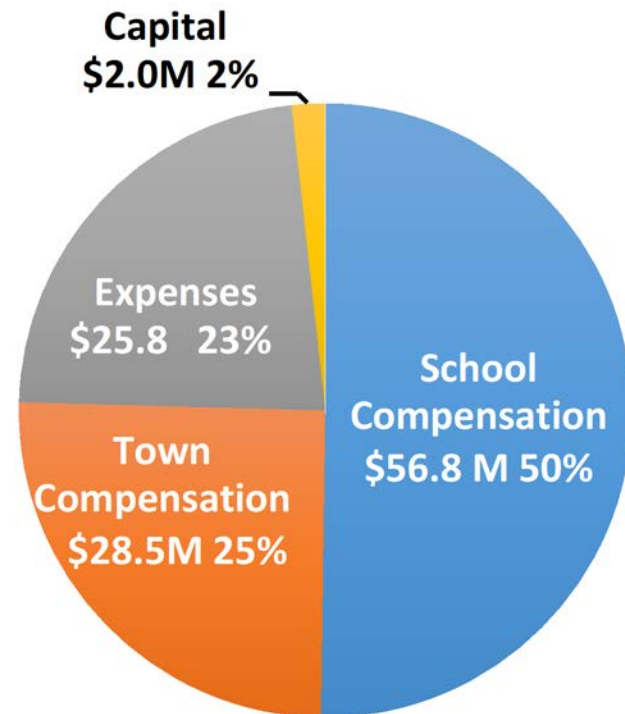
Budget gap shown is after using \$2M in Reserves in each year

# How Can We Reduce Expenses?

**Department Budgets = \$113.1M**  
(excluding Fixed Cost obligations)

75% of department budgets are personnel.

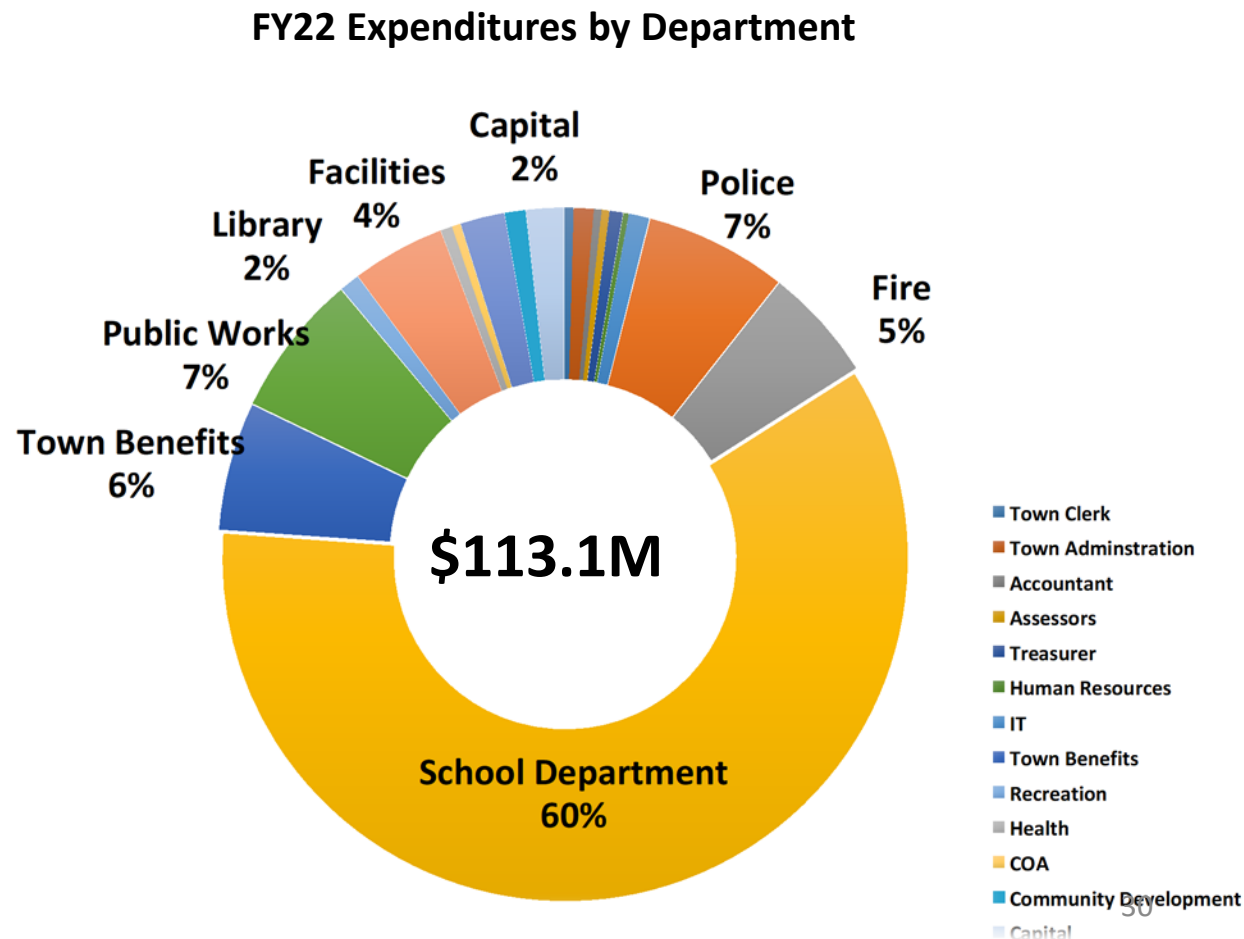
These are the people who deliver town and school services, so reductions in personnel will mean loss of services.



