

March 15, 2017

Fellow Town Meeting Members,

The Finance Committee is pleased to present both its 106th Annual Report to Town Meeting and our recommended operating budget for Fiscal Year 2018. Today, Needham remains financially secure. Revenues continue to grow due to new construction and an expanded tax base. In addition, meals and hotel tax revenues continue to increase. Recent years of extraordinary growth have enabled the Town to invest in one-time expenses and to reserve funds for future needs.

In spite of the Town's positive financial position, a great deal of risk and uncertainty remain as we look to the future. Cutbacks in the Federal budget may push the costs for services down to the State and ultimately to local governments. Some of the grants and subsidies we currently receive may disappear or be reduced. The Fed is looking to raise interest rates as much as two or three times in each of the next few years to protect the economy against inflationary pressures. Each of these events could negatively impact the Town's financial future.

The Town has made significant steps implementing the Facilities Master Plan. Construction is underway on the new elementary school and feasibility studies are underway to address deficiencies and determine current and future needs at the Police and Fire buildings, the Memorial Park Building, and the High School. There are also significant projects on the horizon including expansion or reconstruction of the Public Works and School Administration buildings.

It is critical that the Town continue careful financial planning to pay for these significant projects, as well as the associated increase in operating costs. The Town is also preparing to expand services significantly with a new Full Day Kindergarten program and increased staffing in public safety. The Town must also continue to maintain and update current facilities and services. The Finance Committee remains committed to addressing the growing needs of the Town without unduly burdening the taxpayers. The Town will need to take on additional debt to finance these projects, some of which may need debt exclusion financing (often called "overrides") approved by the voters.

The Town's operating budget once again faces certain known costs that outpace revenue growth, including increases both in health insurance costs within Townwide Expenses and in the area of Special Education in the School Department. Both Town and School administrators continue to seek ways to slow the growth of costs in these areas. The Town is now actively examining health insurance options for future years. The School Department continues to consider expanding "in-house" Special Education programs such as the new, very successful, therapeutic program at the High School which was funded last year and which seeks to provide services that were previously available only outside of the district at a higher cost. The Finance Committee is satisfied that the budget recommended herein is reasonable and meets all critical needs of the Town, while exercising fiscal restraint and working to prepare for future expanding needs.

The Finance Committee supports the efforts of the Board of Selectmen and the Town Manager and the School Committee and the Superintendent in striving to build sustainable programs that both address current needs and make the investments necessary to meet future needs.

Revenue Summary

In FY 2018, General Fund revenue is projected to increase by a total of 7.3%. General Fund revenue is derived from three principal sources of revenue: property taxes, state aid, and local receipts. Property tax receipts comprise the largest source of revenue for Needham, accounting for 79.8% of projected General Fund Revenues in FY18. Needham has experienced substantial new growth in recent years, resulting from significant increases in property values. This new growth has now become part of Needham's property tax base. Property tax receipts are increasing at a healthy rate, with an expected increase of approximately \$6.5 million or 5.2% in FY 2018.

The amount of new growth remains strong, although it is projected to be \$539,775 lower than FY2017. The level of new growth will fluctuate depending for the most part on the number of large commercial projects in a given year. Although this is the third year that the amount of new growth is lower than the previous year, this decrease is not a concern. As noted above, the property tax values that are new growth become part of the property tax base for future years. This represents a slowing of the rate of growth that was extraordinarily high in recent years due to exceptionally large projects in Needham Crossing. In FY 2018, 95.7% of the property tax levy is anticipated to be supported by the tax base from the prior year. New growth is expected to continue to increase, but at a more moderated pace.

The portion of property taxes collected for debt exclusions will begin to increase in FY 2018, since the Town has authorized a debt exclusion to fund the new elementary school to replace the Hillside School. Tax revenues for excluded debt will be almost \$7.0 million, which is 5.3% of the anticipated tax levy for FY 2018. This compares to excluded debt service revenue of approximately \$5.9 million for FY 2017, which was 4.7% of the tax levy.

