# Topics to Discuss with Your Finance Team

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### Topics to be reviewed today

- Developing a budget
- Budget calendar
- Major revenue sources/Proposition 2 ½
- Capital Planning
- Bonds/Debt
- School budgeting and SOA



### Why do we develop a budget?

Budgets are "developed" rather than simply "created" or "made" for several important reasons:

- 1. Strategic Process
- 2. Inclusivity and Collaboration
- 3. Transparency and Accountability
- 4. Flexibility and Responsiveness
- 5. Data-Driven Decision Making
- 6. Legal and Regulatory Compliance
- 7. Reflects Community Needs and Values
- 8. Long-term Planning and Sustainability



### A budget is ... a strategic process

An annual budget should be a careful, strategic process. It is not just a collection of numbers, but a thoughtfully constructed plan that aligns with the municipality's strategic goals and priorities.

From when you begin the budget process with department heads to presenting your budget to the public and city or town council, set the context.

You are the expert in your municipality. Base the budget in the local context, from issues that were part of your mayoral campaign to recent strategic planning processes.



### A budget is ... inclusive and collaborative

The budget development process typically involves input from various stakeholders, including city departments, community members, and other elected officials.

#### Key internal stakeholders:

- Chief Administrative Officer
- Budget/Finance Director
- Comptroller / Auditor
- Treasurer
- Assessor
- School Business Officer
- Department Heads

#### Key external stakeholders:

- City Council
  - Finance Committee
  - Note: City councils usually only can cut budgets, not add
- School Committee
  - Recommend a total budget to the municipality, not a line item budget



### A budget is ... transparent and accountable

The process of developing a budget is often transparent, involving public meetings and opportunities for input. This process builds trust and accountability with constituents. The more they are part of the process, the less you have to explain why you made these decisions after the budget is passed.

Key dates when setting your budget calendar:

- The fiscal year is from July 1 to June 30
- The mayor is legally required to recommend a budget to the city council no later than June 21 or 170 days after the organization meeting
- The city council must adopt the budget within 45 days of the Mayor's submission

The budget process is governed by M.G.L. Chapter 44, Section 32, but check your local charter in case there are any specific timelines for your municipality.



### A budget is ... flexible and responsive

A developed budget implies that it is adaptable and responsive to changing circumstances. It is not a static document but one that evolves as the needs and resources of the municipality change.

Here are a few helpful tips when developing your budget:

- Your budget must be balanced
- Forecast revenue conservatively (i.e. spent 98% of estimated revenue)
- Match recurring expenses with recurring revenues and one-time expenses with one-time revenues
- Fully budget for all staff salaries and benefits
- Watch out for 'budget busters'
- Understand your biggest cost drivers and departments
- It is your budget



### A budget is ... data driven

The development of a budget is typically based on a thorough analysis of financial data, trends, and forecasts. This data-driven approach helps ensure that fiscal decisions are grounded in reality and aimed at long-term financial stability.

#### This may include:

- Examining your year-to-date spending and how it compares to prior years, especially for large spending categories
- Monitoring year-to-date revenue collections and analyzing prior year forecasts for actual collections
- Keeping up to data with state aid estimates during the state budget process
- Analyzing staffing trends, from vacancies to turnover to benefit costs



### A budget is ... compliant

There are specific legal and regulatory requirements for municipal budgeting and directing the activities of your departments. The development process ensures compliance with these rules.

As mentioned, Massachusetts General Law (M.G.L.) Chapter 44 Section 32 governs municipal budgeting, but there may be specific regulations as part of your charter, such as timelines.

Also, there may be new requirements and mandates from the state or federal government for you and your department heads. This is a good opportunity to make sure that you have funding for these mandates.



