City of Chelsea

Five Year Financial Forecast for Fiscal Years 2013-2017 and Preliminary FY'13 Budget Overview

to be Presented to the City Council

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Five Year Financial Forecast
Revenue and Expenditure Summary

	FY'13	FY'13	FY'15	FY'16	FY'17
REVENUES	$119,836,655	122,455,702	125,334,436	128,537,638	131,626,672
% CHANGE	4.05%	2.19%	2.35%	2.56%	2.40%
EXPENSES	$120,724,325	122,832,127	125,436,637	128,039,215	130,644,723
% CHANGE	4.82%	1.75%	2.12%	2.07%	2.03%
SURPLUS (DEFICIT)	($887,670)	(376,426)	(102,201)	498,423	981,949
FREE CASH AFTER AT FY END	$3.3m	$2.7m	$2.7m	$3.2m	$3.7m

Forecast Summary

<u>GENERAL SUMMARY</u>

- City finances are stable and improving, albeit with enough future uncertainty that continued fiscal prudence is required.
- Contributing to stability is the continued growth of locally-generated revenues (including economic development) and future cost containment (like reduced health insurance costs).
- Causing consternation is historically depressed non-school local aid; the projected increases in employee overhead costs, including health insurance, retirement and retiree health insurance costs, and the loss of Federal funding for public safety supports and other categories of spending.
- The deferment of expenditures on operations and capital improvements are also concerning.
- The City "process" of managing finances was just re-affirmed by Standard & Poor's as a "strength."

Forecasting Optimism

<u>FOR THE OPTIMIST</u>

- The City's structural deficit continues to shrink and could turn into modest surpluses in the out years.
- The City has achieved a long-held goal of agreeing with labor on municipal health insurance savings.
- Local aid is not projected to decline and will actually see modest increases in FY'13.
- No position reductions caused by budget issues are projected on either the municipal or school sides of City government.
- Economic development continues to produce projects and new tax revenues to help balance the City's budget.
- Debt service levels continue to decline.

Forecasting Optimism

FOR THE OPTIMIST (continued)

- State adoption of casinos should deliver more local aid in the out-years – that aid is not factored into this forecast.
- Reserves remain in place to guard against future budget shocks in both expenditures and revenues.
- No Proposition 2 ½ overrides appear to be necessary to balance the budgets over the next five years.
- The City’s municipal charges continue to be the lowest in the region, while services are being maintained and enhanced.
- Audits and a recent Standard & Poor’s review reflect positively on the City’s management, financial accountability and future.

Recognizing Pessimism

<u>FOR THE PESSIMIST</u>

- Despite the economy recovery, the City's budget continues to feel the impacts of what may be the "new normal."
- The City did achieve health insurance savings, but projected increases of 6% growth in costs (down from 10% and beginning on a lower base), retirement costs expected to grow by 5+% annually and OPEB (other post employment benefits) costs, which are not yet required to be funded, raise future concerns about the affordability of employee overhead.
- Annual infrastructure spending needs may not be fully met.
- Non-school local aid remains below 1987-levels and with inflation are the lowest in the Prop. 2 ½ era – Ch. 70 school aid is growing at levels too low to meet recurring expenses.
- Cost-cutting measures are largely exhausted, so the need for major expense savings would require more drastic measures.

Recognizing Pessimism

FOR THE PESSIMIST (continued)

- Regionalism is underway but not providing immediate financial benefits.
- If economic development fails, substantial gaps in out-year revenues will exist.
- Excise tax revenues are potentially volatile.
- Charter school costs are threatening to take away millions annually from the City (School) budget.
- Federal grants, reimbursement and transfers are shrinking, with revenue losses resulting in either program elimination or the City paying a larger share of costs.
- Municipal employees have been "out-of-contract" for almost two years and may be reluctant to accept the City's reduced offers that are based upon the "new normal."

Understanding the Numbers

REVENUES

- LOCAL AID
  - General Gov't – FY'13 – The House increased the Gov's budget by 7% to level fund local aid at $6,946,677.
    - Non-school local aid is $3.7m below FY'01 high ($10.6m), unadjusted for inflation (DOWN 35%!).
    - Non-school local aid is $7.2m below FY'01 high, adjusted for inflation (OFF 48%!!).
  - Schools – assumes the House recommendation, providing a 6.1% ($3.3m) increase in Chapter 70 (however, Fed stimulus money is no longer available, meaning that aid increases are making up for lost revenues elsewhere).
  - Since '00, non-school aid is down an average of 1.7% a year, while school aid is up an average of 3.2%.
  - It is hard to predict any significant increase in local aid in the out-years because of State's own budget issues.

Understanding the Numbers

REVENUES (continued)

- OTHER MAJOR IMPACTS
  - Payments around late taxes are down 7% (on top of being down 23% in FY’12), Medicaid reimbursements are down 17% (after being down 48% in FY’12) and School indirect reimbursements to the City are down 82%.
  - Tax levy is projected to grow by 2.5% ($962k) plus new growth ($625k). The new growth is lower in FY’13 than the $845,921 in FY’12 but is expected to pick-up again in the out-years.
  - Overlay provision remains at the reduced level of 1.5% of the prior year levy ($578k), instead of at 2%.

Understanding the Numbers

REVENUES

- OTHER (continued)
  - Fines & forfeits grow from nighttime parking enforcement, most licenses & permits are expecting no change, and building fees are expected to increase (43%) as a result of economic development activity.
  - Trash fees are expected to rise in the area of 2.5% yearly ($40k); this is reduced from a 5% annual historical increase.
  - Hotel (up 84%, or $214k) and meals (up 18%, or $50k) taxes are growing with new establishments opening.
  - Motor vehicle excise tax is budgeted as level funded, although the volatility will add or subtract revenues annually, thereby impacting free cash.