Total state aid, which is primarily "Cherry Sheet" aid, is determined as part of the state budget process. State aid accounts for 6.8% of the projected General Fund revenue for FY 2018. The proportion of state aid to revenue is decreasing slightly from 7.3% in FY 2017, since we are projecting state aid to be level-funded in FY 2018. Although the Governor's proposed budget includes increases in Chapter 70 School Aid and Unrestricted General Government Aid, the budget is subject to change as it makes its way through the legislature. Furthermore, changes in the federal administration have led to additional uncertainty for federally derived benefits, so we have chosen a conservative approach.

Local receipts are another important General Fund revenue source, comprising 6.3% of FY 2018 General Fund revenue. Local receipts include revenues received for automobile, hotel room, and meal excise taxes, licensing and permitting fees, fines and penalties, and income from departmental activities and services. Local receipts can fluctuate greatly, so revenue projections are based on conservative assumptions in order to protect against an unexpected

drop in one of the sources of revenue. We are expecting the increase in revenue from local receipts to be strong for a second consecutive year. Last year saw an increase in revenue relating to the new solar power project. In FY 2018, the increase in local receipts, expected to be \$734,120, is driven primarily by an increase in the amount of motor vehicles excise taxes. Receipts from hotel and meals taxes are also increasing due to the strong local economy.

Free Cash is another substantial component of General Fund revenue. Free Cash results from revenue collections that exceed estimated revenue and from expenditures that are lower than appropriations at the end of the prior fiscal year (in this case, unused funds from FY 2016.) The budget was based on an estimated \$8.6 million Free Cash to be available in FY 2018, which represents 5.2% of General Fund revenue. This is \$1.7 million more than the level of Free Cash certified for use in FY 2017. We anticipate that there will be additional Free Cash available for appropriation at the Annual Town Meeting. We are recommending that Free Cash in FY 2018 be used to fund cash capital and financial warrant articles, to bolster reserves, and to partially support the operating budget.

The Town is careful to rely on only recurring revenues to support ongoing operating expenses. Because the Town consistently budgets each year in a conservative manner, a portion of Free Cash each year is fully expected to be recurring and therefore that portion can and should be used to support operating expenses. This year the operating budget includes approximately \$2.7 million of available Free Cash. The balance of Free Cash is then used for one-time needs or for reserves. If a higher level of Free Cash is certified, as we expect, then we would suggest that the additional funds be added to reserves for upcoming needs, or to contribute toward the unfunded portion of the OPEB outstanding liability.

At the time of this writing, the estimated total General Fund Revenue for Fiscal Year 2018 available for appropriation is \$163,598,081.

FY18 Operating Budget

The total recommended operating budget for FY 2018 is \$152,704,148, which is 5.8% higher than the current FY 2017 operating budget. Please note, for FY 2018 the Town has diverted some recurring funds from the operating budget into the Debt Service Stabilization Fund in order to have funds available for known future increases in operating needs, rather than use those funds to expand the current operating budget. The School Department plans to institute a full-day kindergarten program which will require an increase in the operating budget. In addition, the Town plans to increase staffing in both the Police and Fire Departments to improve service and keep up with the additional pressure placed on these departments due to expanded development in Needham Crossing. This step was taken specifically to avoid a request for an operating override vote to cover these future operating expenses.

Townwide Expenses

The FY 2018 budget recommendation includes an increase of 9.2% in Townwide Expenses. The primary driver of the increase is an increase in debt service payments. Other notable increases

in Townwide Expenses include the Reserve Fund, OPEB, Retirement Assessments, and Classification, Performance and Settlements.

The Casual, Liability, Property and Self-Insurance line item accounts for the insurance coverage that the Town receives through the Massachusetts Inter-local Insurance Agency (MIIA) for buildings, vehicles, property damage, and liability, as well as a small contingency for non-covered claims. This line item is increasing by 4.1%, or \$23,800 in FY 2018, to cover premiums for the Town's growing inventory of facilities and equipment.