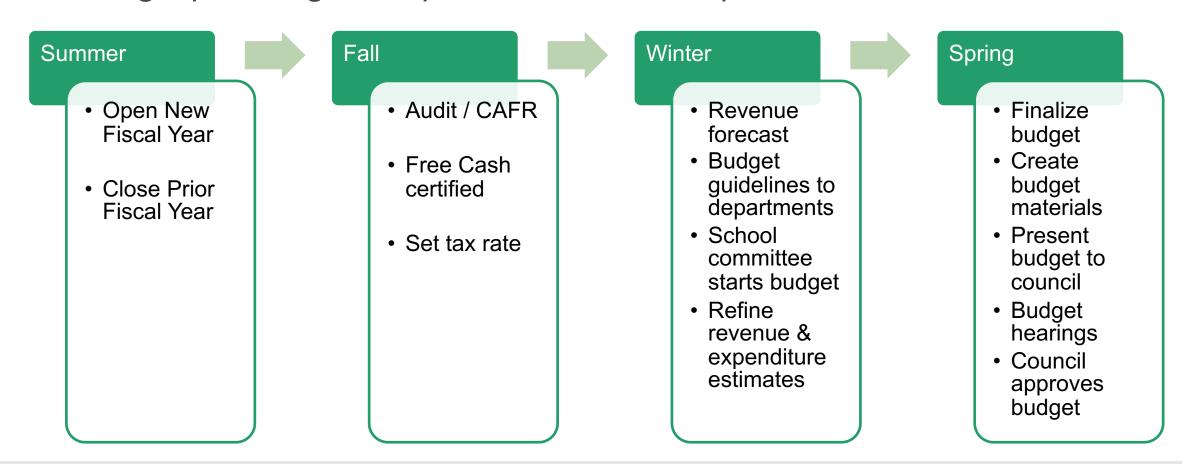
### A budget is ... reflective of community needs

A well-developed budget reflects the needs and values of the community. It is a tool for mayors to address priorities of their constituents effectively and equitably.



### Typical budget development timeline

The budget process goes all year. Here is an example:





### There are 5 major sources of revenue

- 1. **Property Taxes:** the tax levy is raised through taxing real property and personal property. This is highly regulated through Prop 2 ½
- 2. Local Receipts: examples of these revenue sources include excise tax, charges for services, licenses and permits, fines and fees, PILOTS
- 3. State Aid: state aid allocation is determined during the State's budget process. Examples include Chapter 70 and Unrestricted General Government Aid
- 4. Federal and state grants: these are recurring or one-time grants from federal and state agencies. Examples include Title I and IDEA
- 5. One time revenue: can include revenue from city's stabilization reserves



### Proposition 2 ½

Enacted in 1980 and effective since 1982, Proposition 2 ½ places limitations on property tax levels imposed by municipalities in Massachusetts

#### **Key Components:**

- <u>Level Limit</u>: constrains annual property tax increases to a maximum of 2.5% above the previous year's total tax level
- Levy Ceiling: ensures that the total property tax collected does not exceed 2.5% of the full and fair cash value of all taxable real and personal property

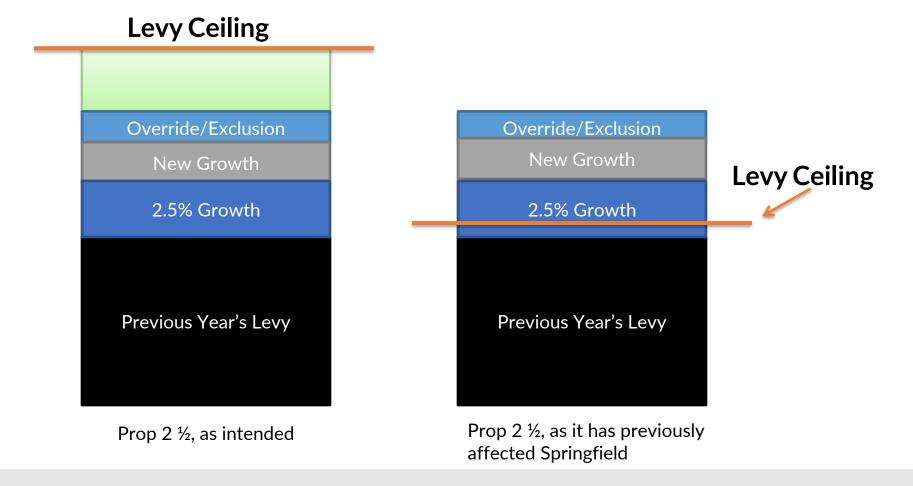
Critical Point: the level limit must always stay below the levy ceiling

#### **Mechanisms for Levy Limit Increase:**

- An annual rise of 2.5% from the previous year's levy limit
- Incorporation of new growth into the tax base
- Approval through a voter override process



# Example of a city hitting its levy ceiling





### Overview of MA State Aid Components

Massachusetts provides state aid and assessments to communities. This information is transmitted on 'Cherry Sheets' during the state budget process.

#### **Major State Aid:**

- Chapter 70: primary source of state funding for K-12 education
- <u>Unrestricted General Government Aid (UGGA)</u>: flexible funding to support municipal services
- Charter school aid: funding to support the transitional cost of students attending charter schools
- Other state aid includes <u>veterans</u> benefits and <u>elderly exemptions</u>

#### **Major Assessments:**

- MBTA or RTA: municipal contributions to regional transit authorities
- Charter School or School Choice: costs for students attending charter schools or choosing another school district

Net state aid is the total aid minus assessment costs.