Understanding the Numbers

EXPENSES

- Total spending is projected to be up 4.8% in FY’13 (up $5.5m).
- School spending is projected to increase by 6%, or $3.8m, State assessments by 17%, or $1.2m, while all other spending is up 1%, or $500k.
- School increases are begin driven by higher Ch. 70 and increased local minimum spending requirements.
- State assessments are increasing largely because of charter school assessments.
- Wage increases (COLA and step increases) reflect assumed cumulative impacts of FY’12 and FY’13 totaling 3%, and then 1.75% in FY’14 and 2.25% each year thereafter.

Understanding the Numbers

EXPENSES (continued)

- Health insurance rates are down 13% as a result of State legislation which directed municipal management and labor to negotiate new agreements on future coverage and cost.
- Retirement costs – the City continues to follow the recommended funding schedule, which results in a 3.6% increase in costs ($209k to $6.0m) for FY'13.
- The City is making its 2nd OPEB (other post employment benefits) payment. Although there is not presently a requirement to fund the $227m outstanding liability for retiree health insurance, that requirement could exist in the future. To lessen that burden, the City proactively placed $150k in FY'12 into a fund, and will increase the contributions by $25,000 yearly. The nominal amount, though, does not compare to the $20m+ the OPEB payment could be if a funding schedule was required.

Understanding the Numbers

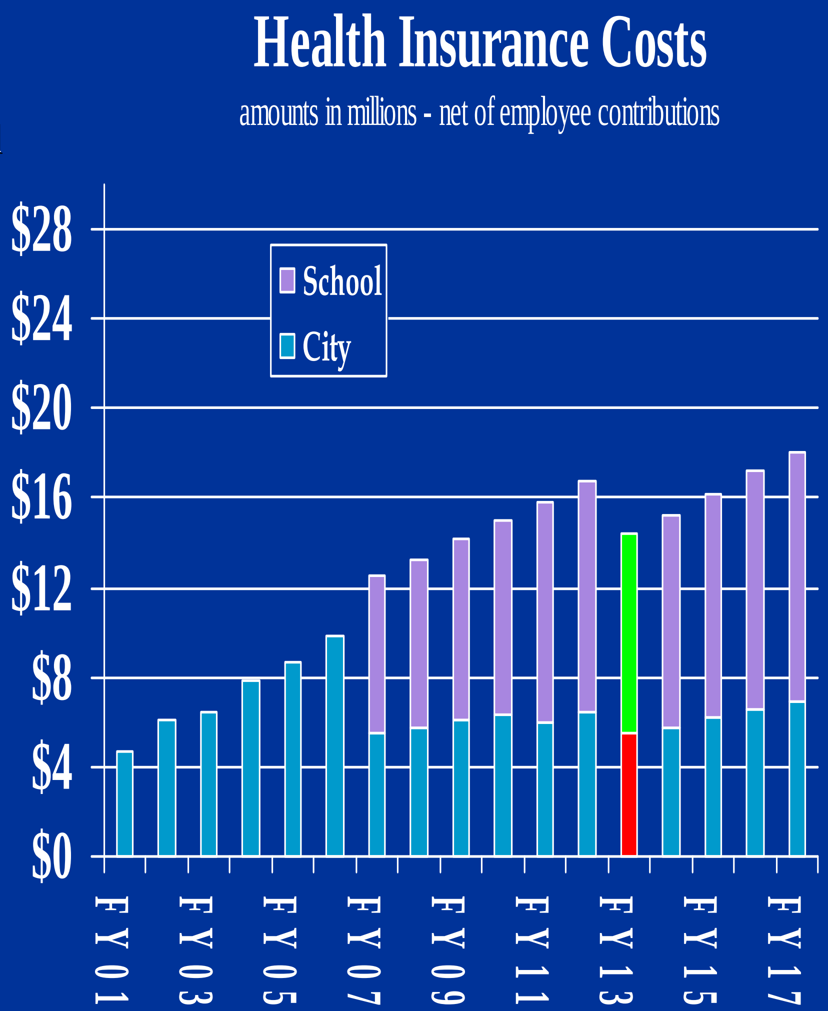
EXPENSES (continued)

- Debt service was down 64% in FY'12 and down another 2.8% in FY'13 as a result of :
  - The City is making a conscious effort to reduce debt during this period of fiscal uncertainty. Instead of incurring more debt, the City is emphasizing increases in pay-as-you-go expenses in the operational budget.
  - In FY'12, the early payoff of schools loans resulted in a net overall benefit to the City of $2.5m.
  - In the out-years, debt continues to decline. This is again reflective of a conscious decision to avoid adding too much debt by paying for more capital projects through a pay-as-you-go process. In fact, the FY'13 CIP contains more than $2.5m in pay-as-you go spending on capital and only $590k in general obligation (GO) bonding.

