

SUMMER RESIDENTS ADVISORY COMMITTEE
POSITION PAPER – BUDGETARY ISSUES
August 22, 2014

The Summer Residents Advisory Committee respectfully submits this Position Paper for consideration by the Board of Selectmen, the Finance Committee and the Town Manager in developing the General Fund Budget for FY16 and in planning for FY17 and FY18.

SUMMARY

- The 2016, 2017 and 2018 budgets should be “level funded”, meaning that the total property tax levy in each of those years should not exceed the levy in 2015 of approximately \$29.5 million, plus any increased amount attributable to new growth.
- Contrary to past practice where only out of pocket OPEB costs of current retirees have been funded, the Town should also fund the actuarially determined costs of providing these benefits to future retirees by contributing additional funds to the OPEB Trust. The Committee recommends an increase in the Hotel/Motel tax earmarked for the OPEB Trust for this purpose.
- Additional revenues should be raised through an increase in mooring permits, and other permits where appropriate.
- Operating costs should be reduced through reduction of overtime, department consolidation, additional regionalization, review of service levels, and, where possible and appropriate, outsourcing.
- The Town should allocate the costs of employee benefits to their respective departments to better account for the costs of the services provided by the Town, rather than reporting these expenses as a separate cost center.

BACKGROUND

At the 2013 Summer Town Meeting and in its August 2013 Budget Position Paper, the Committee recommended that the Board of Selectmen, as a matter of policy, direct the Town Manager to prepare a budget for 2015 with total operating expenses, including education and debt service not to exceed the \$34.9 million of expenses in the 2014 budget. The Committee is pleased that this goal was substantially accomplished, with the increase limited to just over 1%.

<u>2014 Budget</u>	<u>2015 Budget</u>	<u>Change</u>
\$34,917,727	\$35,352,239	1.2%

The Committee believes that every effort should be made to avoid future increases in these operating expenses, particularly in light of the substantial challenges facing the Town in the years ahead.

It should be noted that the average Chatham single family tax bill has increased from \$3,271 in 2009 (below the Cape wide average) to \$3,970 in 2014 (just above the Cape average) up 21%, while the expenditures per capita have increased from \$4,564 in 2008 to \$5,721 in 2013, up 25%, among the highest of the Cape towns. Although our debt service as a percent of budget is one of the highest of the Cape towns, it is offset by our education expense which is among the lowest on the Cape.

Unless aggressive steps are taken to limit operating expenses, the Town will become even less affordable for residents and non-residents alike, particularly those living and working in Chatham.

The high cost of living in Chatham is reflected in our demographics. As the Chronicle reported in its July 24, 2014 issue, school enrollment has dropped from 731 in 2003 to 543 in 2013; births have dropped from 30 to 29; and deaths have increased from 158 to 182. An unintended consequence of our budgetary practices is the outward migration of young families and the inward migration of seniors, a trend which Chatham needs to reverse, or at least moderate.

The Committee recommends and encourages the Town to continue to plan on a three year cycle so that issues facing the Chatham in FY17 and FY18 will be considered while planning the 2016 budget.

The Town faces several significant challenges during FY16-FY18, including the capital costs and resulting debt service obligations for a new firehouse and continued implementation of the wastewater plan.

Of particular concern to the Committee, is the Town's funding of its other post employment benefit liabilities (OPEB). According to the most recent report, the unfunded actuarial accrued OPEB liability was \$16.5 million at June 30, 2012. For 2014, the actuarial OPEB cost was \$1,220,000, with the Town funding only an estimated \$733,000, or just 60% of the liability. This means that the unfunded liability has increased almost \$500,000 in 2014. The Town needs to adopt a policy to address and resolve this issue as promptly as possible. The

Committee understands that the Town has created an OPEB Trust to fund this liability, but the amounts contributed to date have been modest.

Maintaining a level funded budget while dealing with normal operating expenses, with added debt service and OPEB liabilities, will require a critical review of the way the Town does business, and a willingness to make hard choices and tough decisions to contain those costs which are within the control of the Selectmen and Town Manager.

OPEB

The Committee recommends that the Board of Selectmen amend the statement of Budget and Financial Management Policies adopted December 18, 2012, to provide that the Town's obligation for Other Post Employee Benefits be funded annually at a level equal to not less than the Total Annual Required Contribution as determined by the periodic Barnstable County Actuarial Valuations.

The Committee has been advised that the 3% Land Bank surcharge will expire in 2020 and consideration has been given to dedicating a 3% surcharge to the OPEB Trust when the Land Bank surcharge expires. This potential solution, if feasible, will not occur for another five years and the Committee believes the issue should not be deferred beyond the next budget cycle.

One potential source of funding is an increase in the Hotel/Motel Tax from 4% to 6% which will generate an estimated \$600,000 annually, the use of which can be dedicated to the OPEB Trust. Several Cape Towns have already increased this tax (Barnstable, Bourne, Brewster, Provincetown and Yarmouth), without any apparent adverse effect on tourism. .