*Non-personnel expenses include: Contracts for outsourced services (such as trash and recycling); Snow removal; Pool and rink expenses; Street maintenance; Facilities maintenance costs; Computers, software, and networking; Utilities and fuel; Fleet repair; Printing and supplies; Fees, dues, etc.*

# Where Can We Reduce Expenses?

We face a very difficult set of choices to determine which town and school services would be reduced or eliminated without additional funds.



# Should We Use an Override to Close the Gap?

An override is a strategy to eliminate a budget gap for multiple years by resetting the level of property tax revenue, but there are two key questions that must be answered.

- How much should the override be? This depends on how much we use from reserves and whether we also choose to reduce town and school services.
- How long would we want it to “last”? In other words, how long will it be until the structural deficit produces another gap. This depends on the size of the override.

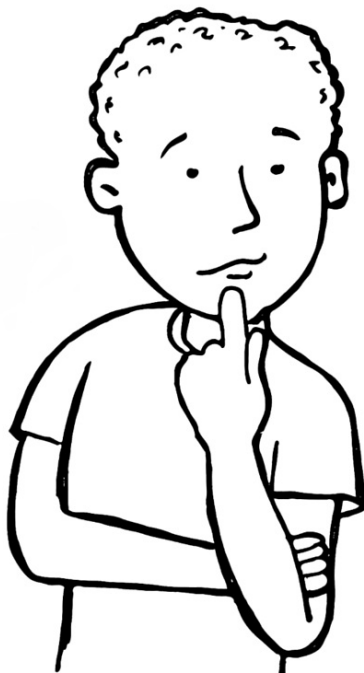
# Decision: How Will We Manage the Budget Gap?

## Expenses

- Cut services to help shrink the gap?

## Revenue

- Already factored in all predictable revenue increases



## Reserves

- Use reserves to help plug the gap for 1-3 years?

## Override

- Reset the property tax baseline to help remove the gap?



# Next Steps

Town & Schools are working on two budgets.

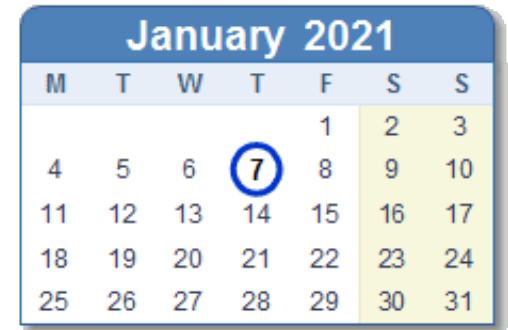
- Budget with an override
- Budget without an override

Community Submits Questions & Ideas through Online Form

## Next Forum on January 7

- Community feedback to help inform the difficult choices in preparing the two budgets

Many more meetings of the Financial Task Force, Select Board, School Committee, and Warrant Committee



January 2021						
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11	12	13	14	15	16	17
18	19	20	21	22	23	24
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Thursday 7th Jan 2021