# TOWN of ATHOL

## FISCAL MANAGEMENT POLICIES

Athol Board of Selectmen
*Adopted October 7, 2014*

Finance and Warrant Advisory Committee
*Endorsed December 3, 2014*

Town Manager ~ Town Accountant ~ Principal Assessor ~ Treasurer/Collector

Introduction

The Town of Athol recognizes the need to ensure consistent and predictable budgeting procedures as an intrinsic component of its financial management procedures. Towards that end, the following principles set forth a program for prudent fiscal planning and management of the Town's assets.

These principles address current operational activities, and longer-term planning, and are intended to guide the Town Manager, Board of Selectmen, Finance and Warrant Advisory Committee and all other Town agencies. However, it is also acknowledged that Town Meeting ultimately retains its authority to appropriate funds and to incur debt at levels it deems appropriate, subject only to statutory limitations such as Proposition 2½. Adherence to the following policy is intended to ensure the Town's sound financial condition now and in the future, quantified by:

- Cash Solvency – the ability to pay bills in a timely fashion.
- Budgetary Solvency – the ability to balance the budget annually.
- Long-Term Solvency – the ability to pay future costs.
- Service Level Solvency – the ability to provide needed and desired services.

It is equally important that the Town maintain flexibility in its finances to ensure that the community is able to effectively react and respond to changes in the economy, or new service challenges, without measurable financial stress.

A. FISCAL POLICIES – GENERAL FUND

Municipalities maintain reserves in order to provide budgetary flexibility for unexpected events, to withstand financial emergencies and to help guard against fluctuations in revenue-expenditure patterns. The Government Finance Officers Association recommends that local governments maintain reserves (unreserved fund balance) of five to 15 percent of general fund revenues depending on the needs of the community *(note: general fund herein refers to total operating budget less water and sewer enterprise funds)*.

1. Reserves are generally established in three categories:

   - Contingency Reserves – a reserve for unforeseen events.
   - Unrestricted Reserves – a reserve that can be used for any purpose.
   - Restricted Reserves – a reserve dedicated for specific use at some future time.

2. Reasons for Creating and Maintaining Reserves:

   - Operational Needs – These are contingency reserves, which are typically appropriated as part of the annual budget. The purpose is to meet unexpected increases in department operational cost such as legal fees, major equipment repairs and anticipated increases in service costs.

   - Catastrophic or Emergency Expenditures – These are contingency reserves which provide emergency funds for use in a major calamity such as a hurricane, uninsured loss or damage to a capital asset.

- Maintenance of Assets – These are restricted reserves used to replenish the continuing depreciation or replacement of buildings and equipment. Under GASB 34, since fiscal 2003 cities and towns are required to report the depreciation of certain fixed assets.

- Liquidity or Cash Flow – These are unrestricted reserves used to reduce the need for short-term borrowing, generate investment income and to maintain a strong credit rating.

- Unfunded Liabilities – These are restricted reserves used to fund an unfunded liability that has been incurred during the current or prior years, but which does not have to be paid until a future year, and for which adequate reserves have not been set aside. These liabilities may not be apparent in typical financial records in a way that makes their impact easy to assess. This type of liability accumulates gradually over time and may go unnoticed until it has created severe financial problems. Unfunded liabilities are predominantly pension obligations and so-called Other Post Employment Benefits (OPEB) which is primarily health insurance costs for retirees.

3. All current operating expenditures will be paid for with current operating revenues.

   The purpose of this policy is to maintain a financially sound operating position for the Town by promoting Athol's ability to: (1) balance its budget on a current basis; (2) maintain reserves for emergencies; and (3) have sufficient liquidity to pay bills on time to avoid sort-term borrowing costs. The Town will avoid actions that balance current expenditures at the expense of meeting future year's expenses, such as postponing expenditures, utilizing future year revenues or rolling over short-term debt.

4. The combined balance of Free Cash and Stabilization funds should be maintained at seven to ten percent (7%-10%) of the prior fiscal year General Fund operating budget.