### Local Receipts: volatile vs steady sources

#### **Volatile Sources**

Sources that are subject to significant fluctuations and unpredictability

- <u>Investment income</u>: revenue from municipal investments
- Motor vehicle excise
- <u>Licenses and permits</u>, including:
  - o Building
  - Plumbing
  - Electrical
  - Alcohol
- Optional local revenues:
  - Hotel/motel tax
  - o Meals tax
  - o Short-term rentals
  - o Marijuana tax

#### **Steady Sources**

More predictable and consistent revenue streams:

- Fees and charges:
  - o Clerk's fees (vital records)
  - Municipal lien certificates
  - Copying charges
  - o Swimming pool usage
  - o Document copies, maps
- Fines
  - o Moving violations
  - o Library late fees
  - o Open container penalties
- Rental income: earnings from municipal property leases
- Interest and Penalties on Taxes:
  - Late fees from delinquent taxpayers



### Additional Sources for Municipal Funding

#### Free Cash

o Unrestricted funds from the previous year's operations that can be used for any lawful purpose

#### Stabilization Fund

o Also known as a 'Rainy Day Fund,' set aside for unforeseen expenses for economic downturns

#### Transfers from other funds

- Allocating revenue generated from specific municipal services to support the General Fund.
- o Example: Parking meter revenue directed to support municipal projects or services

#### Administrative overhead charges

- Reimbursements paid to the General Fund from utility and service-specific funds
- Example: Charges to water and sewer funds for the administrative support provided by the city or town's central government

#### Note

- Utilization of these funds often requires adherence to state laws and local policies
- Strategic use of these sources can enhance financial stability and flexibility



### Capital Improvement Plan (CIP)

- A CIP provides a framework for decision-making, promotes fiscal responsibility, and helps ensure the sustainability and resilience of public infrastructure systems.
- A capital improvement plan (CIP) is a comprehensive outline or roadmap created by a
  government entity, such as a city, county, or state, to guide the acquisition, construction,
  maintenance, and improvement of physical assets and infrastructure over a specific period,
  typically ranging from three to ten years.
- The purpose of a CIP is to strategically allocate resources and prioritize projects to address the current and future needs of the community while promoting economic growth, enhancing quality of life, and ensuring the efficient use of public funds.
- The goal is to prioritize investments and allocate resources in a manner that maximizes the long-term benefits for the community.



# Capital Management: Debt vs Cash Strategies

### **Debt – Leveraging Capital for Long-term Investments**

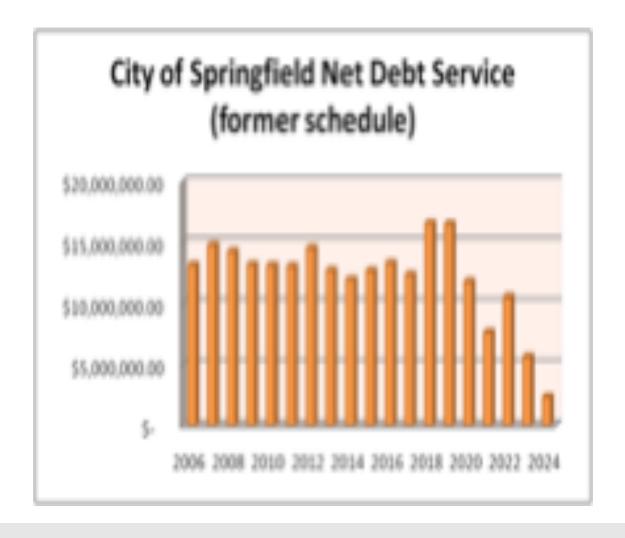
- Match debt term to useful life: align the duration of debt with the lifespan of the asset to optimize financial planning
- Makes major investments affordable: debt financing enables significant projects and investments without the need for upfront capital
- Spreads the cost to users who use the asset: ensures equitable cost distribution over time among those who benefit from the asset
- Consistent impact on future budgets: predictable, planned debt service payments aid in long-term fiscal planning
- Match payments to savings or new revenue: debt payments can be structured in line with anticipated savings or revenue generation from the asset