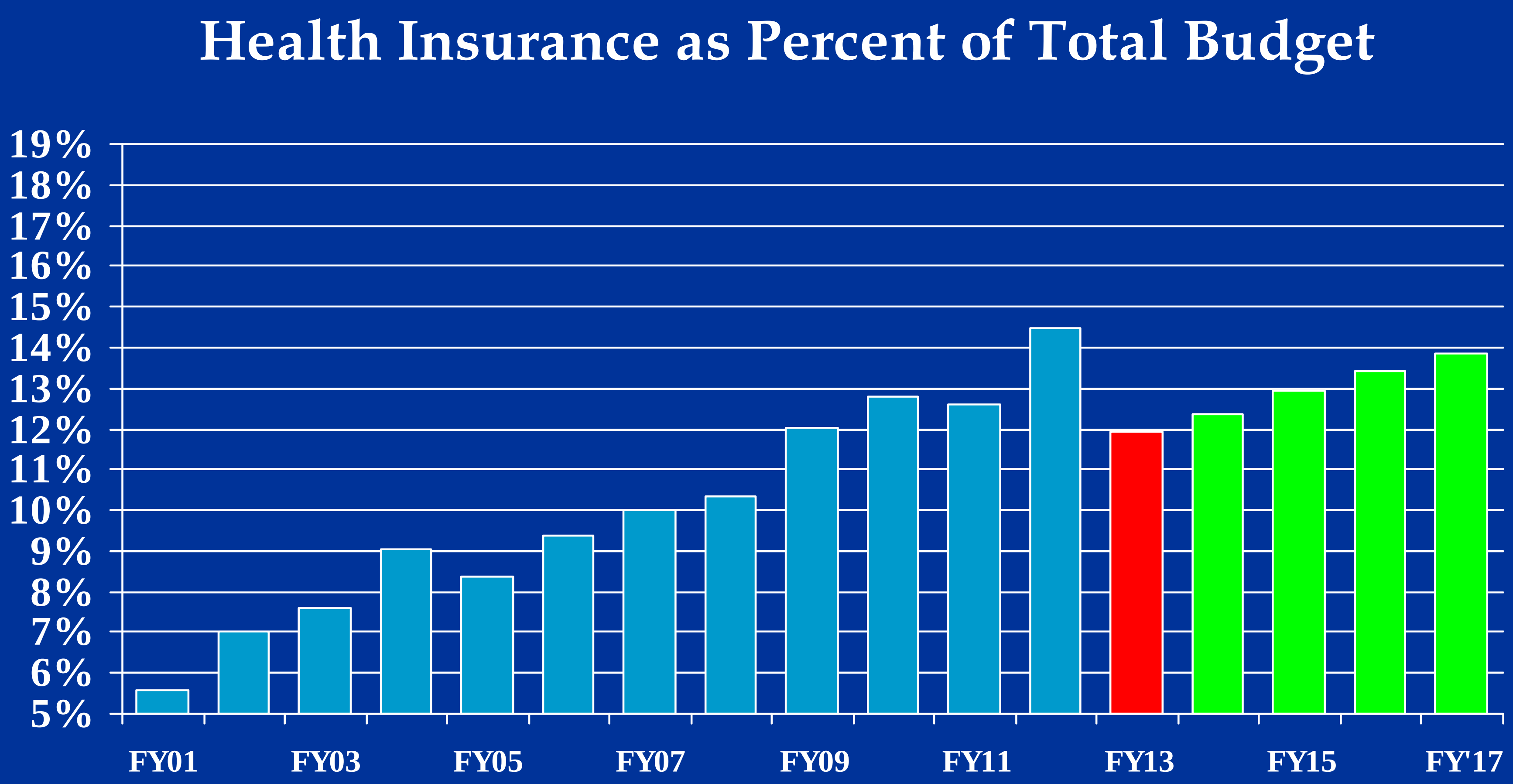
Budget Pressures

Expenditures:

- As of May, 2012, the City left the City of Boston health insurance program for a "stand alone" program offered through Harvard.
- That program increased co-pays and increased employee premiums to 20% for HMO and 30% for PPO coverage. Retiree rates vary.
- It is anticipated that the program will reduce expect costs by approximately $1.3m in FY'13.
- Premium increases are expected to be in the 6% range in the out-years, as oppose to the 10% approximate average of the last decade – that reduction is as a result of local and industry cost containment.
- The agreement governing the program ends in FY'15, at which time a new agreement can begin or the City can opt into the State GIC.
- Even with the changes, health insurance costs are expected to grow beyond the FY'12 high by FY'16.
- As seen on the following graph, health insurance will still commands a significant portion of overall City spending.