   - The Town will endeavor to maintain a certified Free Cash balance ranging from three to seven (3%-7%) percent of the prior fiscal year General Fund budget. The Free Cash balance is an important indicator of whether a town is living within its means. Free Cash can be utilized in case of emergency to provide enough cash in the bank to meet payrolls and pay current bills without having to borrow in anticipation of revenues. Together with the Stabilization Fund goal the Free Cash target is a widely accepted measure of good financial standing and a factor in Athol's bond rating.

   - The Town will endeavor to maintain a Stabilization Fund balance ranging from five to ten (5%-7%) percent of the prior fiscal year General Fund budget. Funds held in Stabilization should only be appropriated for one-time capital expenses or major unforeseen events.

     In the absence of a Capital Stabilization Fund, the Town may appropriate monies into the Stabilization Fund over a series of years for a specific planned capital project in order to avoid borrowing costs.

5. Free cash in excess of the Town's goal should be used for non-recurring or emergency expenditures, used to lower the tax rate or appropriated to a stabilization fund for future capital projects and equipment purchases. This policy will provide a strategy to avoid creating future operating deficits by over-reliance on Free Cash to subsidize the operating budget. The policy provides for a contingency reserve to be used for expenditures of a non-recurring nature, capital and equipment purchases, or unexpected, non-recurring small increases in service costs.

6. The annual budget should include a Capital Improvement Plan fund from current dollars to maintain an equipment replacement and facilities maintenance schedule equal to a minimum of two percent (2%) of the General Fund operating budget. Much of the Town's government wealth is invested in its capital plant (i.e. buildings, fields, infrastructure, equipment and vehicles). Long-term debt is an appropriate source of funding for certain types of projects while current revenues should be used for those assets with a shorter useful life.

7. Fees and user charges should be reviewed on a three-year cycle in relation to the costs of providing the service. As state and federal assistance has declined and/or been eliminated, the Town's non-property-tax revenue base has provided more funding for local services. In order to continue to provide these services without an additional burden on the tax rate, fees should be reviewed to ensure they cover the cost of program and service delivery.

B. FISCAL POLICIES – WATER & SEWER

1. Rates and fees for water and sewer funds shall be set at a level to provide for self-supporting operations. Rates shall be reviewed annually to project revenues and expenditures for the ensuing fiscal year. Estimates of capital projects and debt service should be included in order to project the future impact on water or sewer rates.

2. Water and sewer main replacements should be scheduled so as to avoid major increases in water and sewer rates. The current water and sewer enterprise funds are established as self-supporting on a cash basis. Revenues are planned to cover operating budgets, indirect and overhead costs, and debt service payments. Depreciation is not funded; therefore, a carefully designed replacement plan is necessary to ensure a rate structure adequate to pay all costs including proposed new long-term debt.

3. Water and sewer debt service, not including debt issued as a betterment assessment, should not exceed 40% of water and sewer operating revenues. The water and sewer capital plan should endeavor to invest in the infrastructure at a rate that does not place dramatic increases on the ratepayer.

C. CAPITAL IMPROVEMENT PROGRAM (CIP) POLICIES

Section 6 of the Town Charter stipulates the basic tenets of the Town's "Capital Improvement Program" including the role of the Capital Planning Committee (CPC) in developing a five-year plan for capital outlays. The purpose of the Capital Improvement Program (CIP), as stated in the 2004 Master Plan, is "to identify major planning, design, acquisition, renovation, and construction projects, which are planned for the next five years so that they can be prioritized and coordinated. Capital Improvement Projects are large ticket items which are nonrecurring or very infrequent and do not include annual operation and maintenance items. Projects may be proposed by town departments, municipal boards and the townspeople."

The CIP is a useful planning tool to coordinate the many projects that are occurring in the community. This is particularly important for water, sewer and transportation projects. In addition, the CIP will help Athol anticipate funding needs in advance for important projects rather than react to emergencies. The following policies shall apply to the CIP:

<u>Capital Project/Item</u> – An expenditure of $25,000 or more with a useful life of three or more years for one of the following purposes:

- Acquisition of land.
- Construction, expansion or renovation of a facility. Facilities include buildings, streets, bridges, sidewalks, parking lots, utilities, playing fields, cemeteries, playgrounds, etc.
- Acquisition of large capital items including vehicles, technology, communications equipment, etc.
- Facility maintenance projects including roof repair, HVAC, electrical, masonry, painting, carpeting, street resurfacing, sidewalk reconstruction, playground equipment or major repairs.
- Planning, feasibility, engineering or design studies related to a capital project.