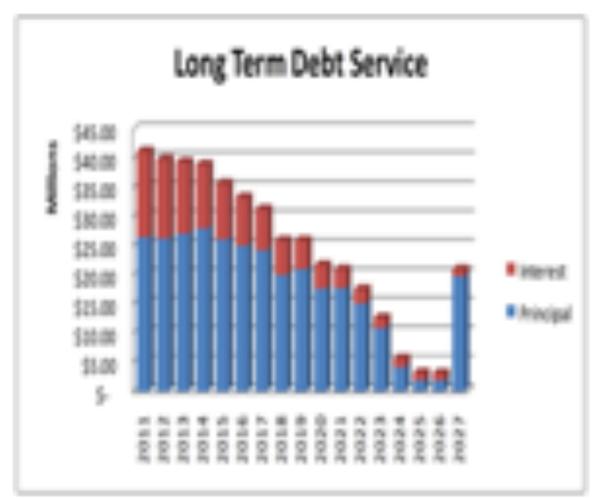
#### **Cash - The Prudent Choice for Immediate Needs**

- No interest costs: utilizing cash reserves avoids the extra cost of interest, making it a costeffective choice
- No debt issuance costs: eliminates expenses associated with raising debt, such as legal fees, underwriting costs, and ratings
- No impact on future budgets: cash payments are a one-time expense, not affecting future fiscal allocations
- Best for small or mid-sized items: ideal for purchases or investments that are not large enough to justify the costs and complexities of debt financing



### **Debt Structure**







### **Bond Ratings**

#### **Moody's Investors Service:**

- Aaa: Highest quality, minimal credit risk.
- Aa1, Aa2, Aa3: High quality, low credit risk.
- A1, A2, A3: Upper-medium quality, moderate credit risk.
- Baa1, Baa2, Baa3: Medium quality, some credit risk.
- Ba1, Ba2, Ba3: Speculative-grade, substantial credit risk.
- B1, B2, B3: Highly speculative, significant credit risk.
- Caa1, Caa2, Caa3: Poor quality, very high credit risk.
- Ca: Highly speculative and near default.
- C: In default or expected to default.

#### Standard & Poor's (S&P):

- AAA: Highest quality, minimal credit risk.
- AA+: High quality, low credit risk.
- AA, AA-: High quality, low credit risk.
- A+: Upper-medium quality, moderate credit risk.
- A, A-: Upper-medium quality, moderate credit risk.
- BBB+: Medium quality, some credit risk (investment grade).
- BBB, BBB-: Medium quality, some credit risk (investment grade).
- BB+: Speculative-grade, substantial credit risk.
- BB, BB-: Speculative-grade, substantial credit risk.
- B+: Highly speculative, significant credit risk.
- B, B-: Highly speculative, significant credit risk.
- CCC+: Poor quality, very high credit risk.
- CCC, CCC-: Poor quality, very high credit risk.
- CC: Highly speculative and near default.
- C: In default or expected to default.



### Types of Municipal Bond Sales

- **Competitive Sale:** In a competitive sale, the municipality issues bonds through a competitive bidding process. The municipality specifies the terms of the bonds, such as interest rates, maturity dates, and principal amounts, and invites underwriters to submit bids. The underwriter with the lowest interest cost wins the bid and purchases the bonds, which are then sold to investors.
- Negotiated Sale: In a negotiated sale, the municipality selects an underwriting syndicate to manage
  the sale of the bonds. The underwriting syndicate, led by a lead underwriter or senior manager, works
  with the municipality to determine the bond terms and structure, including interest rates and timing.
  The underwriters then market the bonds to investors and negotiate the terms of the sale. Negotiated
  sales are often used for larger or more complex bond offerings.
- **Private Placement:** In a private placement, the municipality sells bonds directly to a single investor or a small group of investors, rather than offering them to the public through an underwriting syndicate. Private placements are typically used for smaller bond issues or when the municipality has a preexisting relationship with the investor(s).
- **Refunding Bonds:** Refunding bonds are issued to refinance existing debt at lower interest rates, similar to refinancing a mortgage. The municipality may sell refunding bonds through competitive or negotiated sales, depending on market conditions and the specific goals of the refunding.



### Debt to General Fund Ratios Risk

- Low Risk: A debt-to-general-fund ratio below 5% to 10% may be viewed as indicating a low risk of default.
- Moderate Risk: Ratios between 10% and 15% might be considered moderate risk, depending on other factors such as economic conditions, revenue volatility, and debt management practices.
- **Higher Risk**: Ratios above 15% could signal higher risk and potentially lead to lower credit ratings, especially if accompanied by other negative financial indicators or weak fiscal management.



### Ratings Criteria

#### Financial Ratios

Used to assess the issuer's financial health and ability to meet its debt obligations.