The Debt Service budget line is increasing significantly in FY 2018 after three consecutive years of decline. This line item covers payments for outstanding debt obligations for excluded debt, Community Preservation Act debt, and debt within the levy. The FY 2018 Debt Service line is increasing by 12.7%, or over \$1.4 million. This substantial increase is the result of debt payments for the purchase of property and the construction of the new elementary school.

The Employee Benefits line (known as Group Insurance, Employee Benefits and Administrative Costs) is increasing by 5.5%, or \$728,687. This includes increases for additional benefit eligible positions. The Employee Benefits budget also includes a projected 7.0% increase in health insurance costs. The Town is evaluating different options for health insurance in order to keep health premium increases as sustainable as possible.

The Needham Electric Light and Gas Program covers the costs relating to electric and natural gas usage; the costs of maintenance and repair of street lights; and the costs of producing solar electricity that is sold to the grid. Energy costs were removed from the budgets of the various operating divisions and consolidated in a single line item under Townwide Expenses in FY 2017 for better transparency of the effects of changes in energy costs. This line is increasing by 2.8%, or \$95,845, in FY 2018. These costs are offset by revenue received from the solar electricity project, from both lease payments and from the sale of electricity generated by the solar array.

The FY 2018 Retirement Assessments line item is increasing by 9.0%, or \$607,777. This line item covers pensions for retirees as well as unfunded pension liability. The Retirement Board reduced the assumed rate of return for pension assets from 8.00% to 7.75% in FY 2016 and has discussed an additional reduction in the near future, paralleling actions being considered by many other governmental entities. The funding schedule in the most recent actuarial analysis includes at least two more years of continuing increases to the Town's annual contribution to make up for the increased unfunded liability resulting from the reduction in the assumed rate of return. An additional decrease in the assumed rate of return will also affect the annual contributions needed to address this unfunded liability.

The Retiree Insurance and Insurance Liability Fund line is increasing by 9.8%, or \$546,532. The program, also known as "OPEB" (other post-employment benefits), funds benefits other than pensions, such as health insurance, that are provided to eligible retirees. For the FY 2018 budget, the assumed rate of return for OPEB funds was reduced from 7.75% to 7.5% which means that the budget must increase to keep up with the funding schedule. The FY 2018 OPEB budget is based on a 2015 actuarial analysis that is being updated in 2017. The new analysis is expected to further increase the required funding in this line item.

The Classification, Performance, and Settlements line item serves as a reserve for personnel-related needs during the fiscal year, including performance-based salary increases for managers, or increases resulting from new collective bargaining agreements. This line item is budgeted at \$260,000. As of this writing, the collective bargaining agreement for the Needham Independent Public Employee Association (NIPEA) has not been settled for FY 2018.

The Reserve Fund provides funds that may be used for extraordinary or unforeseen budget needs that arise during the fiscal year. In the past the Reserve Fund has been used to fund expenses such as unexpected legal costs, unexpectedly high energy expenses, and costs associated with extraordinary snow and ice removal. This year the recommended Reserve Fund appropriation is \$1,862,600, an increase of 28.1% over the FY 2017 budget. This increase is higher than usual because the Finance Committee chose to move certain salary and benefits costs for a proposed new position in the Public Facilities Department to this line. The Committee deferred the inclusion of this position in the budget until a new Director is in place and has an opportunity to fully review and assess the department's needs. The Finance Committee also moved funds into the Reserve Fund from the Park and Recreation budget. These funds were originally proposed to cover the staff salaries needed to open a new Rosemary Pool Complex in May or June of 2018. The Finance Committee chose to move these expenses to the Reserve Fund pending a better determination of an actual opening date for the Pool Complex.

Municipal Departments (excluding Education)

The Municipal Departments category includes 21 different budgets encompassing operational departments, boards and committees, as well as the municipal parking program. This report groups those budgets within Municipal Departments by functional groups.