Budget Pressures

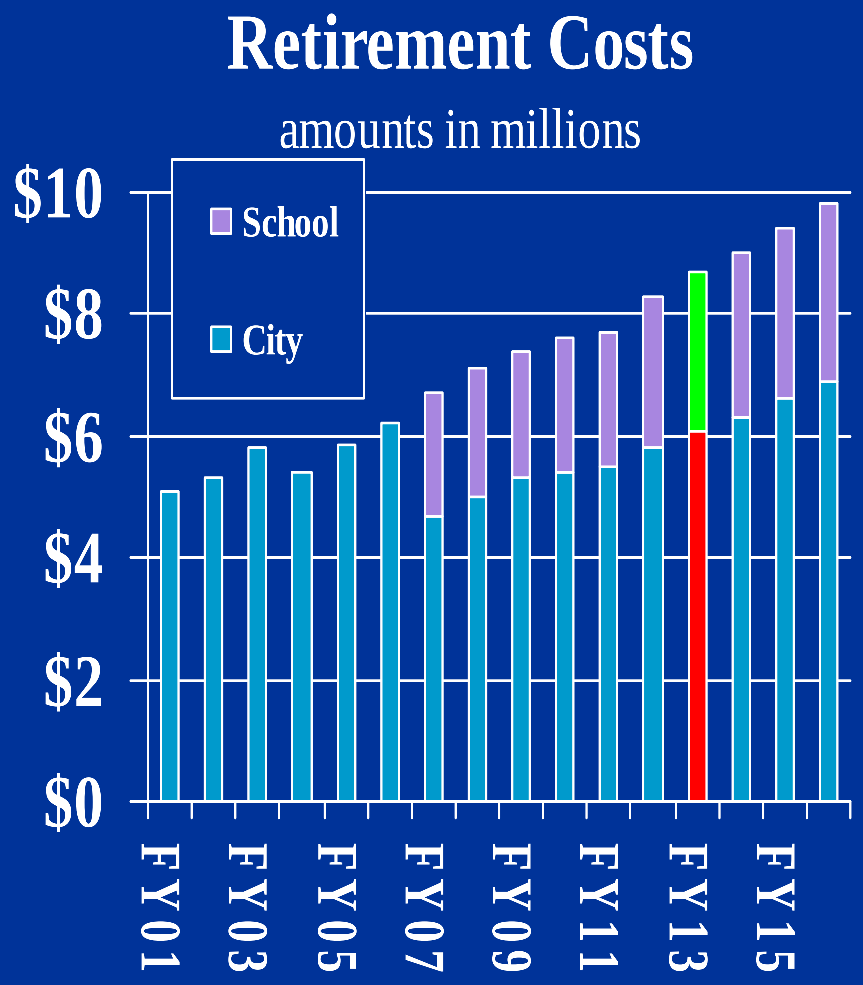


Reflects combined City and School expenditures

Budget Pressures

Expenditures:

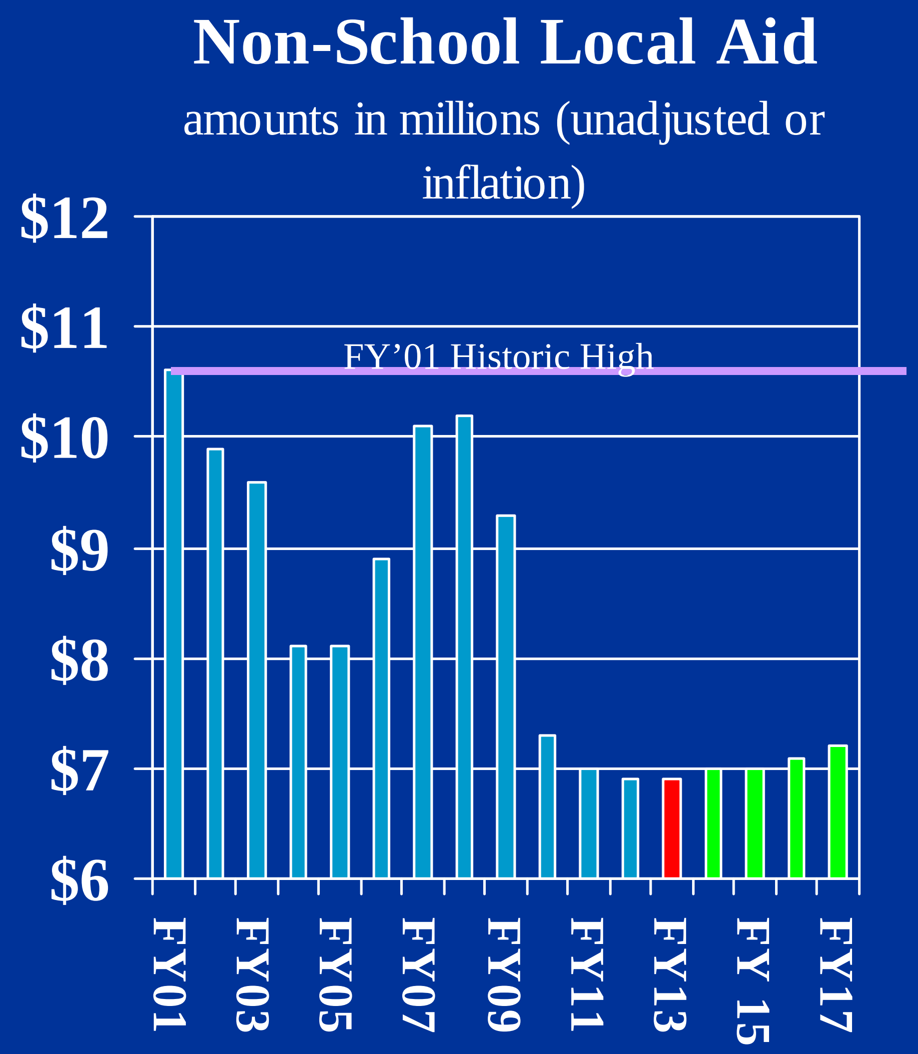
- The City voluntarily entered the State's system for pension asset management.
- The State determines the amount needed for the City to fully fund the retirement system by 2028, 12 years ahead of the maximum allowed by the State. The unfunded liability is approximately $70m.
- The School Department pays its portion of the retirement appropriation through its budget.
- Approximately 75% of annual charges reflect catch-up payments to provide for the decades that no payments were made into the system.
- Payments grow into 2028 - approx.$6m in FY'13 and almost $11m in FY'28.
- Retirement costs, Schools included, increased by an average of 4.5% from FY'01 to FY'12, and are projected to rise at two times the rate of overall budget growth in the out-years.
- Teacher retirement costs are paid through a statewide system and are not reflected in the School's calculation.
- The City is making its second payment into a retiree health fund in FY'13 of $175k. It is estimated that the fund is has a liability of $227m.