<u>Criteria for Setting Priorities</u>:

Capital planning will be accomplished to ensure that the highest priorities and greatest needs of the town are met. The CPC will assign a value to each capital request from one to ten on each of the following factors (max score 100). From the overall priority ranking, the CPC will deliberate and recommend its annual Capital Improvement Plan and develop a Five-Year Capital Plan outlook.

1) <u>Risk to Public Health or Safety</u> – Projects must address a clear and immediate safety or public health risk.

2) <u>Deteriorated Facility</u> – An investment to reconstruct, rehabilitate or replace a deteriorated facility or equipment. This "deferred maintenance approach" provides for replacement of equipment or a facility only when it is worn out. This approach is the opposite of Systematic Replacement (see below).

3) <u>Systematic Replacement</u> – An investment that replaces or upgrades a deteriorated facility or equipment as part of a systematic replacement program. Assumes the equipment or facility will be replaced at approximately the same level of service although some increase in size to allow for normal growth is included.

4) <u>Improvement in Operating Efficiency</u> – An investment that substantially improves the operating efficiency of a department or reduces operating expenses.

5) Coordination – An expenditure necessary to coordinate with another CIP project (e.g. a sewer or water main replacement with a road reconstruction project) or to comply with the requirements of a court order or changing federal or state regulations.

6) Protection and Conservation of Resources – An investment in a project that protects natural resources at risk or restores impaired resources.

7) New or substantially expanded facility – an investment in the construction or acquisition of a new facility.

8) Fiscal Impact – The projected fiscal impact (positive, neutral or negative) expected to be generated by a project.

9) Equitable provision of services – An investment that serves the special needs of a segment of the population deserving special attention (e.g. elderly, disabled, low and moderate income persons).

10) Overall need – the individual reviewers rating of overall need when balanced against all other requests.

Funding Sources

Borrowing – Projects/items of $100,000 or more with a useful life of at least 10 years may be considered for borrowing. The sources of revenue to support borrowing are:

- General Fund – Within Proposition 2½.
- General Fund – With debt or capital exclusion vote.
- Water and Sewer Fund.

Available Funds – Projects of $25,000 or more with a useful life of three or more years may be considered for funding with available revenues. Sources of available funds are:

- Capital Improvement Budget as recommended by the Capital Program Committee.
- Water and sewer reserves.
- Free Cash warrant articles.

Departmental Operating Budget – Projects/items of less than $25,000 with a useful life of greater than one year may be considered for funding in departmental operating budgets.

- General Fund
- Water/Sewer Fund
- Departmental Revolving Fund
- Raise and appropriate article (free cash or transfer)

Capital projects may increase future expenses, decrease future expenses or may be cost-neutral. The funding of capital projects may fall within available revenues (taxes or fees) or new revenue sources (debt or capital exclusions). It is important to project the impact that the proposed capital project has on the operating budget so that the operating budget has adequate resources to meet long-term operating expenses. Therefore the annual operating cost of a proposed capital project, as well as debt service costs, will be identified before any long-term bonded capital project is recommended.

Capital projects should also be reviewed in relation to impact on property tax limitation and annual operating budgets.

- Projects/items funded with current tax revenues should identify the impact on the annual operating budget.
- Projects/items funded with long-term debt and not exempted from Proposition 2½ should identify the impact on annual operating budgets.
- Projects funded with long-term debt and exempted from Proposition 2½ should identify the impact on the annual tax rate and/or tax bill (debt or capital exclusion).

## D. DEBT MANAGEMENT POLICIES

The use of long-term debt is a common and often necessary way for a community to address major infrastructure and equipment needs. It is also a means of spreading the cost of large capital projects over a larger, changing population base. However, when a local government incurs long-term debt, it establishes a fixed obligation for many years. Accumulation of such fixed burdens can become so great that a local government finds it difficult to pay both its operational costs and debt service charges. Great care and planning must therefore be taken when incurring long-term debt to avoid placing a strain on future revenues.