The Committee understands that extending the tax to short term private rentals also has been considered, but doing so raises collateral issues and, in any event, requires action by the Massachusetts legislature which to date has declined to do so.

The Committee suggests that 100% of the hotel/motel tax increase be dedicated to the OPEB Trust. This amount, when added to the estimated out of pocket OPEB expense for current retirees of \$750,000, will meet or slightly exceed the recommended policy goal of fully funding the current years OPEB liabilities.

CHALLENGES

The following challenges will place upward pressure on the budget:

Debt Service. Debt service in FY15 is rising to \$7.7 million, a 31% increase over FY12, and constitutes 21% of the operating budget. With the new firehouse and continued wastewater plan implementation debt service will increase, even though the increase will be mitigated by continuing debt drop off. The Committee strongly believes that both of these capital expenditures are essential. Although the Committee is disappointed in the projected cost of the firehouse, there is no doubt that the existing facility must be replaced. To date the initial phases of the wastewater project have been completed on or ahead of schedule and under budget, and the next phases should be completed as promptly as possible.

Education. Although the Town will continue to realize savings from consolidation with Harwich, the annual assessment beginning in FY 16 will include an estimated \$600,000 increase over FY15, covering Chatham's share of the School District's debt service obligation for the new high school.

Five Year Capital Plan. The Committee is pleased that the Five Year Capital Plan in FY15 is being funded at the top end of the policy range. We recommend that funding at this level continue throughout the three year planning cycle, since the Five Year Capital Plan has been underfunded for several years due to the economic downturn.

OPPORTUNITIES

The following opportunities should be considered to increase revenues and decrease expenses.

Increased Revenue. The Committee believes that there are opportunities to increase revenues apart from raising the tax levy: In addition to the recommended increase in the Hotel/Motel tax, they include:

Mooring Permits. Chatham's mooring permit fees are the lowest on the Cape, less than half the average of other Cape towns. For the average 23 foot boat moored in Chatham, a mooring now costs \$57.50. In Falmouth, it is \$91, in Barnstable \$70, in Yarmouth \$175, in Harwich \$125, in Orleans \$75, in Dennis \$150, in Wellfleet \$212, and in Provincetown \$80. Current fees total about \$200,000 annually and are not sufficient to cover the costs of the Harbor Master Department. The fees should be raised to levels competitive with other cape towns, which should generate between \$200,000 and \$300,000 annually. The Committee understands that these fees are now under study and we are looking forward to results of the review with the hope that increases will be implemented in FY16.

Other Fees. All other fees for town services should be reviewed to make sure they are both competitive and cover the costs of the services involved.

Decreased Expenses. The Committee believes there are opportunities to decrease expenses. They include:

Overtime. According to the Annual Reports, Fire Department overtime in 2013 totaled over \$675,000, up 5% from \$640,000 IN 2012. The Committee finds this level of overtime to be excessive and unacceptable. If, as currently structured, it is not possible to eliminate or substantially reduce overtime, the Town needs to consider other models for providing these services. How are fire and EMT services provided in other Massachusetts towns? Has Chatham benchmarked the cost of these services? When will central dispatch be implemented and what impact will it have on overtime? In all events the Town Manager should begin to plan now for how to substantially reduce, if not entirely eliminate fire department overtime in FY16 – FY18. In addition, Police Department overtime has grown from \$189,000 in 2011, to \$318,000 in 2012 and \$445,000 in 2013, so that the overtime of these two departments exceeded \$1 million in 2013, the last year for which the Committee has information.

Additional Regionalization. Consideration should be given to regionalizing additional services during the planning period. Potential candidates include the Tax Assessors Office. This important function is conducted throughout the Commonwealth under a common set of laws, regulations and standards. There is no reason to perform the function differently in Chatham than in any other cape town. A study should be initiated to determine if saving could be realized by performing this function for all cape towns at the county level.

Department Consolidation. Are there opportunities to reduce costs, improve service and realize efficiencies by consolidating existing departments?

Facility Consolidation. The Committee encourages the Town Manager and BOS to continue the current review of whether savings can be realized by relocating the departments now housed in the Main Street building to other facilities, such as the Community Center, the new Annex and the Police Station. This could generate revenue through leasing the existing Main Street building for commercial or residential use, and reduce utility, insurance and maintenance costs. The Committee sees no need for the Town to maintain offices in the center of town. In addition, it potentially will make available additional parking space currently used by employees and visitors to the Town Office, as well as making the Town offices more accessible for residents and visitors during the height of the summer season.

Surplus Property. The Town is the owner of a large number of properties some of which may not be needed in Town operations. Is there a potential for reducing insurance and stewardship costs for surplus properties, by selling or leasing any of them which will also increase revenue, through rent or taxes?