Budget Pressures

Revenues:

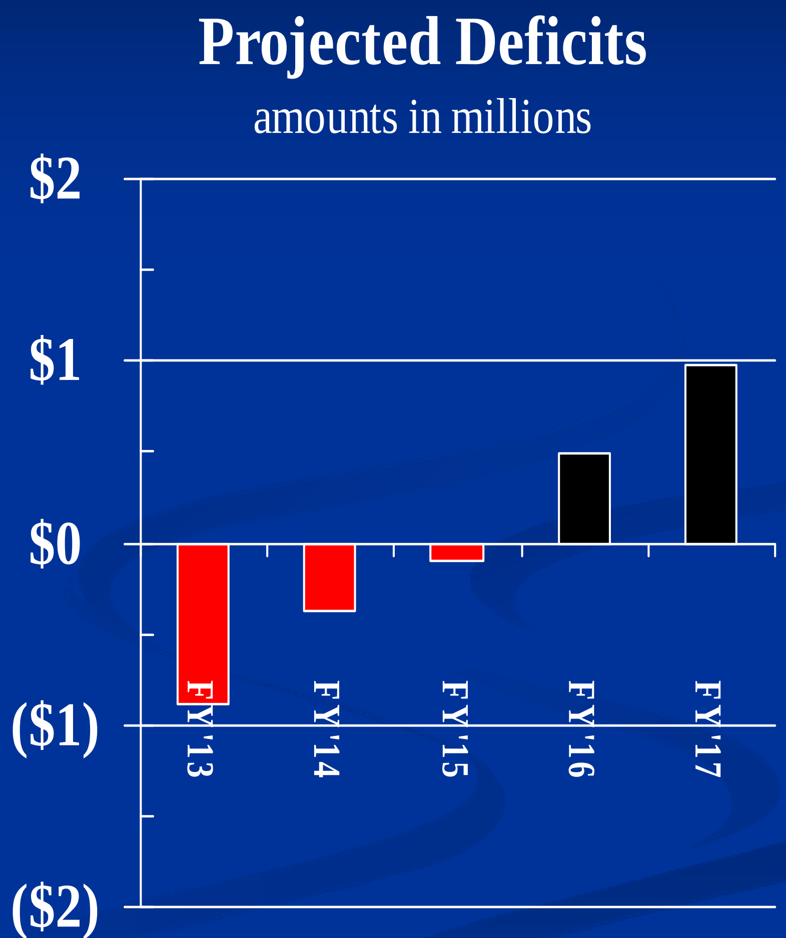
- Non-school local aid (LA) is Unrestricted General Gov't Aid (UGGA), which was established as the combination of Lottery Aid and Additional Assistance by the State in FY'10.
- This forecast assumes level funding of total UGGA from FY'12, which was recently affirmed by the House.
- For FY'13, LA of $6.9m is $3.7m less than the FY'01 high of $10.6m, or 63% of the historic LA high.
- The cumulative loss in LA from FY'01-'13 is $25.7m (meaning free cash/cuts have been used to make up for the loss).
- Adjusted for inflation since FY'01, LA is down $7.2m for FY'12, far eclipsing the City's proposed deficit ($887k).
- The cumulative loss of inflation-adjusted LA from FY'01-'12 is $47.2m.
- No scenarios exist for a quick return to the historical high levels of LA, although additional gaming revenue could be directed to LA by FY'17.



Budget Pressures

FIVE YEAR ~~DEFICITS~~ **SURPLUSES**

- Deficits are being turned into surpluses in the out-years:
  - FY’13 ($887k)
  - FY’14 ($376k)
  - FY’15 ($102k)
  - FY’16 $498k
  - FY’17 $982k
- The cumulative surplus is $115k for 5 years, compared to a combined estimated deficit of $6.3m made in CY’11.
- The City’s finances are stable, especially when considering the budget pressures of the City’s peers.
- Prudent City management has led to a better “bottom line” with fund balances to reduce existing deficits and protect and enhance core municipal services.
- Of concern: potentially volatile local revenues, charter school costs and net minimum school spending requirements.



Projected Use of Reserves

	FY13	FY14	FY15	FY16	FY17
General Fund					
Free Cash Certified at Previous Year's End	4,200,000	3,300,000	2,700,000	2,700,000	3,200,000
Free Cash (Used) or Generated	(400,000)	(100,000)	500,000	1,000,000	1,000,000
Supplemental Appropriations of Free Cash	(1,500,000)	(1,500,000)	(1,500,000)	(1,500,000)	(1,500,000)
Years Net Activities Affecting Free Cash	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Free Cash Estimated at Year End	3,300,000	2,700,000	2,700,000	3,200,000	3,700,000
Stabilization Balance at Start of Year					
General *7020*	4, 309,577	4,395,768	4,483,683	4,573,357	4,664,824
Capital *7022*	999,794	1,019,790	1,040,185	1,060,989	1,082,209
Planning and Development *7021*	167,234	170,579	173,990	177,470	181,020
Operational (School Refunding) *7023*	3,060,000	3,121,200	3,183,624	3,247,296	3,312,242
School Capital (School Refunding) *7024*	2,445,941	2,494,859	2,544,757	2,595,652	2,647,565

assuming a 3.5% investment return

Potential Future Budget Impacts

ON THE POSITIVE

- There is no Prop. 2 ½ override anticipated in the future.
- Promising economic development could lead to further increases in building fees and property, hotel/motel excise and vehicle excise taxes.
- Entrepreneurial activities around excise tax and loan refinancing have strengthened the City’s overall bottom line.
- Debt service continues to reduce and savings can support additional capital projects or other service needs.
- Overall costs appear to be roughly equal to anticipated annual revenues.
- The City is active in statewide policy discussions that could lead to reduced impacts from future health insurance, retirement and charter school costs, as well as promoting regionalization of services to improve efficiencies.
- Reserves, along with fiscal prudence, do provide a method to assure balanced budgets for at least the next 5 years.