Massachusetts General Laws, Chapter 44, Sections 7 and 8 regulate the purposes for which municipalities may incur debt and the maximum maturity for bonds issued for each purpose. MGL c. 44, sec. 10 specifies that the debt limit for towns is five percent of its equalized valuation. There are two “annual” limitations applicable to municipal debt. First, if a municipality borrows $5 million in a fiscal year, it may be subject to an arbitrage penalty. If a borrowing is over $10 million in one fiscal year, it is not “bank qualified”. This essentially means that the issue is not marketable.[1]

The following principles shall apply to the Town’s debt service management:

1. Long-term debt should not be incurred without a clear identification of funding sources.

   Long-term debt is generally utilized to fund capital projects that have a long useful life and are relatively expensive. Because of the debt service costs and annual appropriations necessary to retire this debt, there should be clear knowledge and commitment of revenue sources available to pay these costs without competing with operating budgets for limited resources.

2. Betterments may be assessed on capital projects that impact a targeted group of properties. When specific benefits accrue to property owners, betterments may be assessed to contribute all or a portion of the costs associated with the capital project.

[1] These limitations do not apply to loans from a state or federal agency such as USDA or MWPAT.

3. General Fund debt service will not exceed ten percent (10%) of the General Fund. The major credit rating agencies consider debt service on net direct debt (i.e. non-self-supporting) exceeding 20% of net operating revenues as a potential problem. Dramatic increases in debt service also indicate potential problems unless revenue sources increase to keep pace with these additions to fixed costs. The ten percent benchmark provides a policy to apply to new projects and the growth of revenues to such projects.

4. Capital Improvement Plan. The town will establish and maintain a five (5) year Capital Improvement Plan (CIP), including all proposed projects and major pieces of equipment that exceed $25,000 in cost. The town's long-term debt strategies will be structured to reflect its capital needs and ability to pay. No capital project or purchase will be placed on the Town Meeting warrant without the approval of the Capital Planning Committee. Ideally, two (2%) percent of the Town's budgeted annual expenditures should be set aside to pay for capital improvements for vehicles and building maintenance items that cost under $100,000 and are not funded by a debt issuance. Any balance remaining from the two percent set-aside will be placed in a Capital Stabilization Fund for future projects.

5. Bond Rating. The community's bond rating is important because it determines the rate of interest it pays when selling bonds and notes. Generally, a higher the bond rating yields more competitive bids for the bond (lower interest rate). Rating agencies have historically looked at four sets of factors in assigning a credit rating:

   - Debt Factors – debt per capita, debt as a percentage of equalized valuation and rate of debt amortization.
   - Financial Factors – operating surpluses or deficits, free cash as a percent of revenue, state aid reliance, property tax collection rates, and unfunded pension liability.
   - Economic Factors – property values, personal income levels, tax base growth, tax and economic base diversity, unemployment rates and population growth.
   - Management Factors – governmental structure, the existence of a capital improvement plan, the quality of accounting and financial reporting, etc.

   The Town will continually strive to improve its bond rating through sound financial management, diligent management of receivables, sound management, accounting and financial reporting and by meeting its stated reserve policies.

6. Debt Guidelines

   - General Fund Debt Service – A limit on debt service costs as a percent of the town's total budget is especially important because of Proposition 2½ constraints on the town's budget. At the same time, the community's regular and well-structured use of long-term debt symbolizes the municipality's commitment to maintaining and improving its infrastructure. Municipal credit analysts often use 10% as a maximum benchmark for financial soundness. The Town of Athol is committed to establishing a debt service ratio that will not exceed the benchmark. The Town will also, by policy, establish a debt service "floor" of 2% as an expression of support for continued investment in the town's roads, associated infrastructure, public facilities and other capital assets.

- Debt Maturity Schedule – As previously stated, MGL c. 44 specifies the maximum maturity for bonds issued for various purposes. However, a town may choose to borrow for periods less than the statutory limit. A reasonable maturity schedule reduces interest costs and the Town is committed to establishing an average debt maturity goal of 10 years. This can be accomplished through more aggressive amortization of new debt service – such as was done with the Library expansion in 2013-2014 – and by reducing terms for existing debt when the option to refinance a bond becomes available.[2]

7. Debt Strategies

- Alternative Financing Strategies – The town will continually pursue opportunities to acquire capital by means other than conventional borrowing; such as grants and low or zero interest loans from state or federal agencies, such as the Massachusetts Water Pollution Abatement Trust (MWPAT), USDA, CDBG, EDA, etc.