Review Service Levels. How are service levels determined? For an example, do we have a plan spelling out which streets should be swept and how often? If the Town reduced street sweeping 50% would there be an adverse impact on health, safety or appearance of the Town? What would be the impact on fuel, equipment maintenance, life of the equipment, and personnel costs? Harwich appears to have an identical piece of equipment. Could we share one sweeper and both towns realize savings. The Committee obviously does not have the experience or ability to sort out and come to conclusions about these types of questions. But they are questions which the town management should raise and answer for all departments, over the three year planning period.

Outsourcing. The Committee recognizes that opportunities for outsourcing may be limited given constraints imposed under collective bargaining agreements and state law. However, when and if opportunities arise to provide services through alternate means, such as outsourcing, they should be carefully considered and implemented, where appropriate.

Productivity Improvement. Over the long term productivity improvement in the private sector averages between 2 and 3 percent annually. Retirements and resignations should be considered as an opportunity to promote efficiency and productivity, improve service, and reduce costs, through combining functions, reassignments and departmental consolidation or reorganization, as a part of a continuing process to consider and change, as circumstances make appropriate, the way the Town does business. This is exactly the process that takes place on a daily basis in the business world and, in large measure accounts for the remarkable improvement in productivity and resulting increases in standards of living for most Americans.

Improvements in productivity have the potential of offsetting increases in compensation, benefits, insurance, pensions as well as other items outside the control of the BOS and the Town Manager

ACCOUNTING FOR EMPLOYEE BENEFITS

For many years Chatham has accounted for the expense of providing benefits as a separate cost center. The 2015 budget provides \$4,142,979 for “employee benefits”, or 21% of the general fund budget excluding education and debt service. There are two components: first is the amount paid for benefits for current employees (about \$3,400,000); and second the amount paid for retired employees or OPEB (about \$740,000).

The Town’s Statement of Budget and Management Policies appropriately provides that “Fees for all municipal services shall be set to recover approximately 100% of the cost of the service.” As long as employee benefits are accounted for as a cost center, it is likely that fees will not be recovering the costs of the service in question. Starting with the next budget cycle,

the Committee recommends that benefit costs of current employees be allocated to the employing departments (the Town already allocates depreciation back to the departments, see note 6 to 2013 audit, p. 24). The “Employee Benefits” cost center should be limited to OPEB and renamed accordingly.

This modest change in the way the Town accounts for and reports employee benefit expense will enable better matching of costs and revenues at the department level.

Attached is an Appendix which illustrates the budgetary impacts of the Committee’s recommendations over the three year planning period, FY16, FY17, and FY18.

As the Appendix illustrates, with:

- No increase in the tax levy, other than those attributable to new growth;
- About \$850,000 in new revenue from increases in the Hotel/Motel tax and permits;
- Increased debt service attributable to the new fire station and wastewater implementation;
- Continued funding for the five year capital plan at the 2015 level;
- General Fund operating expenses (excluding debt service and education) continuing at the 2015 level; and
- Full funding of OPEB actuarially determined annual cost;

The Town will generate modest surpluses in FY16-FY18.

The Committee understands the reasons why the Town adopts very conservative estimates of its non-tax revenues in the annual operating budget. The Appendix departs from this practice and adopts a more aggressive (and in its opinion more reasonable) estimate of “Local Receipts”. The Appendix projects “Sources” and “Uses” of funds over the four year period FY15-FY18. Sources include Local Receipts at the 2013 level, escalated at 2.5% annually (although State Aid is projected to continue at the 2013 level). The Committee believes that with a realistic estimate of Local Receipts, sources of funds will exceed uses in 2014 and generate a modest surplus, which may be treated as “Free Cash”.

The Committee recognizes that the same type of non-discretionary expense increases impacting prior budgets are likely to also affect FY16, FY17, and FY18. Accordingly, it is essential that these increases be offset by cost reductions, including modest headcount reductions, largely achieved through attrition.

By exercising strict budgetary discipline during the next three years the Town has the opportunity hold the tax levy constant, provide essential services, fund its five year capital needs, build a new fire station, continue to implement the Wastewater Plan, and fully fund the current cost for OPEB obligations..

The Summer Residents Advisory Committee very much appreciates the opportunity to express its views and hopes that its suggestions will be useful as the Town considers the 2016 budget and plans for FY17 and FY18.

The Committee recognizes that its understanding of the issues may be incomplete, and would appreciate any comments which the Selectmen, Town Manager, Finance Director, or Finance Committee may have with regard to these recommendations.

Information Sources Include: 2011, 2012, and 2013 Annual Reports; Annual Town Meeting Warrants, 2009-2013; 2013 Annual Audit dated June 4, 2014, Massachusetts Department of Revenue Reports; Barnstable County Actuarial Valuation and review of Other Post Employment Benefits as of June 30, 2012, dated August 27, 2013.