Potential Future Budget Impacts

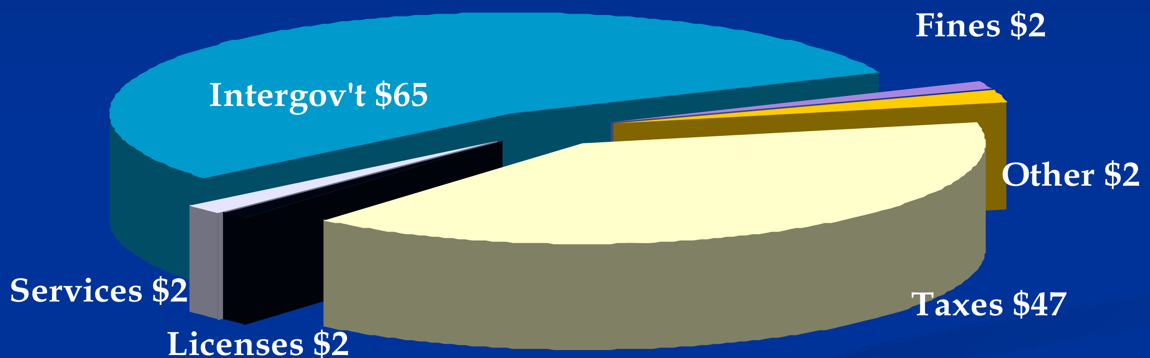
<u>ON THE NEGATIVE</u>

- Matching the City's economic development agenda of the last 15 years is vital but could prove to be difficult.
- Motor vehicle excise taxes are volatile.
- Fuel and energy costs could skyrocket again.
- Costly infrastructure projects are pending, including Broadway, the City Yard and Clark School.
- The long-term impact of charter schools is not modeled yet and may be incorrectly projected in the out-years.
- Minimum school spending requirements are now a factor, have not been modeled and are probably understated.
- The lingering State and Federal budget crises could lead to further revenue reductions and impacts on services.
- OPEB could be implemented, with the potential of adding millions or tens of millions to annual costs.
- Reserves are less than ideal should another recession hit.

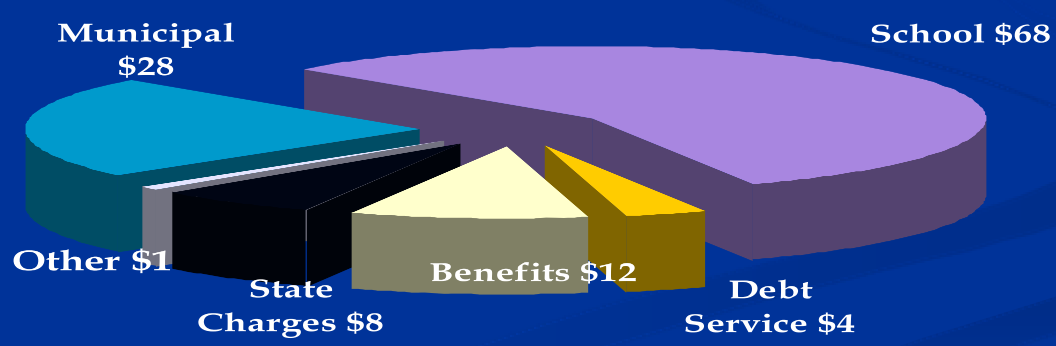
FY'13 Budget
General Fund Revenue & Expenses

(in millions)