- Scheduling of Debt – The town will schedule its bond issues to preferably remain under the $5 million annual limit (for arbitrage purposes), but in no case over $10 million in a given year.

- Debt Issuance – The town will work closely with the town's financial advisor and bond counsel to ensure that all legal requirements are met and that the lowest possible interest rate can be obtained. This includes preparation of the all-important disclosure document (prospectus), as well as preparation of the required documents to be signed by the Board of Selectmen and the Treasurer and signed/notarized by the Town Clerk.

## E. <u>ADDITIONAL POLICIES / APPENDICES</u>

The following are attached and incorporated herein by reference:

- Appendix 1 – Specific Reserve Policies
- Appendix 2 – Additional Financial Polices

[2] It should be noted that debt service for water and sewer projects will not be subject to this objective.

**APPENDIX 1**
**SPECIFIC RESERVE POLICIES**

It is recommended that the Town of Athol establish the following Reserve Policies and target dates for financial reserves:

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| Reserve: | <u>Reserve Fund (Finance and Warrant Advisory Committee)</u> |
| Statutory Reference: | MGL Chapter 40, §6 |
| Type of Reserve: | Contingency and Unrestricted |
| Proposed Reserve: | 0.5% of the prior year general fund operating budget less debt service |
| Current Balance: | $75,000 as of July 1, 2014 |
| Uses: | For extraordinary and unforeseen expenditures as determined by the FWAC |
| Target Date: | This reserve policy is substantially met in FY15 |

| | |
|---|---|
| Reserve: | <u>Free Cash</u> |
| Type of Reserve: | Unrestricted |
| Proposed Reserve: | 5% of the prior year general fund operating budget |
| Current Balance: | $0 as of July 1, 2014 |
| Uses: | To be used for one-time expenses, capital expenses and to lower the tax rate using only the amounts above the reserve. |
| Target Date: | Years of constraining department budgets have resulted in reduced free cash certifications. Seek to achieve this reserve level in FY17. |

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| Reserve: | <u>Stabilization Fund</u> |
| Statutory Reference: | MGL Chapter 40, §5B |
| Type of Reserve: | Contingency, unrestricted, may be restricted by vote of Town Meeting |
| Proposed Reserve: | 5% of the prior year general fund operating budget |
| Current Balance: | $855,000 as of July 1, 2014 |
| Uses: | Stabilization funds should only be used for: (1) capital purchases requiring debt issuances when the balance of the fund exceeds 5%; (2) if state aid payments are reduced creating a budget shortfall; or (3) for catastrophic or emergency events if the financial impact of the event is in excess of an amount which the FWAC Reserve Fund can accommodate. All appropriations into and out of the Stabilization Fund require a 2/3 vote of Town Meeting. |
| Target Date: | This reserve policy is substantially met in FY15. |

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| Reserve: | <u>Other Post Employment Benefits (OPEB) Trust Fund</u> |
| Statutory Reference: | MGL c. 32B, §20 |
| Type of Reserve: | Restricted. |
| Current Balance: | $10,000 as of October 20, 2014 |
| Uses: | To fund post-employment health benefits for retirees. |
| Target Date: | An OPEB Trust Fund will be established at $10,000 in FY15 and increased annually by $10,000., or two percent of Free Cash – whichever is greater – until an actuarial funding level is reached. In the future, upon fully funding the Town's pension liability, those funds can be redirected to the OPEB Trust Fund. Further, the Mass. Municipal Association is working diligently with the state Legislature to develop a predictable and affordable funding schedule for all municipalities to meet this obligation. |

## APPENDIX 2
## ADDITIONAL FINANCIAL POLICIES

| No. | Functional Title | Promulgated / Endorsed By | Date |
|---|---|---|---|
| 14-01 | Minimum Annual Contribution to Stabilization Fund | Town Mgr. / BOS / FWAC | 10/7/14 BOS<br>1/15/15 FWAC |