

Report of the Town Manager



FISCAL YEAR 2010 RECOMMENDED BUDGET AND FINANCING PLAN

REPORT OF THE TOWN MANAGER

The fiscal year 2010 general fund budget totals \$139,467,683, an increase of \$4,613,065 or 3.4 percent over the fiscal year 2009 adopted budget. The recommended budget is balanced and will not require a Proposition 2 ½ override vote. The Board of Selectmen has voted to bring forward to Town Meeting the budget reflected in this FY2010 Recommended Budget and Financing Plan.

Overview of the FY2010 Recommended Budget and Financing Plan

In light of the state of the economy, anticipated reductions in State Aid and the Town's increasing fixed costs, the Board of Selectmen held the first of five financial summits with the School Committee, Appropriation Committee and Capital Expenditures Committee in October 2008 to begin working on the fiscal year 2010 budget. At the fifth financial summit on February 25, the Board of Selectmen approved the FY2010 recommended budget.

A number of events took place between the first and last financial summit. The Superintendent of School's budget proposal was presented to the School Committee on December 10, 2008. On January 12, 2009 the Town Manager presented the initial budget recommendation for the municipal departments. At that time, the overall budget shortfall was \$2,242,943. Based on the Town's established revenue-sharing model, the Municipal portion of this shortfall was approximately \$386,000 and the School Department portion was \$1,867,000. As more accurate budgetary information became available, and through proposed budget efficiencies, staffing changes and fee increases, the Selectmen and School Committee were able to eliminate this shortfall and now present a balanced budget, as summarized below, to the Town's financial committees and Town Meeting.

	FY2009	FY2010			
	Budget	Recommended	Change \$	Change %	
Education	\$ 65,924,737	\$ 68,669,847	\$ 2,745,110	4.16%	
Shared Expenses	\$ 40,201,720	\$ 41,775,141	\$ 1,573,420	3.91%	
Municipal	\$ 25,688,411	\$ 26,526,287	\$ 837,876	3.26%	
<i>Subtotal Operating</i>	\$ 131,814,868	\$ 136,971,274	\$ 5,156,407	3.91%	
Capital-Cash Funding Only	\$ 1,520,750	\$ 1,545,719	\$ 24,969	1.64%	
Other	\$ 1,519,000	\$ 950,690	\$ (568,310)	-37.41%	
Total General Fund	\$ 134,854,618	\$ 139,467,683	\$ 4,613,065	3.42%	
Projected Revenue	\$ 134,854,618	\$ 139,467,683	\$ 4,613,065	3.42%	
Surplus/(Deficit)	\$0	\$0			

Selectmen's Budget Principles

In developing the annual operating budget, the Board of Selectmen continued to adhere to the following principles in order to preserve the Town's financial condition:

1. Recurring revenues, not reserves or one-time revenues, should support operating expenses and debt service.
2. Debt will not be used to fund current operating expenditures.

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3. Adequate reserves and contingency funds will be budgeted, based on the overall recommendations of the Ad hoc Financial Policy Committee as adopted by the Board of Selectmen.
4. Sufficient funds for building maintenance will be budgeted to properly maintain facilities and equipment as well as foster energy conservation.
5. Payments in-lieu-of-taxes (PILOT) from the water and sewer enterprise funds to the general fund will be eliminated, continuing a policy established by the Board of Selectmen in FY2007 to phase out PILOT payments by FY2010.
6. The operating and capital budgets will strive to maintain the core services currently provided, and recognize that changes in service demands may require that additional resources be provided in certain areas.
7. The budget should strive to maintain the core services and staff that were restored by the voters with the passage of Questions 3 and 4 of the June 2006 Proposition 2 ½ override and Question 1 of the June 2007 Proposition 2 ½ override.

The FY2010 Operating Budget

While the Town's FY2010 operating budget has many complexities, certain matters deserve specific attention:

I. Financing Plan:

Revenue Allocation Model: It has been the Town's practice to share Town revenues between the municipal departments and School Department. Based on a model developed by the Town Manager and Superintendent of Schools and accepted by the Board of Selectmen, School Committee and financial committees, projected revenues are allocated such that after shared expenses are funded, 71.5 percent of all general fund revenues are allocated to the School Department and 28.5 percent are allocated to the municipal departments.