<u>Revenue</u>

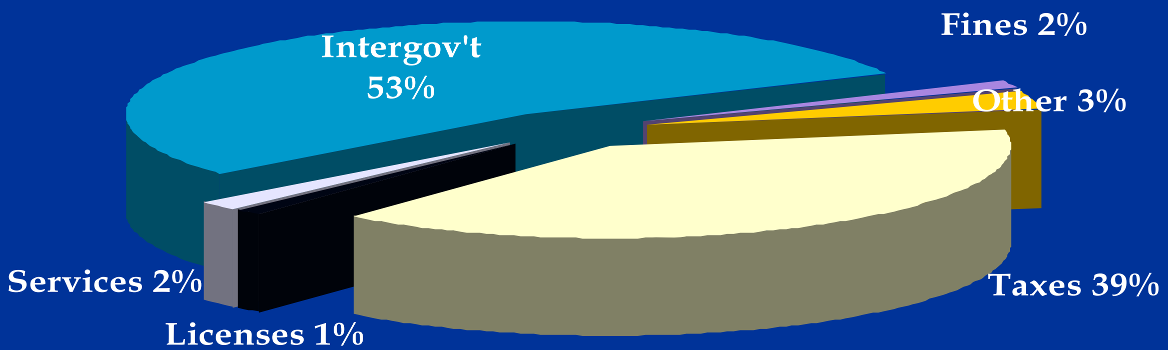


<u>Expense</u>

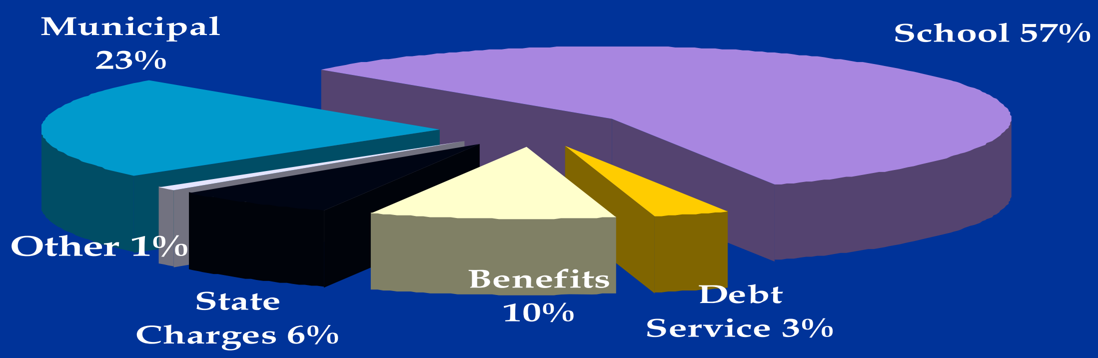


FY'13 Budget
General Fund Revenue & Expenses

Revenue



Expense



School Department Budget Proposed New Spending

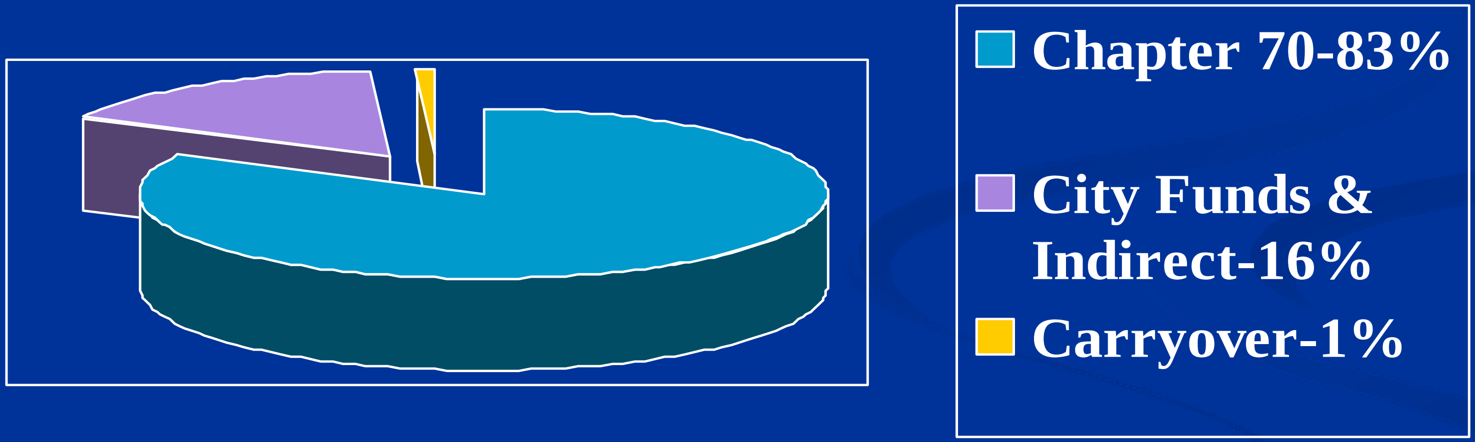
Salary Adjustments	$1,543,482
Teachers & Paras	$421,655
Extraordinary Maintenance	$360,000
Federal Stimulus Funding Reductions	$309,700
Retiree Health Insurance, Other Fringe	$159,670
Replace Revolving Fund Revenue	$60,400
Special Ed. Tuition & Contract Services	$75,000
Computer Replacement, School Supplies	$98,200
Yellow Bus Daily Rate & Crossing Guards	$28,300
Total New Spending	$3,056,407

School Department Budget Savings and New Revenue

■ New Lower Cost Health Plan Savings	$598,800
■ Homeless Transportation ruled State Obligation	$75,000
■ Special Ed. Transportation Savings	$80,000
Total Budget Savings	$753,800
■ Net New Revenue (Ch. 70 – Charter School increases – projected local contribution)	$2,302,607
Total New Funding for Budget	$3,056,407

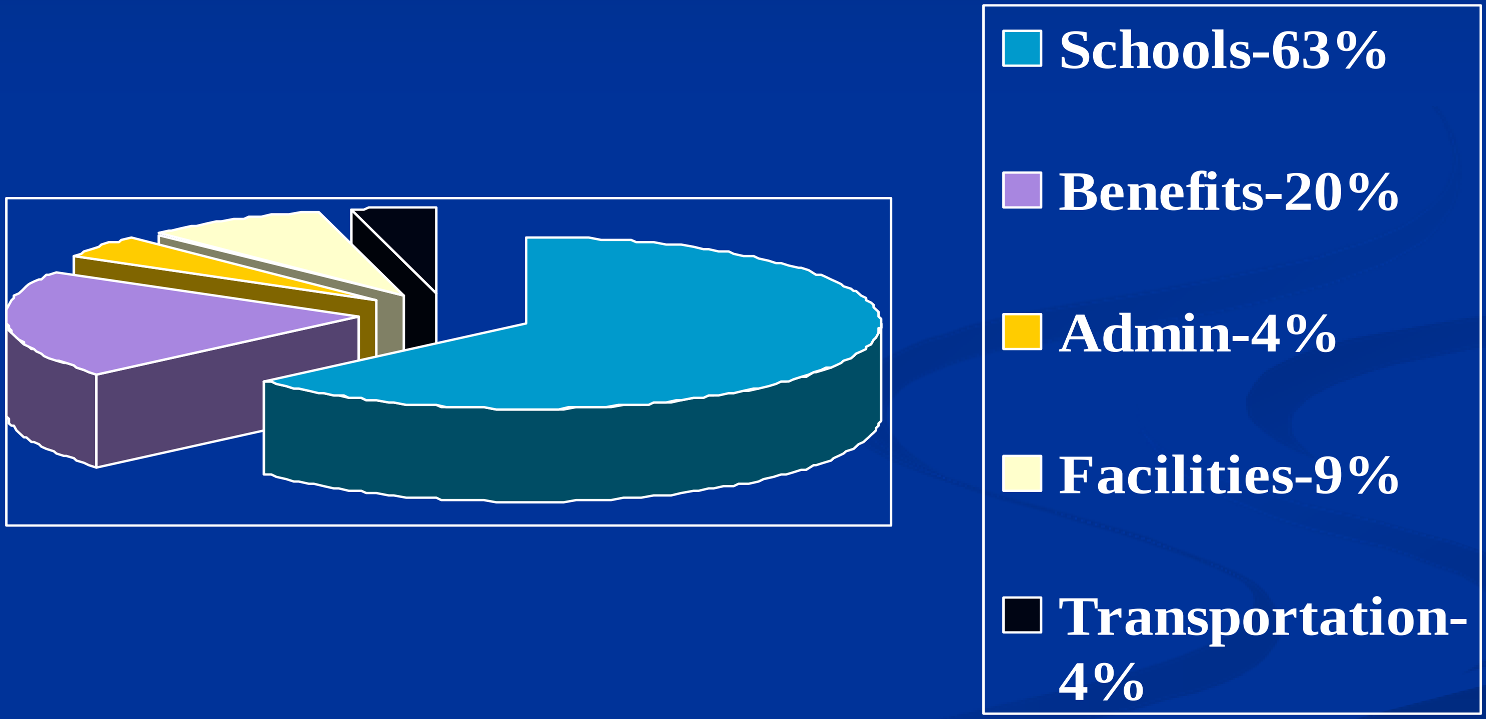
School Department Budget Sources of Revenue