General Government and Land Use

The FY 2018 proposed budget for all General Government and Land Use departments is 3.1% higher than the FY 2017 budget. The Board of Selectmen/Town Manager budget line item is increasing 11.8% compared to FY 2017. The FY 2018 budget adds back a Benefits Administrator position to Human Resources to replace a position that was reclassified last year. This budget also includes an increase in the expenses to fund a consultant to develop an employee engagement initiative.

The Town Clerk and Board of Registrar's FY 2018 budget is decreasing by 6.7%. In FY 2017 the Town conducted three scheduled elections, including a presidential election with early voting. While the budget includes an increase in wages for elections workers, this is offset by the fact that the Town has only one scheduled election in FY 2018

Public Safety

The Public Safety Departments, which include the Police, Fire, and Building Departments, have a combined increase of 3.9% in the FY 2018 budget. The Police Department budget is increasing 1.8%, reflecting increases in salary and wages and a decrease the FY 2018 cost for the police

vehicle replacement cycle. The Police Department budget submission included a request to hire additional Police Officers starting in FY 2019, due to growing needs including an expected increase in service calls resulting from redevelopment at Needham Crossing, including new businesses and potential new residential housing. A staffing study is currently being conducted for both the Police and Fire Departments, and the Finance Committee will review the necessity of increasing Police staffing in the coming years.

The Fire Department budget is increasing by 5.5% in FY 2018. There is an article in this warrant seeking approval for funds to design a new Public Safety Complex downtown and a replacement Fire Station 2 in the Heights. It was agreed that the staffing increase in the Fire Department should be deferred until FY 2019, in the same manner as the Police Department. It is important to note that increases in staffing in both the Police and Fire Departments will affect not only the operating budgets of those departments, but will increase costs of employee benefits in Townwide Expenses.

The FY 2018 budget for the Building Department is increasing 5.2%, due contractual salary increases with no change in the expense line.

Public Facilities and Public Works

The total combined budget for the Public Facilities Department, the Department of Public Works (DPW), and the Municipal Parking Program, is increasing by a modest 2.7%. These budgets are less susceptible to volatility since the energy costs have been consolidated into Townwide Expenses.

The Public Facilities Department budget is increasing by 5.0% in the FY 2018 budget, due to contractual salary increases. The department contains two divisions, Construction and Maintenance. The Finance Committee chose to defer funding a request for the new position of Contract Administrator in the FY 2018 budget. At the time of this letter, the Town was conducting a search for a new Director of Operations. The Finance Committee concluded that the new Director should have the opportunity to analyze the needs of the department before a new position is created and funded. As mentioned previously, the Finance Committee chose to move the funds for the salary and expenses relating to this position into the Reserve Fund. The FY 2018 budget for the Department of Public Works is virtually flat with an increase of 0.1%. This reflects the fact that there is not yet a settled agreement between the Town and the union representing many of the positions in Public Works. As noted earlier, the funds to cover wage increases that may be occasioned by a new contract are reflected in the Classification, Performance and Settlements line item under Townwide Expenses.

The Municipal Parking budget is increasing by 4.0% due to an increase in the contracted cost for lot maintenance. There is currently no settled contract for the employees who perform the work covered by this budget on an overtime basis.

Community Services

While the Community Services budget constitutes only 2.5% of the overall operating budget, the six divisions that comprise Community Services provide significant services to residents and businesses throughout the community and receive substantial funding from fees, grants, and donations, as well as support from volunteer services. The budgets for the Health Department; the Council on the Aging; the Youth Commission; and the Veteran Services Division were recently merged into one budget in FY 2016. The combined budget for the four Divisions is increasing 9.0% in FY 2018. The FY 2018 budget includes salary increases for staff as well as the annual salary for a new Public Health Inspection position that was considered during the budget process this year, and funded for a partial year at the Fall 2016 Special Town Meeting. Veterans' Services is increasing due to an increase in the cost of benefits. Expenses in the HHS Department are increasing due to increases in costs of contractual services and increased wireless communications needs.