Revenue Sources:

The property tax remains the Town's primary revenue source, comprising 82 percent of total revenues. Residential property values make up 87 percent of the total assessed value in Lexington. Residential property owners, however, pay only 78 percent of total property taxes, as a result of the tax classification model adopted by the Board of Selectmen. Due to the strong commercial real estate market of the last two years, there has been a slight shift in the Town's tax levy, with commercial and industrial property owners paying a greater share of the Town's overall tax burden.

State Aid, which is estimated at 6.5 percent of total revenues, is also an important source of revenue. Due to the state of the national and State economy and sharply declining tax revenue, the Legislature authorized Governor Patrick to make a mid-year reduction in State Aid for fiscal year 2009. The Governor's budget proposal for fiscal year 2010 calls for an additional reduction in State Aid. Since the Legislature will not likely vote a fiscal year 2010 budget until after the close of Town Meeting, the Town's recommended budget assumes a 9 percent or \$900,000 reduction in State Aid. This assumed reduction is being made up by the use of Free Cash.

- #### **II. Expenditures:**
- Overall, the FY2010 School Department budget is increasing by 3.95 percent and the municipal budget by 3.26 percent. Approximately \$3.6 million of Free Cash, inclusive of the \$900,000 referenced above, is being recommended to support the operating budget. Other

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highlights include:

- a. **Health Insurance for Employees and Retirees:** The Town currently contributes 80-85 percent towards the health insurance premium for employees and retirees. The health insurance budget for employees and retirees is expected to increase by \$526,759 or 2.6 percent in fiscal year 2010. This modest increase, however, is masking significant increases in health insurance rates. Overall, the estimated premiums for the Town's Blue Cross products are increasing by 9.5 percent. Premiums for the Harvard Pilgrim products are increasing by 12 percent. The budget, however, is increasing by just 2.6 percent for the following reasons: 1) The School Department is reducing the number of benefit-eligible positions, saving approximately \$552,000 in FY2010; and 2) The FY09 health insurance budget overstated the number of retirees taking the Town's health insurance plan. As a result, the percentage increase for the FY2010 budget is less because the Town over budgeted in FY09 by approximately \$1,000,000. This additional appropriation will close to Free Cash at the end of FY09 or may be appropriated by Town Meeting for some other purpose.

The Town's health insurance benefits program is currently a subject of collective bargaining between the Town and the Employee Health Insurance Coalition. The Coalition is comprised of representatives from each Municipal and School collective bargaining unit plus one retiree representative. The Town Manager is required to negotiate with the Coalition to make any change to health or dental insurance benefits. A 70 percent weighted vote of the Coalition is needed to approve any change, as is a majority vote of the Board of Selectmen. It is anticipated that, in the absence of changes in the Town's health insurance program, future budgets will reflect continued health benefit increases at a rate greater than the overall increase in the Consumer Price Index, given the nature of health care.

- b. **Utilities/Fuel:** The budgets for electricity, gasoline and other utility increases are projected to decrease in FY2010. The Town participates in a regional purchasing consortium for gasoline and heating oil and has long-term contracts for the purchase of natural gas and electricity. This provides competitive prices and budget stability for the Town. Utility costs for FY2010 are expected to decrease by 8 percent, partially due to declining rates. More importantly, however, is the progress made by the Facilities Department to improve the energy efficiency of the Town's buildings. Electricity consumption in the school buildings has decreased by 14 percent from 2006 to 2008, saving approximately \$250,000. With the Clarke Middle School new natural gas heating system, an additional net savings in energy costs of \$80,000 is projected.

	FY 2009	FY 2010			
	Adjusted	Recommended		Change \$	Chg. %
Electricity	\$ 2,354,723	\$ 2,203,665	\$	(151,058)	-6.4%
Heating Oil	\$ 581,470	\$ 352,540	\$	(228,930)	-39.4%
Natural Gas	\$ 772,578	\$ 947,693	\$	175,115	22.7%
Diesel/Gasoline	\$ 432,741	\$ 306,817	\$	(125,924)	-29.1%
TOTAL	\$ 4,141,512	\$ 3,810,715	\$	(330,797)	-8.0%

- III. **Budgeted Reserves:** Following the last downturn in the economy in the 2001-2003 period, the Board of Selectmen became increasingly concerned about the Town's lack of financial reserves to bridge the budget gap that occurs when a recession is upon us. In addition, Lexington had not