General Fund-$66,719,586



School Department Budget Spending Allocation

General Fund-$66,719,586



Water and Sewer Enterprise Funds

- Enterprise Funds recover costs for providing water & sewer services and are projecting modest FY'12 surpluses.
- User fees account for 98% or more of the revenues.
- The MWRA preliminary assessment is up 6%, and accounts for 55-60% of system costs.
- Other costs include the RH White maintenance contract, indirect expenses to pay for DPW and other employees and debt services to pay for water and sewer infrastructure.
- The City seeks to keep costs down by controlling debt service, but must also update a system that still has significant age to it.
- Local charges are slightly above the average of all MWRA communities.

Municipal Costs Affordability Index

- The City reviews data from 7 neighboring cities (Boston, Everett, Lynn, Malden, Revere, Somerville and Winthrop) to chart a Municipal Costs Affordability Index. Below, the chart refers to those communities anonymously, but lists out average property tax and water & sewer bills for the average single-family owner occupied unit in each city in FY'13.
- Municipal charges remain less in Chelsea than all other cities.

City	Average Tax Bill	Combined Water & Sewer Bill	Combined Homeowner Costs	% Above Chelsea Cost
G	$4,564	$1,597	$6,161	72.5%
E	$3,572	$1,592	$5,164	44.6%
C	$3,670	$1,138	$4,808	34.6%
F	$3,463	$1,428	$4,891	37.0%
D	$3,305	$1,128	$4,432	24.1%
B	$3,116	$1,114	$4,230	18.5%
A	$2,946	$674	$3,621	1.39%
Average	*$3,344*	*$1,266*	*$4,610*	*29.1%*
Chelsea	$2,115	$1,456	$3,571	

Conclusion

- The current municipal finance environment, of trouble for the last twelve fiscal years and the most severe since the Great Depression, continues to threaten the viability of municipalities throughout the commonwealth and country.
- Despite that, the City is succeeding at managing through these tough times.
- Out-years are adversely impacted by stagnant non-school local aid and growth in non-discretionary spending areas, most notably, health insurance and pensions. The City has played a significant role in raising the statewide debate about these three “budget busters.”
- With about 54% of the City’s revenue coming from local aid (down from 67% in FY’01), the lagging State budget crisis continues impacting the City’s budget. In FY’13, non-school local aid will provide only 63% of that from FY’01.

Conclusion

- In FY'13, the City will receive $3.7m less in non-school local aid since its $10.6m high in FY'01. That reduction, when adjusted for inflation, is $7.2m. Cumulatively, non-school local aid reductions have cost the City $25.7m from FY'01-'13; $47.2m when adjusted for inflation.
- The School budget is using new local aid and savings to make up for losses from other sources and higher expenses. Even with projected increases in revenues, more pressure on the School budget threatens current services.
- Although major economic development projects continue, the reduced growth in those projects as a result of a maturing plan and the general economy is putting more pressure on maintaining sufficient reserves and austerity measures.

Conclusion

- A municipal tax and fee study examining property tax and water & sewer fees for the City and seven neighboring communities finds that the City is the least expensive place to be a single-family owner occupant.
- With no local Proposition 2 ½ overrides projected, the City's relative affordability should remain as such, but the City will need to overcome numerous challenges in order to maintain and expand core municipal services.
- There is little margin for error, or, more likely, little margin for additional impacts from State/Federal budget stress or another recession. Any further substantial impact will potentially result in a disastrous local result as reserves are lower than at points previous to recent recessions.

Conclusion

- The City saved in “good times” to have reserves to fund operations in “bad times.” Those reserves have been counted upon to provide budget stability during these tough financial times, while the City looks for cost savings and revenue enhancements elsewhere to continue budget stability into the out-years.

- Absent a more robust recovery, additional actions, on top of the judicious use of reserves, will be required to maintain budget stability in the out-years and beyond.

- Fiscal prudence remains a requirement for budgeting as no major revenue “windfalls” appear likely, and, at best, costs will increase in the 2-3% range in the years to come.