#### • Industry and Market

 Considers the issuer's industry dynamics, market position, competitive landscape, and overall economic conditions to gauge the issuer's ability to generate revenue and cash flow.

#### Management Quality

 Assesses the quality of the issuer's management team, including their track record, strategic vision, and ability to adapt to changing market conditions.

#### Legal and Regulatory Environment

 Considers the legal and regulatory framework governing the issuer's operations, including potential legal and regulatory risks that may affect its creditworthiness.



### Ratings Criteria (cont)

#### Market Perception and Investor Sentiment

 Rating agencies may also take into account market perception and investor sentiment towards the issuer. This can influence the issuer's access to capital and its cost of borrowing.

#### Debt Structure and Covenants

 Examine the terms and conditions of the bond issuance, including the debt structure, maturity profile, and any restrictive covenants that may affect the issuer's ability to service its debt.

#### • Environmental, Social, and Governance (ESG) Factors:

 Lately rating agencies increasingly consider environmental, social, and governance factors in its credit analysis, assessing the issuer's exposure to ESG risks and its management of these risks.

#### Rating Outlook

 Rating agencies may provide an outlook, indicating the potential direction of the issuer's credit rating over the medium term, which reflects Moody's assessment of future credit risk factors.



### Mass General Law - Chap 71, Sec 37M

- Section 37M. (a) Notwithstanding the provisions of chapter forty-one or chapter seventy-one or any other special or general law to the contrary, any city or town which accepts the provisions of this section may consolidate administrative functions, including but not limited to financial, personnel, and maintenance functions, of the school committee with those of the city or town; provided, however, that such consolidation may occur only upon a majority vote of both the school committee and in a city, the city council, with approval of the mayor required by law or in a town, the annual town meeting or in a town with no town meeting, the town council.
- (b) Notwithstanding any general or special law to the contrary, a decision to consolidate functions pursuant to paragraph (a) of this section may be revoked by a majority vote of either the school committee of the city or town, or the city or town, or both as such vote is described in said paragraph (a)



### How does the MA school funding model work?

PART 1: What is the minimum amount that every community should spend on public education every year?

Massachusetts calculates this minimum amount (also known as the <u>Foundation Budget</u>) using two main factors:

- 1. Enrollment of public school students (including charter and choice) as of October 1
- 2. Per pupil rates set by the state and differentiated by need

These two components are multiplied together, they total the minimum spending floor (Foundation Budget). Every community must spend at least this amount on public education.









Foundation Budget

Public school students (district, charter, choice) Per pupil rates differentiated by need Minimum amount to spend on education PART 2: How much of the Found Budget floor should a community spend using local tax dollars versus state aid?

Once the state calculates the Foundation Budget (minimum amount every community should spend), it then calculates how much should come from property taxes and other local sources of revenue (known as 'Local Contribution'), and from state aid (known as 'Chapter 70').

The wealthier the community (determined through property values and income levels), the less state aid the community receives. The less wealthy the community, the more state aid.

Foundation Budget

Foundation Budget

State aid

Minimum local contribution (through property taxes, etc.)

Wealthier community

State Aid (also known as Chapter 70)

Min. local contribution

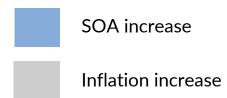
Less wealthy community



### How does the Student Opportunity Act work?

Before SOA, the per pupil rates changed every year due to inflation (DESE uses a price deflator index). If inflation increased by 1.5%, all per pupil rates were increased by 1.5%. Inflation rates are capped at 4.5%.

SOA said that, in addition to these annual changes, rates should be even higher, especially for categories of students with greater needs, such as low income, English learners, and students with disabilities. These increases are so great, that they will be phased in over six years. FY24 represents year 3 of a 6-year phase in.







# How does a community calculate its budget?

The foundation budget formula includes some items and excludes others. Because the formula is for all public students, costs and revenues related to charter schools and student choice are included in the formula. Other common costs for school districts, such as transportation and adult education are not included in the formula.

#### **Included in the Foundation Budget**

- Charter tuition assessments and reimbursements
- School choice tuition assessments
- State special education assessments (students served in state institutions)
- Municipal related costs in support of the school district (known as Schedule 19)

#### Not Included in the Foundation Budget

(and will need to use local revenues to pay for them)

- Transportation
- Maintenance costs in excess of \$100,000 per project

This formula is only applicable for communities that are spending close to or at the foundation budget threshold. For communities spending well above the foundation budget, local officials should determine the appropriate funding level for schools.



### Questions and discussion