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been building reserves to fund its unfunded liabilities (e.g., post employment health benefits), which could impact its flexibility in managing the Town finances during a recessionary period. In response to these concerns, the Board appointed an ad hoc Financial Policy Committee in 2005 to examine and propose comprehensive financial policies to address operational needs, catastrophic and emergency reserves, maintenance of assets and unfunded liabilities. This Committee's recommendations may be found on the Town's website <http://www.lexingtonma.gov/finance.cfm>. The resulting policy recommendations adopted by the Selectmen call for rebuilding financial reserves and addressing the Town's unfunded liabilities over a multi-year period. After three years of building the Town's Stabilization Fund, the balance in this fund is approximately \$6,700,000. The fiscal year 2010 budget, however, does not provide for any additional contribution to this reserve. The Town's goal had been to build a Stabilization fund of \$8.5 to \$9.5 million (2008 dollars), an amount sufficient to make up three years of revenue shortfalls that typically occur during an economic slowdown. The economic downturn is now upon us and the Town anticipates having to draw down its Stabilization Fund in future years. On a positive note, for the second consecutive year, the budget includes a recommendation to set aside \$440,690 for post-employment benefits (i.e., retiree health care) bringing the total in this reserve to approximately \$950,000. The Town's unfunded liability for this retiree benefit is approximately \$100 million, based on a 30-year funding schedule. Lastly, the FY2010 budget includes a recommendation to add an additional \$350,000 to the existing balance of the Special Education Stabilization fund, bringing the total to approximately \$700,000 if approved by Town Meeting.

The FY2010 Capital Budget

The recommended Capital Budget will provide for maintenance, replacement and improvements to our buildings, infrastructure and equipment. Time has proven that deferring capital improvements ultimately results in higher repair and replacement costs in the future. Warrant Articles 11-19 represent the capital portion of this year's budget. For fiscal year 2010, a total capital budget of \$10.6 million is proposed. This is a decrease of approximately \$2 million over the fiscal year 2009 capital budget. \$822,450 of Free Cash is being recommended to support the capital budget. The remainder for the capital budget is being funded through the issuance of debt, Community Preservation Act funds, Water/Sewer Retained Earnings, sale of assets and State grants. A summary of the Town's debt service for all capital projects previously approved by Town Meeting is shown in the following section.

Debt/Debt Service

The Town of Lexington has maintained a Aaa credit rating for a number of years. Moody's Investors Service recently reaffirmed this credit rating in February when the Town issued long-term debt that sold at a 2 percent interest rate. This strong credit rating is due largely to the very strong demographic characteristics of the Town. A "triple A" rating is the highest credit rating a municipality can receive and allows the Town to borrow funds at the most favorable interest rates. Approximately 16 Massachusetts' cities and towns maintain the Aaa rating. Below is an historical summary of the Town's debt service. More detailed debt service schedules can be found in Section 11 of this Recommended Budget and Financing Plan.

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Annual Debt Service	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 Projected
General Fund	\$ 3,490,750	\$ 3,720,061	\$ 3,798,137	\$ 4,017,541	\$ 4,471,432
Prop. 2 1/2 Excluded	\$ 4,943,313	\$ 5,027,256	\$ 5,272,874	\$ 5,632,643	\$ 5,879,524
Water	\$ 213,150	\$ 398,671	\$ 490,833	\$ 850,350	\$ 1,108,100
Sewer	\$ 275,950	\$ 351,643	\$ 473,256	\$ 569,971	\$ 633,497
Recreation	\$ 100,000	\$ 268,000	\$ 103,917	\$ 106,200	\$ 132,600
Total Debt Service	\$ 9,023,163	\$ 9,765,631	\$ 10,139,017	\$ 11,176,705	\$ 12,225,153
Total Revenues	\$ 127,216,691	\$ 143,478,786	\$ 152,344,315	\$ 157,423,868	\$ 163,126,074
Debt Serv. % of Revenues	7.09%	6.81%	6.66%	7.10%	7.49%

History of Proposition 2 ½ Overrides and Debt Exclusions in Lexington

While the FY2010 budget, as presented, can be balanced without a Proposition 2 ½ Override, below is a history of Overrides and Debt Exclusions election results in Lexington:

NR: none requested

<u>Fiscal Year</u>	<u>Override</u>	<u>Debt Exclusion</u>
2010	NR	NR
2009	NR	NR
2008 - approved	\$4,636,987	\$27,500,000 (DPW facility)
2007 - approved	\$1,858,435	NR
<i>2007 – not approved</i>	\$3,166,166	NR
2006	NR	NR
2005 - approved	\$4,224,340	NR
2004 - <i>not approved</i>	\$4,957,000	NR
2003 - approved	NR	\$42,550,000 (schools, roads, Lincoln Park)
<i>2002</i>	NR	NR
2001 - approved	\$3,440,829	NR
2000 - approved	NR	\$52,235,000 (school building projects)
1999 - <i>not approved</i>	NR	\$68,200,000
1998	NR	NR
1997	NR	NR
1996 - approved	\$1,500,000	NR
1995	NR	NR
1994	NR	NR
1993 - approved	\$2,718,092	NR
1992	NR	NR
1991 - approved	\$1,097,829	NR
1990	NR	NR
1989 - approved	NR	\$11,000,000 (Pine Meadows Golf Course)

Elderly/Low Income Property Tax Relief

The Board of Selectmen continues to examine various options to provide property tax relief to our low income and elderly residents. Currently, the Town is able to provide the following options:

1. Senior Service Program – Qualified property owners over the age of 60 can work for the Town and receive up to \$1,000 toward their property tax bills.
2. Property Tax Deferral-Interest Rate Reduction – As a result of 2006 State legislation, Town Meeting voted to decrease the interest rate charged for elderly residents who choose to defer

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payment of their property taxes. The rate for FY2010 will be less than 1 percent, down from 1.66 percent in FY2009.

3. Property Tax Deferral-Qualifying Income Level - The Town has received special legislation to increase the income limits for residents over 65 years of age who wish to defer their property taxes. Currently, only seniors who earn less than \$40,000 qualify for this program. Article 34 will include a recommendation to Town Meeting to increase the qualifying income levels for the Property Tax Deferral program.
4. Increase in the Property Tax Exemption Limits – At the 2006 Annual Town Meeting, the Town voted to double the amount of the property tax exemption for certain qualifying residents, to \$1,000.
5. The Town provides a 30 percent discount on water and sewer rates to qualified low-income residents.

Collective Bargaining

With the exception of two bargaining groups, the Town has not settled collective bargaining contracts with its unions for FY2010. Further, for FY08-09, the Town is currently in negotiations with the Lexington Police Association. Also for this period, the Fire Union has filed for arbitration with the Joint Labor-Management Commission, having rejected the Town's financial package after numerous negotiating sessions.

The budget for fiscal year 2010 includes amounts that, in the best estimate of the Town Manager and Superintendent of Schools, may be required for collective bargaining contract renewals. That being said, Town officials are very mindful of the current economic situation and will take that into account during negotiations.

The Town Manager is also negotiating with the Employee Health Insurance Coalition to modify the Town's health insurance program for FY2010. In FY08, deductibles and co-pays were increased by a modest amount and the Town's contribution for the Blue Cross Network Blue plan decreased from 87 to 85 percent. Over the two-year period of this Coalition agreement, the Town savings from these changes were approximately \$1,100,000.

Tax Rate Estimate

It has been customary to provide an unofficial estimate of the tax rate that might result if the financial plans presented in this report are adopted and the assumptions with respect to State aid prove reasonably accurate. Without assuming any change in assessed valuations for Fiscal Year 2010, a residential tax rate of \$13.31 is estimated compared to the tax rate of \$12.97/\$1,000 of valuation for Fiscal Year 2009.

The following table provides a summary of components of the property tax bill for a home assessed at \$608,000, which is the median residential property value in Lexington.

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MEDIAN RESIDENTIAL TAX BILL	FY2007	FY2008	FY2009	FY2010
Base property tax	\$6,918	\$7,328	\$7,515	\$7,515
Allowable 2.5% increase	--	--	--	\$188
Proposition 2½ debt exclusion	375	378	384	\$438
Community Preservation Act surcharge	186	196	198	\$203
Total tax bill	\$7,523	\$7,958	\$8,097	\$8,344

Notes: Assumes no change in the residential/commercial tax shift.

Assumes no change in total valuation by class of property (residential, commercial/industrial, personal property).

Additional Information

The remainder of this document provides additional information on various aspects of the Town's budget. In addition, the School Committee, Appropriation Committee and Capital Expenditures Committee will be providing separate documents, reports and recommendations. Further questions may also be directed to the Town Manager's Office, Assistant Town Manager for Finance or Budget Officer.