The Library budget is increasing 4.0% for FY 2018. The budget includes funding for additional hours for a Young Adult Librarian, a priority of the Library Trustees. Requests for wireless internet service, book and DVD downloading subscriptions, an online reference database, and the salary for a part-time person for packing and unpacking deliveries will continue to be funded through the State Aid account in FY 2018.

The Park and Recreation Department line is decreasing 18.9% in the FY 2018 budget. This significant reduction is due to the closing of the Rosemary Pool during the summer of 2017. This will result in reduced spending for the pool staff wages, as well as pool-related supplies. As indicated previously, the Finance Committee moved funds for pool staff salaries for May and June 2018, which is the end of FY 2018, into the Reserve Fund, pending further updates on construction of the Rosemary Pool Complex and the determination of an opening date. When the new Rosemary Pool Complex opens, the Park and Recreation Department budget can be expected to increase significantly. The Finance Committee has requested that the Park and Recreation Commission complete a review of the revenue fee structure to determine how much of the increased operating expenses can be offset and paid for by the users of the complex.

Education

The recommended FY 2018 Education budget is \$69,156,335, which represents 45.3% of the total General Fund operating budget. The Education section of the budget is comprised of the Town's assessment for the Minuteman Regional High School and the operating budget for the Needham Public Schools. The Minuteman Regional High School's preliminary assessment for FY 2018 is \$806,252, an increase of 5.2% from FY 2018. This is the first budget under the new Minuteman School District Agreement. The district now has 10 rather than 16 towns. The district projects a decrease in state funding and increased member assessments. The new Minuteman District has authorized borrowing to initiate a new capital building project, the costs of which will be apportioned among member towns in accordance with the District Agreement.

The FY 2018 budget for the Needham Public Schools totals \$68,330,083, an increase of \$3,160,169, or 4.8%, over the FY 2017 appropriation. The Finance Committee's recommended FY 2018 budget fully funds the School Committee's voted budget. The School Department's suggested that it would curb its budget increase in FY 2018 in order to allow the Town to set aside some operating funds in preparation for the planned full-day kindergarten program which will require a jump in operating costs as well as some one-time start-up costs.

The Finance Committee continues to monitor volatile costs within the School Department budget including special education tuitions and transportation costs. The Finance Committee commends the progress made in addressing these escalating costs. Several new programs have successfully strengthened and broadened special education programs, allowing more needs to be met within the district, which ultimately saves on out-of-district tuitions. In addition, new School transportation contracts have been negotiated that have been able to contain those cost increases.

Closing Comments

The Finance Committee's FY 2018 budget recommendation provides the resources needed to maintain the same high level of Town wide services to local residents and businesses. The budget shows the fiscal restraint and careful planning needed to address not only the needs of FY 2018, but to prepare for upcoming demands. This will prove particularly important as the Town initiates a number of significant capital facilities projects which will require increases in both capital and operating costs. A word of caution going forward... The Town must consider not only the benefits of each project and the capital costs, but the effects on the Town's overall debt capacity, the long-term implications to the operating budget, and the burden on individual taxpayers. In addition, expanded residential, commercial and other development throughout Town will lead to rising costs, primarily relating the Schools and Public Safety services, but will also lead to a growth in tax and fee revenue. The Finance Committee looks forward to working closely with the other Town Boards and Committees as well as Town and School administrators during this process.

The Finance Committee would once again like to recognize the hard and excellent work of Town and School Administration, the Directors of Finance for the Town and Schools, and the department heads and managers who all worked closely with the Finance Committee throughout the budgeting process. The Finance Committee greatly values the creative and constructive approaches often presented to address competing operational needs. The Finance Committee would also like to recognize the residents who dedicate their time and effort to serving our community through elected and appointed positions. We could not accomplish our mission effectively without their generous assistance and support.

Finally, I would also like to thank each member of the Finance Committee for their dedication and meticulous work examining and prioritizing financial issues, balancing the budget, and reviewing the Town's capital plans and investments. It has been a privilege and a pleasure to serve with such dedicated and talented people as we strive to achieve the best for the Town and its residents.

Respectfully submitted on behalf of the Finance Committee,

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